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One size fits all? Tailoring retirement plan defaults

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Highlights:

- We interview retirement plan executives and survey members to investigate default asset allocation design
- Executives do not allow for the low risk appetite of passive members
- Executives mistake inactivity based on trust for inactivity caused by disinterest
- Heterogeneity, trust and low skill of passive members support smart defaults

Abstract

Default investment options in retirement plans are a potent influence on member choice. Little is known about how plans set them. We investigate how retirement plan providers choose default investment strategies for passive members. We interview plan executives and survey members during a review of default settings in 2013-14 prompted by a change in the regulation of the Australian retirement system. Passive plan members are different from active members in ways that matter for investment strategy. Passive members are less willing to take financial risks; they are also younger, less wealthy and more often female. Executives say they design defaults with passive members in mind, but they seem to overlook some key factors. For example, plan executives set high risk exposure in default investment strategies. Executives also assume motivations for defaulting that do not match those reported by members. Most plan executives think of passive members as uninterested in their retirement savings but passive members say they trust their plans, and lack skill rather than interest. The heterogeneity, trust and low skill of passive members make opting out of the default less likely and smart defaults more appealing.

Keywords: pensions; default; financial services; regulation

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