Pension disclosures and consumer confusion: **Cure or Cause?**

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BACKGROUND: regulated choice architecture

Clear communication should mean better financial decisions...

Concern about 'financial mistakes'

Disclosure standards aim to:

- Create transparency and comparability
- Promote free markets and autonomy
- Encourage competition

...But things don't always go to plan.

Resort to heuristics
Reliance on defaults
Unintended consequences
Irrelevant influences

Testing for comprehension is not enough!

Studies test two key disclosures for DC plan participants.

Investment disclosure
172 plan participants
Lab experiments

Plan performance dashboard1800 plan participantsOnline panel experiment

How do people use short investment disclosures?

BATEMAN, DOBRESCU, NEWELL, ORTMANN AND THORP (2016) AS EASY AS PIE: HOW RETIREMENT SAVERS USE PRESCRIBED INVESTMENT DISCLOSURES. JOURNAL OF ECONOMIC BEHAVIOR & ORGANIZATION 121: 60-76.

INVESTMENT DETAILS FOR OUR SOCIALLY RESPONSIBLE BALANCED INVESTMENT OPTION

Description of option/ Type of investor	Invests in a diversified portfolio comprising Australian and international shares that are selected on the basis of sustainable investment criteria (refer to pages 22 to 25 for further details) and in fixed interest and cash assets. Designed for investors with a high risk tolerance who are seeking a high level of expected returns.	
Investment return objective*	To achieve returns (after Fund taxes and investment fees) that are at least 3.0% p.a. more than inflation (CPI).	
Strategic asset allocation and ranges	Intn'l shares: 24.5% (12% - 37%) Cash & fixed Interest: 30% (17.5% - 42.5%) Cash & fixed Interest: 30% (17.5% - 42.5%)	
Minimum suggested timeframe for investment	Six years	_
Expected frequency of negative annual return	Four in twenty years	
Summary risk level	High	

Plan participants see the disclosures and choose between pairs of investment options.



Participants choose "diversified" options...



Change in average probability of investment being chosen

...And overlook risk and return.



Change in average probability of investment being chosen

Participants make risk-return tradeoff only where no asset allocations.



Change in average probability of investment being chosen

Diversification heuristics dominate risk-adjusted returns.

People use two heuristics, but not at the same time:

- 1. Choose diversified/balanced allocations
- 2. Choose the best risk-return combination

Diversification heuristics/variety seeking behaviour applied to pre-mixed as well as "mix-it-yourself" portfolios.

It's easy to manipulate investment choices!

How do participants compare plans?

BATEMAN, DOBRESCU, NEWELL, ORTMANN AND THORP (2018) FLICKING THE SWITCH: SIMPLIFYING DISCLOSURES TO IMPROVE RETIREMENT PLAN CHOICES, HTTPS://PAPERS.SSRN.COM/SOL3/PAPERS.CFM?ABSTRAC T_ID=2783113

Do standard disclosures encourage people to overlook fees and chase returns?

XYZ MySuper Dashboard

Use this dashboard to compare this XYZ MySuper with other MySuper products. Go to ASIC's MoneySmart website for more information on how to pick the right MySuper fund for you.

Return	Return target
10 year average return of 7.1% as at 30 June 2013.	Return target for 2014-2023 of 3% per year above inflation, after fees and taxes. Future returns cannot be guaranteed. This is a prediction.



Past performance is not necessarily an indication of future returns.

Level of investment risk	Statement of fees and other costs
High Negative returns expected in 5 out of every 20 years	\$437 per year
The higher the expected return target, the more often you would expect a year of negative returns.	Fees and other costs for a member with a \$50,000 balance.

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We conducted incentivised "choice of plan" experiments.

Subjects from online panel (1800)

Choose between two similar plans over 20 years

Plan performance differs by

- Fees (i.e., high expenses)
- Returns (i.e., low skill)



Risk level and asset allocation same for both plans and constant

Participants respond quickly to fee differences....



...and slowly to returns.



We also tested a simplified format.

XYZ MySuper fund HIJ MySuper fund Use this dashboard to compare this XYZ MySuper with other Use this dashboard to compare this HIJ MySuper with other MySuper products MySuper products 1 year return (after fees and costs) 1 year return (after fees and costs) Past performance is not necessarily an Past performance is not necessarily an 1.8% 1.4% indication of future returns indication of future returns 10 year average return (after fees and 10 year average return (after fees and 7.1% 6.7% costs) costs) Current fees and costs as a Current fees and costs as a 1.1% 1.5% percentage of a \$50,000 balance percentage of a \$50,000 balance There is a 1 in four There is a 1 in four Level of Investment Risk Level of Investment Risk chance of a negative chance of a negative return each year return each year

Which of the two MySuper funds do you prefer?

XYZ MySuper fund

HIJ MySuper fund

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Trial 1 of 20

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Participants treat returns as twice as noisy as fees - made worse by complex presentation.



Key results

Returns => slow switch

- People consider 1 yr and 10 yr returns
- Look for several years of outperformance and then switch
- People are "returns sceptics"

Conclusion: Regulators must choose disclosures that also communicate.

- Consumer meanings, not legal meanings
- Simplifications matter both content and framing
- Need large scale field testing of material decisions



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