

Comments from Joseph Piacentini

August 5, 2011

# **THE DOWNSIDE OF DEFAULTS**

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# DOWNSIDE OF DEFAULTS

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- ✘ Lots of good findings
- ✘ Helpful policy insights
- ✘ But, how to translate into actual policy?
- ✘ Example relating to investment choice in 401(k) plans
- ✘ Directions for future research

# KEY FINDINGS AND POLICY INSIGHTS

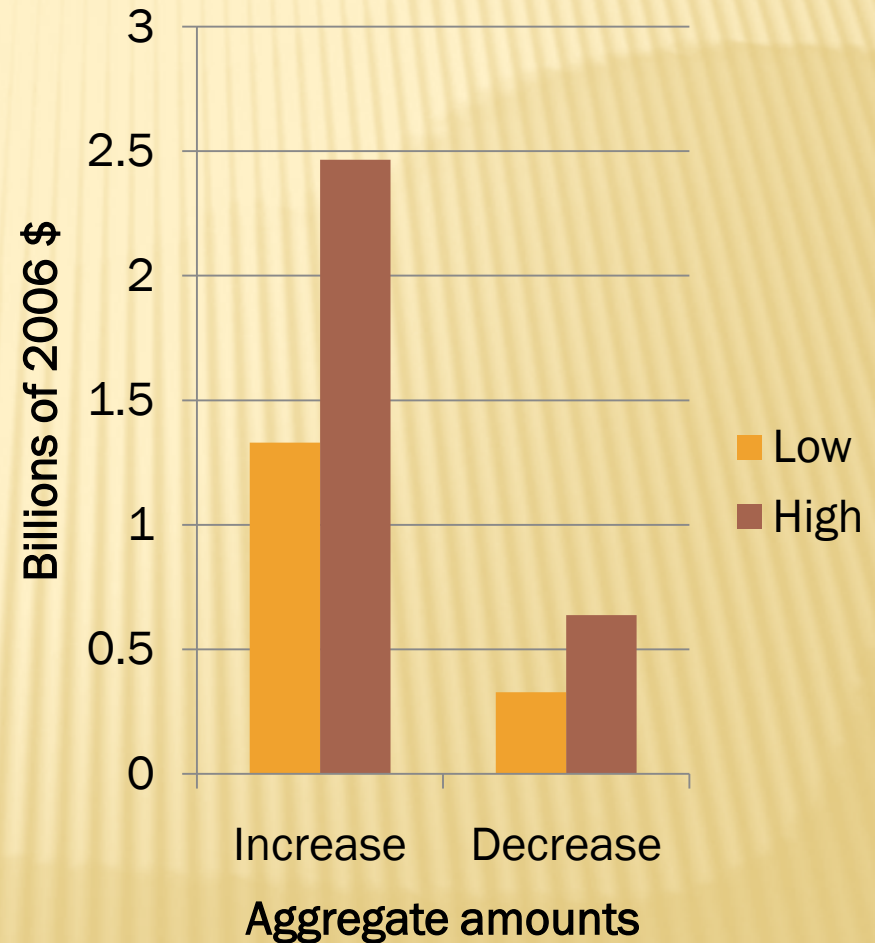
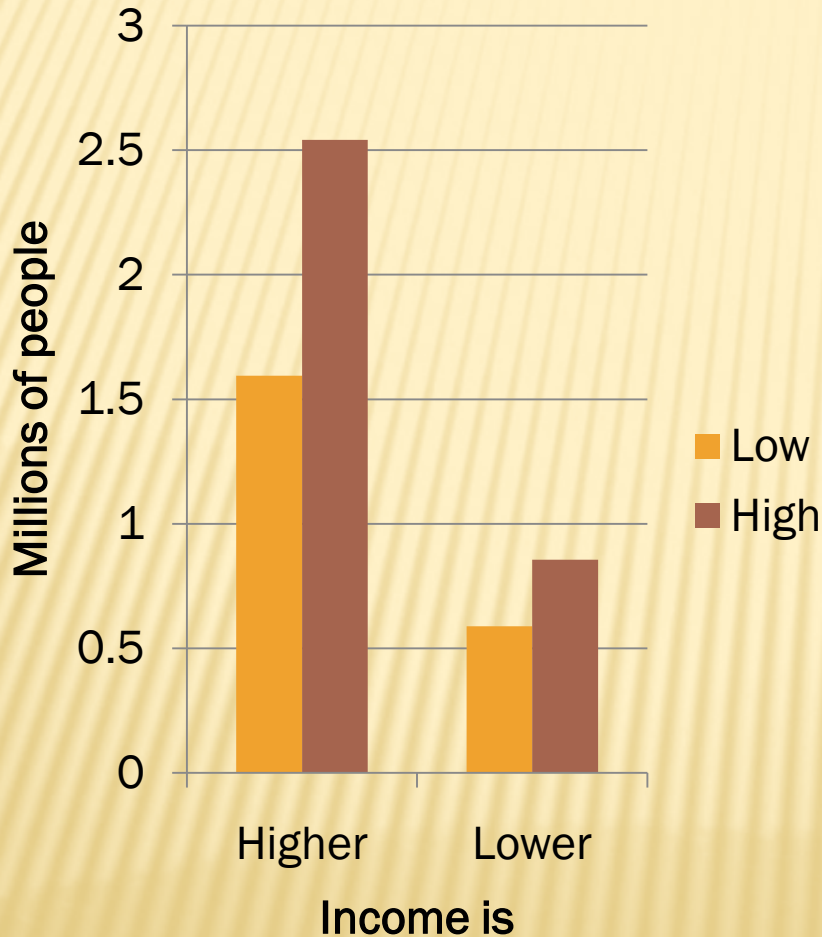
- ✘ “Information problems” increase probability:
  - + Of choosing by default
  - + Of regretting that choice
- ✘ “Quality, decision relevant information can reduce both default rates and regret”
- ✘ Policy should seek to improve communication and information
- ✘ But can policy really improve information, and will better information solve information problems?

