



# The Behavioural Economics of Pensions

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What are “behavioural science”  
(and “behavioural  
economics”)?

## Application of the scientific method to the study of human action

- Controlled experiments
- Quantitative measurement
  - ✓ Behaviours
  - ✓ Choices
  - ✓ Judgements
  - ✓ Beliefs



# Why are defaults so powerful?

- **Defaults:**

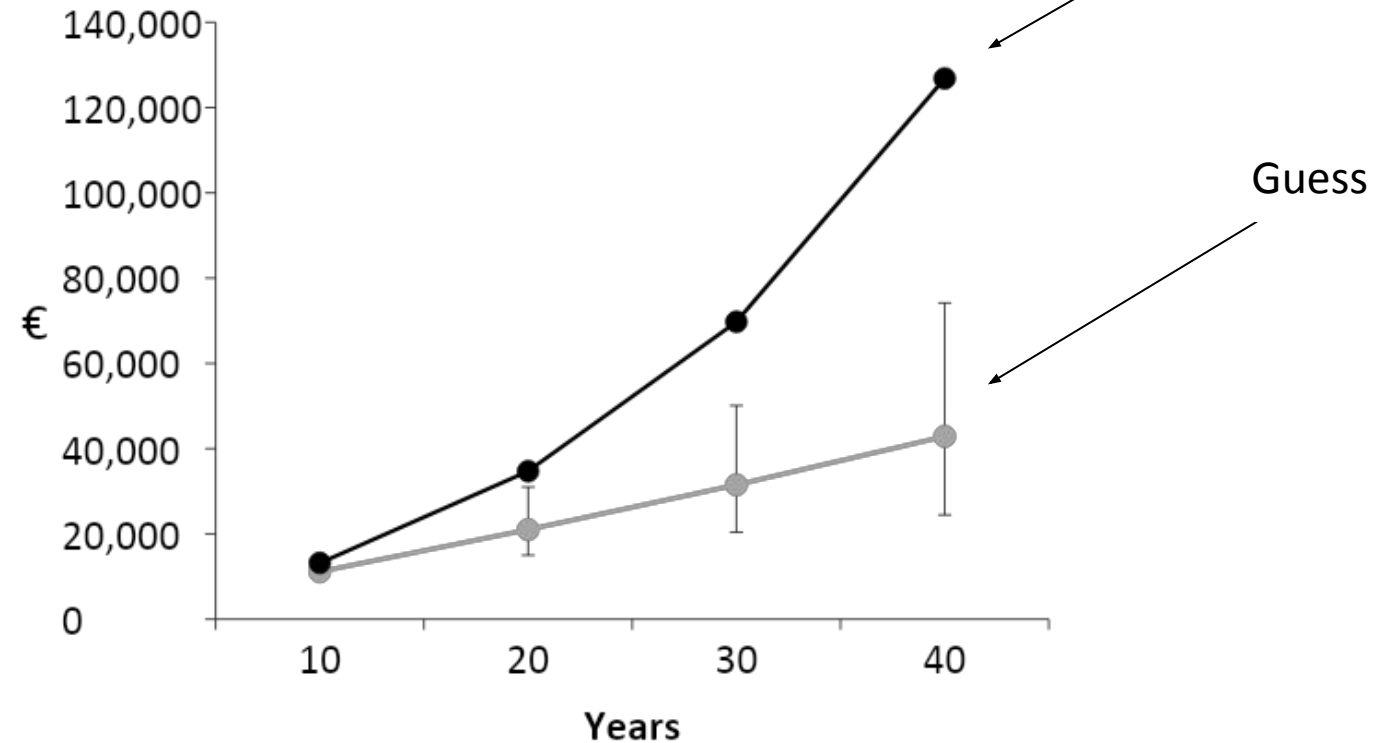
- ✓ Set the reference point for losses and gains
- ✓ Are the status quo
- ✓ Indicate advice
- ✓ Indicate what others typically do
- ✓ Require an action to depart from



# Exponential growth bias

- People massively underestimate benefits of regular saving/investment
- Same bias means that they underestimate apparently small differences in contributions...
- ...and management fees
- NB. This bias is intuitive – NOT a matter of financial education

E.g. €1,000 per year at 5% return?





