

Keys to Addressing Investors' Needs and Expectations

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Suboptimal individual investors: a few examples

- Financial illiteracy:

‘I understand the stock market reasonably well’

‘An employee of a company with publicly traded stock should have a lot of his retirement savings in the company’s stock’

‘It is best to avoid stock of foreign companies’

‘If the interest rate falls, bond prices will rise’

Sophisticated/correct answer to all four questions: 5.8%

- Fee insensitivity: Asked to allocate \$10,000 across four **S&P 500 index funds**...

0% of Harvard students cost minimize

3% of Harvard staff cost minimize

6% of Wharton MBA’s cost minimize

Sources: Lusardi and Mitchell 2010; Choi, Laibson, and Madrian 2010

Using auto-features to help unsophisticated investors

- Target date funds diversify holdings across many asset classes
- Target date funds automatically rebalance participants' portfolios
- Target date funds automatically reallocate away from equities as the participant approaches retirement age
- Target date funds have been embraced by US regulators (PPA), and they have become the leading US default (opt-out).
- Target date funds have been highly successful when used as the default. One year after enrollment, about 2/3 of employees in US 401(k) plans still have 100% of their balances in the age-relevant target date fund
- 1995: \$0.5 billion 2009: \$250 billion

Sources: Beshears, Choi, Laibson, and Madrian 2010; ICI 2009