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Plenary 5: Decisions, Biases and Heuristics: Implications of Behavioural Finance for Pension Funds, their Members and Advisors

Gordon Clark, Oxford University
Iain Clacher, Leeds University Business School
Marcus Hurd, Buck Consultants
Steve Vernon, Stanford Center on Longevity

26 June 2014

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- What is ‘behavioural finance’?
- What are the main concepts in behavioural finance and what do they mean?

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From Markowitz to Kahneman and Tversky

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"People seek to maximise their well-being not at a single point in time, but over time. Someone who saves does so not because extra consumption today has no value, but because he values extra consumption in the future more highly than extra consumption today."

Barr and Diamond (2006)

Rationality – The backbone of modern economic theory

Behavioral Biases – Individuals are not rational; regret; loss aversion; risk preferences; inertia; mental accounting; heuristics;

Do we need collectivism in pensions and retirement savings?

Do we need compulsion (the odd nudge) to get better outcomes?

Can we use behavioral economics to arrive at better pension outcomes? – Save More Tomorrow (Thaler and Bernatzi, 2004)

Leeds University Business School

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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- Do employees have the necessary skills to plan for retirement?
- Do employees have the discipline to implement a plan?

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MONEY FOR LIFE: Help Your Participants Avoid G
Broke in Retirement
Steve Vernon, FSA
Research Scholar, Stanford Center on Longevity

Discussion Question #1:

Do employees have the necessary skills to plan for retirement?

"For many people, being asked to solve their own retirement savings problems is like being asked to build their own cars."

— ***Richard Thaler*, University of Chicago**

Discussion Question #2:

Do employees have the discipline to implement a plan?

Play video on Stanford experiment regarding delayed gratification and discuss

You can see the video on YouTube here:

http://www.bing.com/videos/search?q=marshmallow+experiment+video&FORM=VIRE9#view=detail&mid=E3B306B64DA6AD3283E2E3B306B64DA6AD3283E2

Three Population Segments

1. I'll do it myself
2. Help me do it
3. Do it for me

- What percent of the population falls into each group?
- How would you design plans and communications for each group?

Education is not enough!
Use both logical and emotional messaging

Questions

Comments

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- Is financial literacy a solution to the behavioural issues already identified?
- What are the alternative policy solutions?

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Behaviour and Pensions

Professor Gordon L Clark
University of Oxford
June 2014

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Basic Assumptions

- **The average person is a poor decision-maker**
- **The average sponsor is ambivalent at best**
- **Hence the ‘dual’ governance problem (Clark et al. 2012)**
- **And, the challenge of long-term pension adequacy.**

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Financial Literacy Won't Work

- Too abstract
- Benefits a minority, already effective
- Exposes existing problems of providing 'good' basic education
- Relies, in any event, upon the stability of theory.

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An Approximation

- Regulate the accumulation of pension assets (certifying accepted products)
- Rely upon alternative providers (e.g. mutuals)
- Encourage low-cost, third-party advisors
- Underwrite the welfare of those most at risk to a poor result.

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The Alternative

- The UK government's NEST
- Effectively mandatory, via auto-enrollment
- Aimed at those least able, not able
- But compromised twice-over: by the contribution rate and by the lack of options for those willing and able to save more.

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Questions **Comments**

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- How are consultants and clients implementing ideas from behavioural finance?
- How might the 2014 Budget be assessed through the lens of behavioural finance?

Real world decision making

Old world

Trustee biases
Sponsor biases

Aims and objectives

Purpose of decision making

New world

Individual biases
Understanding and education
Nudges
Individualism vs collectivism
Authoritarian vs libertarian

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