# Tested an intuitive calculator

**Start saving sooner**

If I start saving at: **30**

18 ————— 65

And every month I save: **€200**

18 ————— 65

**If I start saving later, how much would I need to save per month?**

But if I wait until: **35**

18 ————— 65

Every month I will need to save: **€270**

By age 65, I will save a total of: **€227,607**

**Calculate**

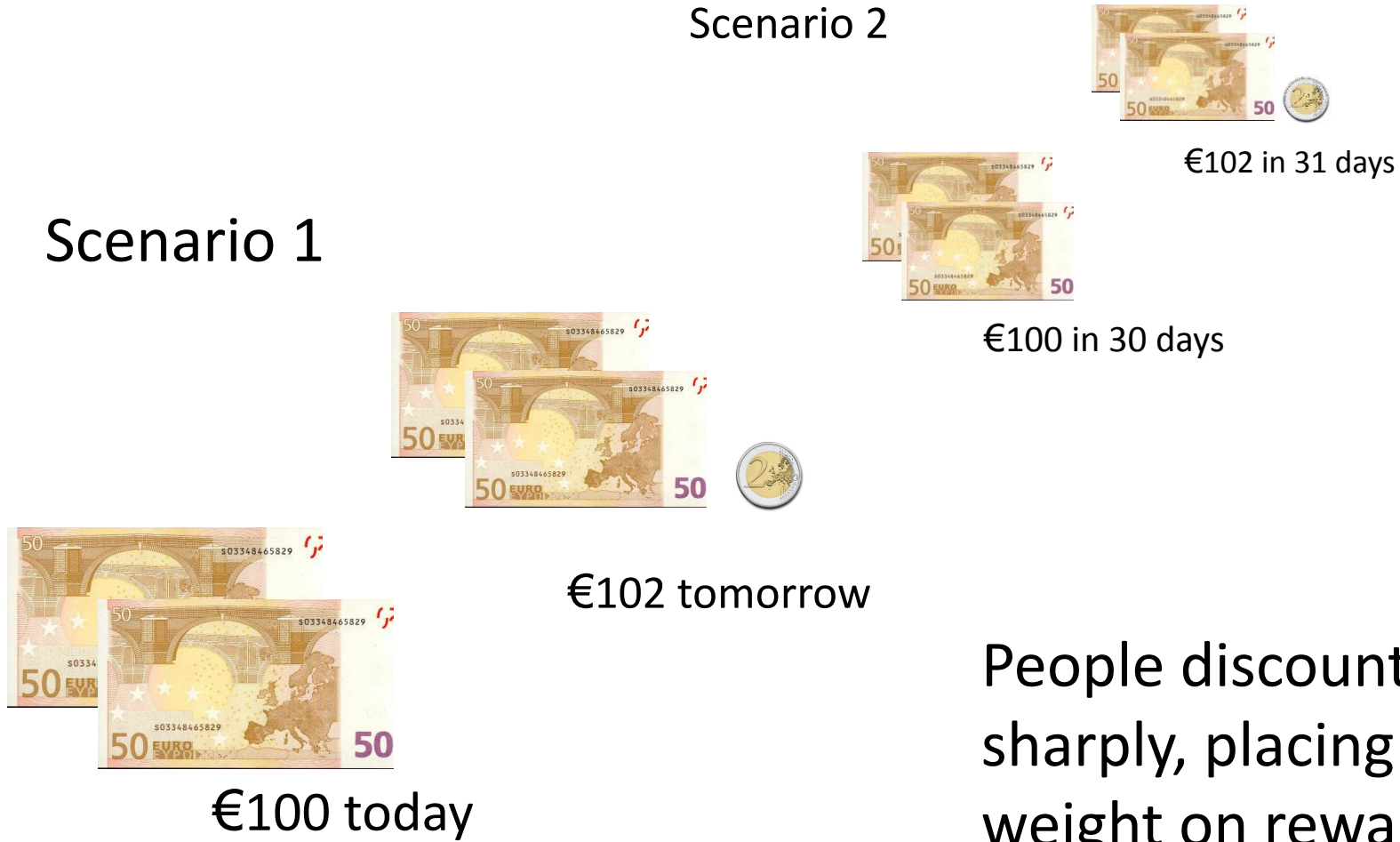
If you save €200 per month from age 30, you will have the same amount saved by age 65 as if you start at age 35 and save €270 per month.