# EXAMPLE: DEFAULT INVESTMENT

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- ✘ “Qualified Default Investment Alternative” (QDIA) – 2007 DOL rule confers fiduciary relief
  - + Target date fund
  - + Balanced fund
  - + Managed account
- ✘ Generally expected (and intended) to increase equity exposure and promote auto-enrollment
  - + Higher returns – usually
  - + Higher participation, but some lower contributions

# QDIA RULE: IMPACT ON 65+ POP IN 2034



# 2007 QDIA RULE – NOTICE REQUIREMENT

- ✘ Provided in advance, and then annually
- ✘ Written to be understood by “average” participant
- ✘ Must explain
  - + When contributions will be invested in the default
  - + Participants’ right to actively direct investment and available investment alternatives
  - + The QDIA’s investment objectives, risk/return characteristics, and fees

# DISCLOSING INVESTMENT OPTIONS

- ✘ DOL rule (proposed 2008, finalized 2010) requires comparative chart showing returns, benchmarks, fees

Options (examples)	Historical returns	Benchmark returns	Fees and expenses
TDF	X.X%	Y.Y%	XX bps
Stock fund	X.X%	Y.Y%	XX bps
Company stock	X.X%	Y.Y%	XX bps
Bond fund	X.X%	Y.Y%	XX bps

(Stylized representation)

