Lessons from Behavioral Finance

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What Have We Learned?

- Choice Architecture Matters
- Many Individuals are “Passive Savers,” Many are Present-Biased
- Financial Literacy and Decision-Making Capacity is Heterogeneous, Low for Many, and Declines with Age
Implications of Declining Cognitive Function

- Couples: If \( p = \) probability of poor decision for each spouse, is couple \( 2p \) or \( p^2 \)?

- Wealth-Weighted vs. Population-Weighted Rates of Decline: Dementia Rates Fall Sharply with Education (and Wealth?)

- If Probability of Facing Dementia Doubles, Would You be More or Less Likely to Annuitize?
On Optimal Default Design

- Behavioral Welfare Economics is a Challenge: Cannot Rely on Revealed Preference to Ground Comparisons
- Need to Model Heterogeneity and Cost of Inaction
- Example of DC Contribution Rate Default: Point of Attraction for Savers Below and Above Default Saving Rate
### Household Wealth, Ages 65-69, 2008

<table>
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<th>Quantile</th>
<th>SS Wealth</th>
<th>DB Wealth</th>
<th>Financial Assets</th>
<th>IRAs &amp; DC Plans</th>
<th>Home Equity</th>
<th>Net Worth</th>
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Spectrum of Retirement Saving Systems

- Compulsory Government-Managed DC
- Compulsory DC with Regulated Private Asset Managers and/or Service Providers
- Voluntary Private DC with Defaults and Nudges
- Voluntary Private DC
Two Key Questions

- How Much Can “Nudges” Deliver in Moving Toward Compulsory Outcome?
- What Role for Education vs. Nudges in Voluntary System?
Behavioral Insights Can Inform:

- **Product Design**: Target Date Mutual Fund, Variable-Maturity ARM
- **Plan Design**: Opt-Out Enrollment Rules, Default Investments or Annuities
- **Market Design**: Government-Provided Investment Option, Requirements for Plan Updating