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Behavioural Science and the Future of Pension Planning

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The National Pensions Summit

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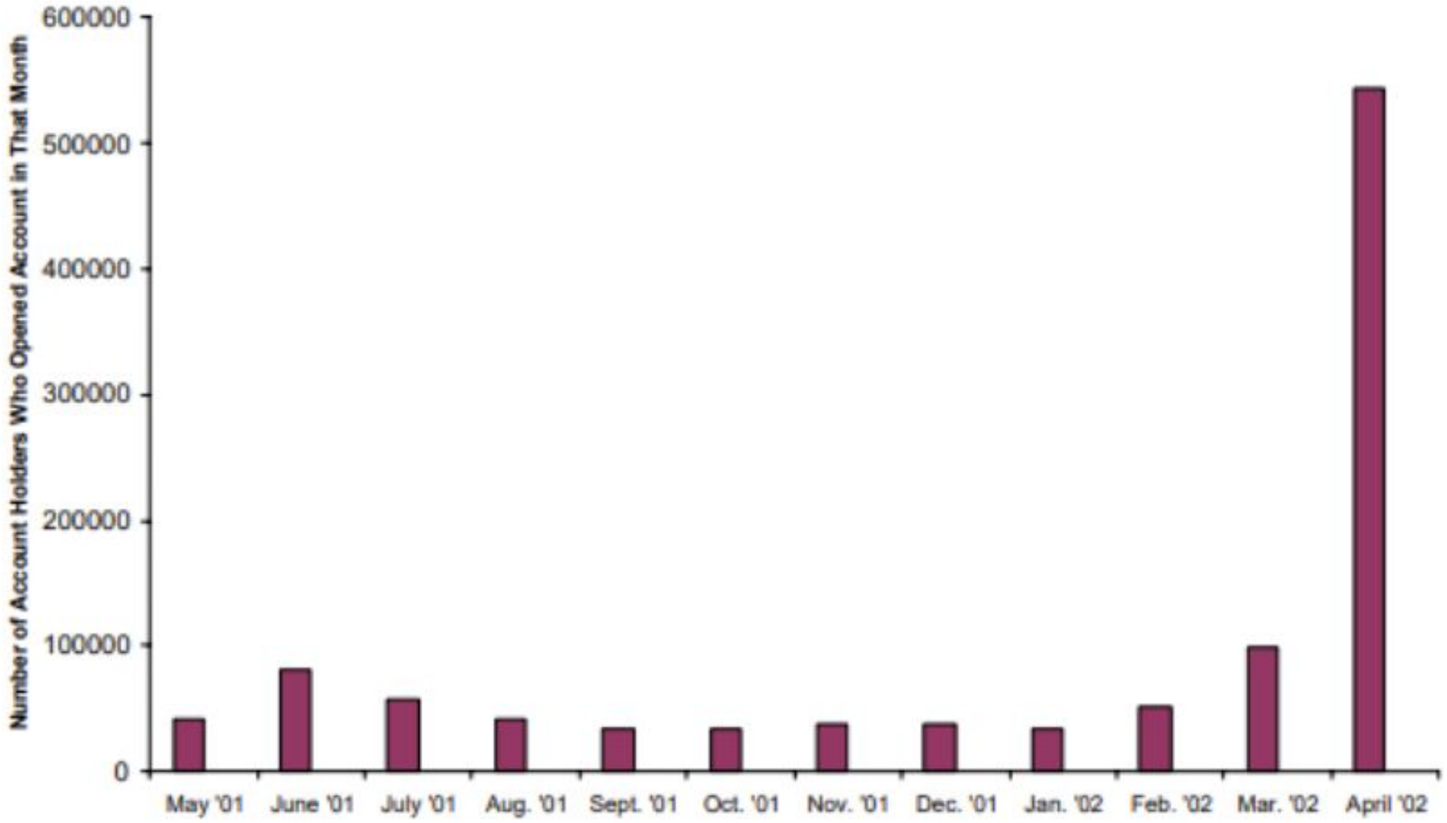
Starting to save for retirement requires *attending* to the future

Two problems with this:

1. More sources than ever are competing for our attention

2. Our intuitions for how money grows over time are terrible.


Number of Account Holders Who Opened Account in That Month
600000
500000
400000
300000
200000
100000
0
May '01
June '01
July '01
Aug. '01
Sept. '01
Oct. '01
Nov. '01
Dec. '01
Jan. '02
Feb. '02
Mar. '02
April '02

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Lessons from Behavioural Science, illustrated by SSIA scheme

1. To defeat procrastination, you need a deadline and a *salient* reward

2. Putting returns in cash terms fundamentally changes how people think about saving products and credit products*

*When the cost of credit is expressed in cash terms on payday loans, with credit card and other credit-product cash equivalents also shown, there is a significant drop in the number of loans taken out.
*Typically people put too much weight on the cashback element of mortgages when choosing between offers, relative to differences in APR. People are more sensitive to APR differences following financial advice (Timmons et al, 2020)

Research on Perceptions of Money Growth

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How Do People Think About the *Cost of Delaying* Saving for Retirement?