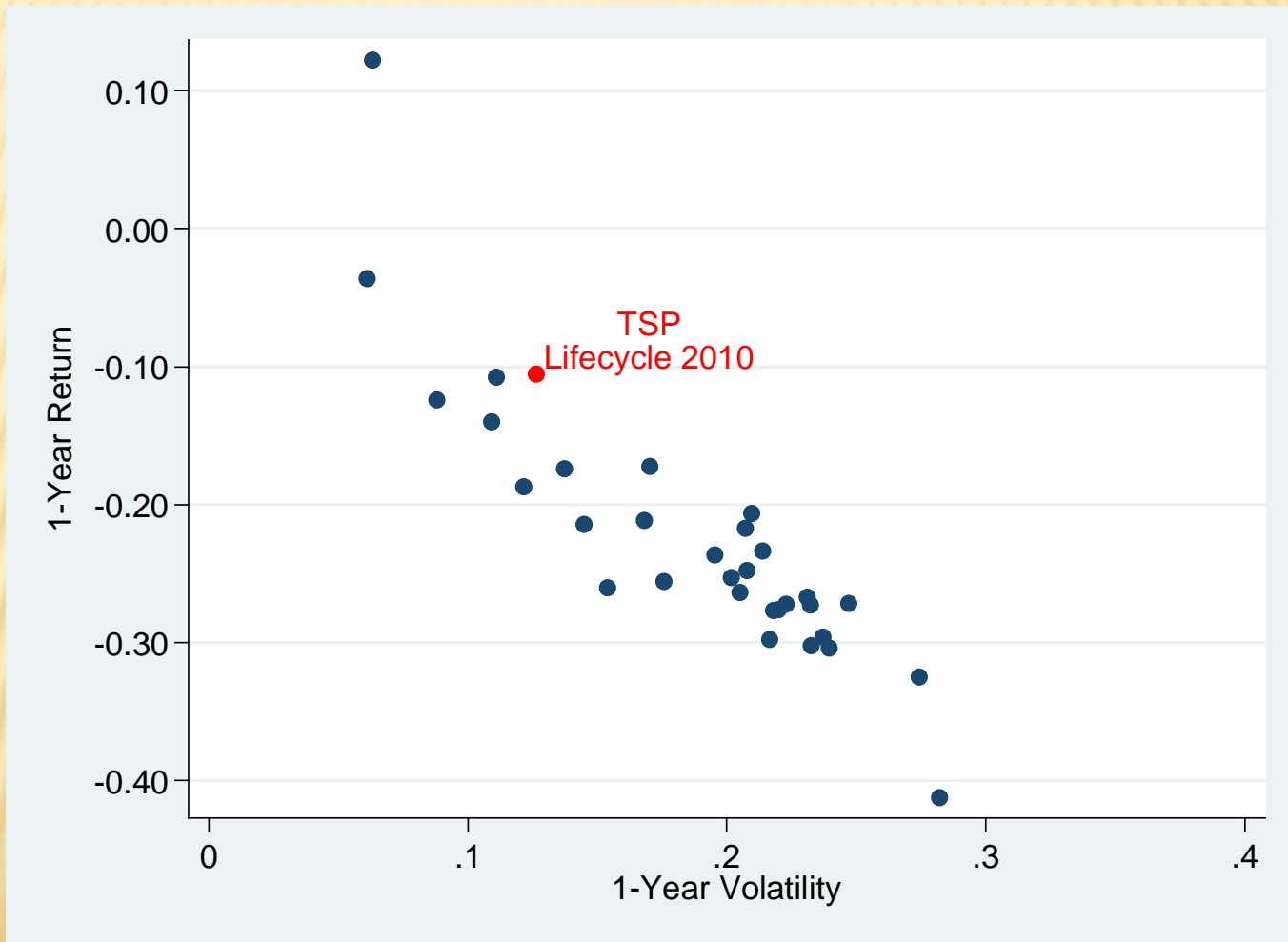
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- ✘ Early focus group testing showed chart is helpful, but:
  - + Confused by abbreviations and jargon (need glossary?)
  - + Can't translate returns, fees to savings outcomes (need examples?)
  - + Too little information is already TMI



# 2008 PERFORMANCE OF "2010" TDFS



# CONTINUED...

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- ✘ Subsequent focus group and large survey testing explored adding simple, graphic risk/return indicator to chart:

● ● ● ● ● = high      ○ ○ ○ ○ ○ = low

- ✘ Had no systematic effect on choices
- ✘ Less financially literate found it unhelpful or even overwhelming
- ✘ Not included in final rule
- ✘ Choices are most affected by the *order* in which the alternatives appear!

# HOW DOES IT REALLY LOOK?

## APPENDIX to S2550.404a-5 – Model Comparative Chart

### ABC Corporation 401k Retirement Plan Investment Options – January 1, 20XX

This document includes important information to help you compare the investment options under your retirement plan. If you want additional information about your investment options, you can go to the specific Internet Web site address shown below or you can contact [insert name of plan administrator or designee] at [insert telephone number and address]. A free paper copy of the information available on the Web site[s] can be obtained by contacting [insert name of plan administrator or designee] at [insert telephone number and address].

#### Document Summary

This document has 3 parts. Part I consists of performance information for the investment options. Part II shows you how well the investments have performed in the past. Part III explains you will pay if you invest in an option. Part III contains information about your retirement plan.

#### Part I. Performance Information

Table 1 focuses on the performance of investment options that do not have a benchmark. Table 1 shows how these options have performed over time and allows you to compare them to an appropriate benchmark for the same time periods. Past performance does not guarantee that investment option will perform in the future. Your investment in these options is subject to the risk of loss. Information about an option's principal risks is available on the Web site[s].

Table 2 shows the performance of investment options that have a fixed or stated rate of return. Table 2 shows the annual rate of return of each such option, the term or length of time that the option has been in effect, and other information relevant to performance.

#### Table 2—Fixed Return Investments

Name/ Type of Option	Return	Term	Other
H 200X/GIC www. website address	4%	2 Yr.	The rate of return does not change term.
I LIBOR Plus/ Fixed-Type Investment Account www. website address	LIBOR +2%	Quarterly	The rate of return on 12/31/xx was fixed quarterly, but will never fall minimum rate of 2%. Current rate is available on the option's Web site.
J Financial Services Co./ Fixed Account Investment www. website address	3.75%	6 Mos.	The rate of return on 12/31/xx was return is fixed for six months. Current information is available on the option's Web site.

#### Part II. Fee and Expense Information

Table 3 shows fee and expense information for the investment options listed in Table 1. Total Annual Operating Expenses of the options in Table 1. Total Expenses are expenses that reduce the rate of return of the investment option. Table 3 also shows Shareholder-type Fees. These fees are in addition to Total Annual Operating Expenses.

#### Table 3—Fees and Expenses

Name / Type of Option	Total Annual Operating Expenses As a %	Per \$1000	Shareholder-Type I
<b>Equity Funds</b>			
A Index Fund/ S&P 500	0.18%	\$1.80	\$20 annual service charge subtracted from this option if valued at less than \$20,000.
B Fund/ Large Cap	2.45%	\$24.50	2.25% deferred sales charge subtracted within 12 months of purchase.
C Fund/ International	0.79%	\$7.90	5.75% sales charge subtracted from

The cumulative effect of fees and expenses can substantially reduce the growth of your investment. Visit the Department of Labor's Web site for an example showing how fees and expenses at [http://www.dol.gov/ebsa/publications/401k\\_employee.htm](http://www.dol.gov/ebsa/publications/401k_employee.htm) can affect your investment. One of many factors to consider when you decide to invest in an option is whether an investment in a particular option, along with your other investments, will help you achieve your financial goals.

#### Part III. Annuity Information

Table 4 focuses on the annuity options under the plan. Annuities are issued to provide a guaranteed stream of payments at regular intervals, usually by the end of each month for your entire life. Annuities are issued by insurance companies. Annuities are subject to its long-term financial strength and claims-paying ability.