**Next**

Reduced but did not remove “exponential growth bias”



# The value of time



People discount the future sharply, placing greater weight on rewards TODAY



# Conversion problems

Please imagine you are 65 and about to retire.

As a result of saving for retirement, you have a guaranteed monthly payment FOR LIFE from the pensions company of: **€850 per month**

In other words, they will pay you this amount every month until you die

The pensions company offers you the chance to convert this guaranteed monthly payment for life into a lump sum payment today. This lump sum will be yours to save or spend as you please.

**Please type in the MINIMUM lump sum you would be willing to accept to convert your guaranteed monthly payment for life.**

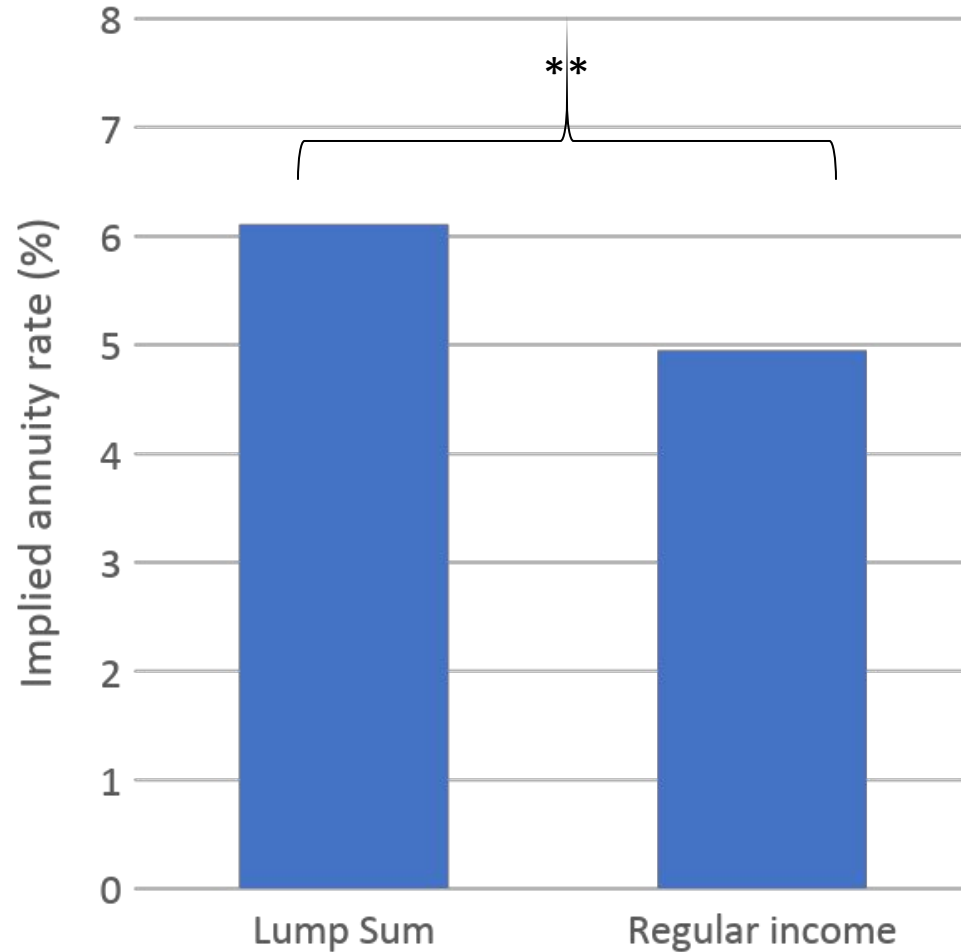
Feel free to use the pocket calculator provided in coming up with your answer

Type your answer and then hit the "Enter" button on the keyboard

Answer: €

lump sum

# Results



Direction of comparison alters choice

Implication is that 39% (LS condition) versus 17% (RI condition) would take an annuity at rate of 4%





# Implications of behavioural economics of pensions

## To improve decisions:

- Disclosure of information is not enough
- Education (including financial education) is not enough
- Financial advice is not enough
- Test and improve the choice environment
  - ✓ Simplify
  - ✓ Provide decision aids
  - ✓ Make “boosts” – point of decision competence interventions
  - ✓ Protect investors from bad online environments
- Regulate fees