Mary starts saving €300 per month from age 30 for retirement at 65.

John delays starting to save until age 35. How much does he need to save per month to have same amount in fund at 65 as Mary does?

In an experiment, we varied:

1. The saving type (regular saving or lump sum) and amount

2. The interest rate (set at 3% or 7%)

3. The time delay (5 year or 10 years)

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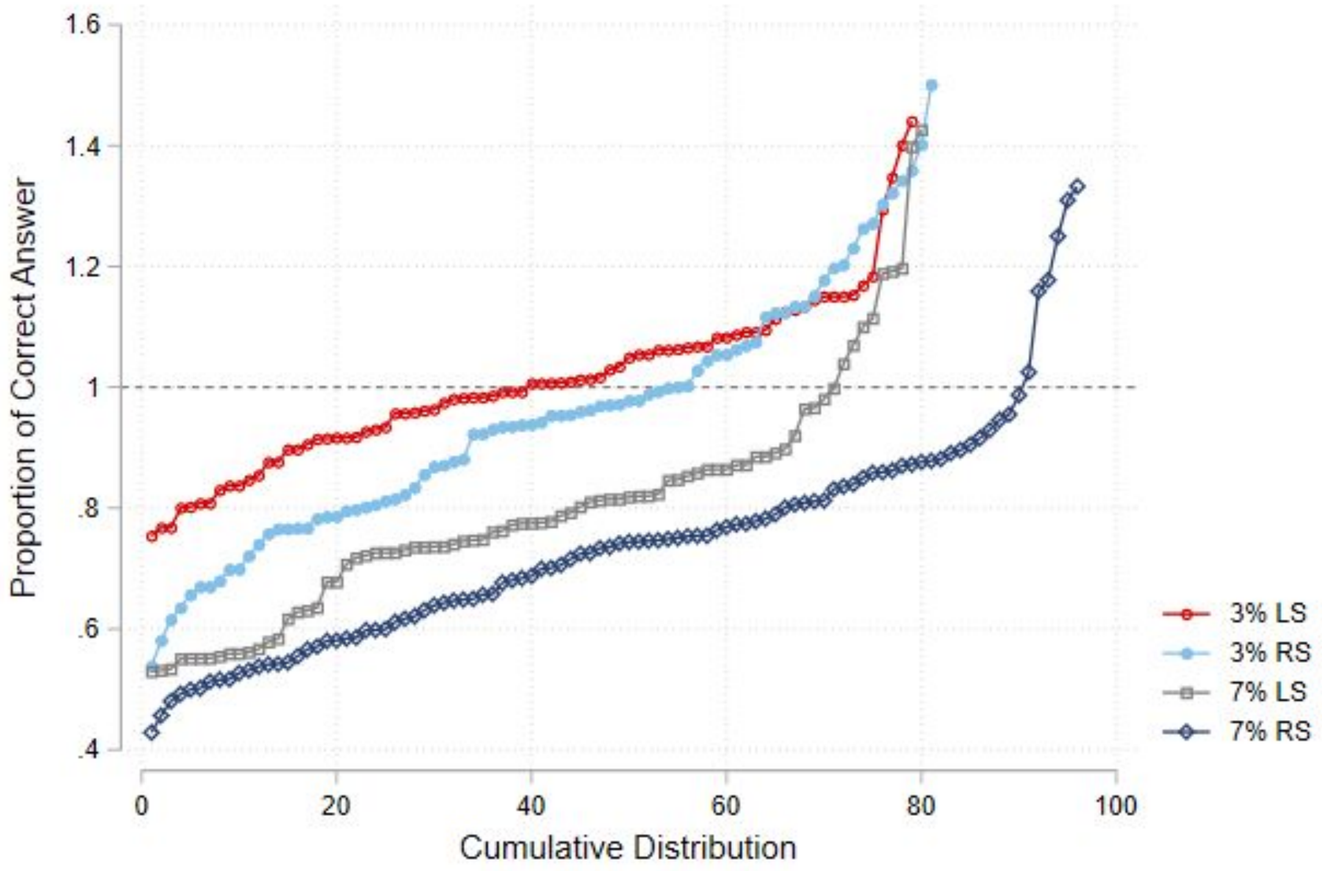
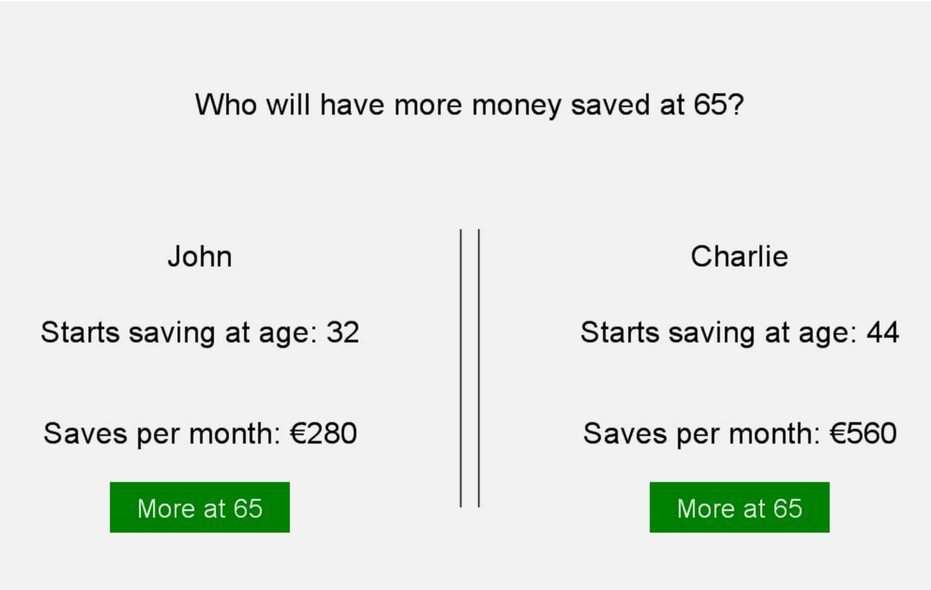
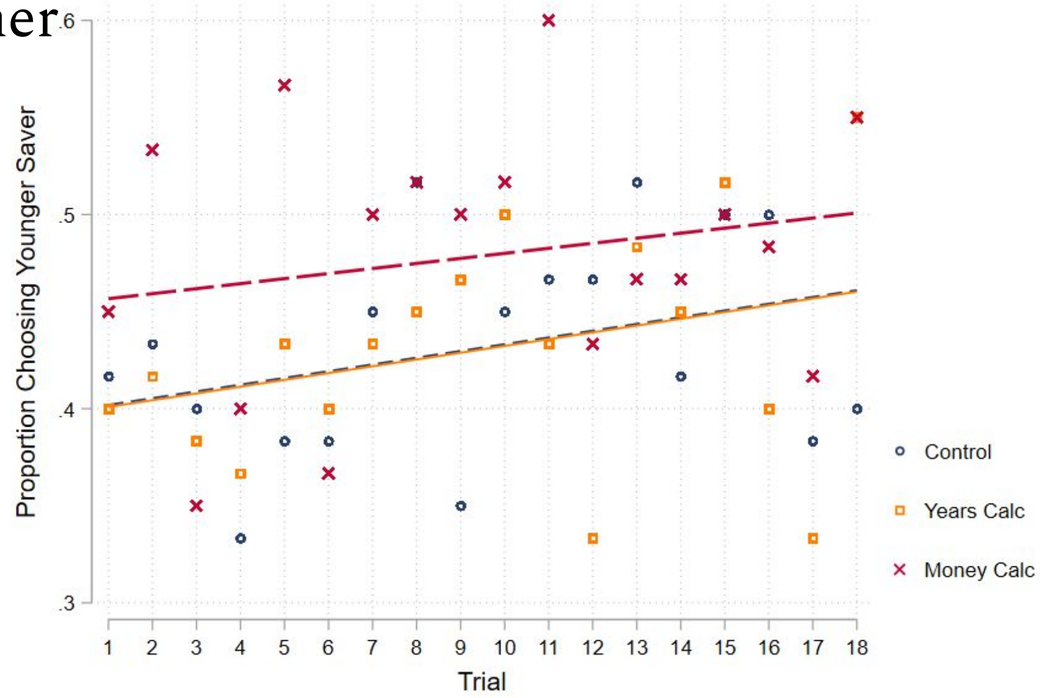
People *underestimate* how much extra they need to save to compensate for a delay in starting