#### Table 4—Annuity Options

Name	Objectives / Goals	Pricing Factors
Lifetime Income Option www. website address	To provide a guaranteed stream of income for your life, based on shares you acquire while you work. At age 65, you will receive monthly payments of \$10 for each share you own, for your life. For example, if	The cost of each share depends on your age and interest rates when you buy it. Ordinarily the closer you are to retirement, the more it will cost you to buy a share.

www. website address	3-month US T-Bill Index				3-month US T-Bill Index			
G Fund/ Stable Value www. website address	4.36%	4.64%	5.07%	3.75%	1.8%	3.1%	3.3%	4.99%
Generations 2020/ Lifecycle Fund www. website address	27.94%	N/A	N/A	2.45%	26.46%	N/A	N/A	3.09%
					23.95%	N/A	N/A	3.74%

\*Generations 2020 composite index is a combination of a total market index and a US aggregate bond index proportional to the equity/bond allocation in the Generations 2020 Fund.

Name/ Type of Option	Return	Term	Other
D Fund/ Mid Cap ETF	0.20%	\$2.00	4.25% sales charge subtracted from amounts withdrawn.
<b>Bond Funds</b>			
E Fund/ Bond Index	0.50%	\$5.00	N/A
F Fund/ GICs	0.46%	\$4.60	10% charge subtracted from amounts withdrawn within 18 months of initial investment.
G Fund/ Stable Value	0.65%	\$6.50	Amounts withdrawn may not be transferred to a competing option for 90 days after withdrawal.
Generations 2020/ Lifecycle Fund	1.50%	\$15.00	Excessive trading restricts additional purchases (other than contributions and loan)
<b>Fixed Return Investments</b>			
H 200X / GIC	N/A		12% charge subtracted from maturity.
I LIBOR Plus/ Fixed-Type Invest Account	N/A		5% contingent deferred sales charge subtracted from amounts withdrawn; charge anniversary of each investment.
J Financial Serv Co. / Fixed Account Investment	N/A		90 days of interest subtracted before maturity.

Generations 2020 Variable Annuity Option www. website address	To provide a guaranteed stream of income for your life, or some other period of time, based on your account balance in the Generations 2020 Lifecycle Fund.	You have the right to elect fixed annuity payments in the form of a life annuity, a joint and survivor annuity, or a life annuity with a term certain, but the payment amounts will vary based on the benefit you choose. The cost of this right is included in the Total Annual Operating Expenses of the Generations 2020 Lifecycle Fund, listed in Table 3 above.	Maximum surrender charge of 8% of account balance.  Maximum transfer fee of \$30 for each transfer over 12 in a year.  Annual service charge of \$50 for account balances below \$100,000.
			The cost also includes a guaranteed death benefit payable to a spouse or beneficiary if you die before payments begin. The death benefit is the total amount of your contributions, less any withdrawals.  If your income payments are less than \$50 per month, the option's issuer may combine payments and pay you less frequently, or return to you the larger of your net contributions or the cash-out value of your income shares.

Please visit [www.ABCPlanglossary.com](http://www.ABCPlanglossary.com) for a glossary of investment terms relevant to the investment options under this plan. This glossary is intended to help you better understand your options.

# 2010 PROPOSED CHANGE TO QDIA RULE

- ✘ Additional requirements to explain TDF QDIAs:
  - + Asset allocation, and how it will change (glide path)
  - + When conservative endpoint will be reached
  - + Table or graph illustrating glide path
  - + If QDIA is dated (e.g., “2020 fund”), what the date means and what age group it is intended for
  - + Statement that QDIA may lose money and is not guaranteed to provide adequate savings
- ✘ Also amends disclosure of investment options

# DIRECTIONS FOR FUTURE RESEARCH

- ✘ Developing specific solutions for specific information problems
  - + Can complex decisions be made simple to make?
  - + How to best communicate information (including role of electronic communication)?
- ✘ Developing strategies to improve outcomes when information problems can't be solved
  - + Developing conditional defaults?
  - + Identifying risk of regret and intervening?