- Underestimation stronger for regular savings (RS) compared to lump sum (LS) saving ('Accumulation bias')
- Stronger for higher interest rates (exponential growth bias)

An intuitive calculator can partially ‘debias’ people, help them see the benefit of saving sooner





- Accumulation bias and EGB push you towards choosing later-larger saver (Charlie above) as having more at 65
- We set up experiment so that on exactly 50% of trials, the sooner-smaller saver had more at 65
- In results, red dotted line (Money Calculator group) shows less of a bias towards later-larger saver (e.g. Charlie)

What is the relevance of this for the future of pension planning?

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Prediction: Fintech apps can help get across the counterfactual – "what if I had started sooner?"

"...if you'd starting saving for a pension two years ago, you would have accrued €1000 in interest by now..."

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Speculation: Could competition for customers entice pension providers to offer time-limited financial bonuses for joining?

".....if you'd starting saving for a pension two years ago, you would have accrued €1000 in interest by now...

...join in the next 14 days and we'll deposit €500 on your behalf, half the interest you missed out on!"

This is the type of innovation we can test rigorously using experimental methods of behavioural science

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Conclusion

1. Digitalisation is an opportunity and threat for prudent pension planning

2. Getting across the true benefit of starting to save early is likely a win-win for most consumers* and providers – our research shows personalised calculators will help get the message across

3. *General* financial literacy is unlikely to work – the dynamics of money growth are too nonlinear

*some consumers may oversave, relative to utility-maximising predictions of lifecycle (consumption-smoothing) models, but the welfare implications of this kind of error are less star and much less likely

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- Thank you for listening
- QR code to working paper of research presented
- For latest (better!) version please email me: