Using Experimentation to Assess Simplified Enrolment Models for Retirement Savings Plans

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Canadian Economics Association conference, Ottawa, June 3, 2011

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The Issue

- A significant portion of the population is undersaving for retirement
  - Particularly true for middle-income workers in the private sector - almost half covered by neither an RPP nor an RRSP (Moussaly 2010)

- Situation likely to worsen in coming years because of several secular trends:
  - higher life expectancy,
  - delayed labour force entry,
  - declining personal savings rates,
  - lower real rates of return on capital,
  - declining employer pension coverage
    - Among those with coverage, shift from Defined Benefit model to Capital Accumulation model

Potential responses

- Expansion of mandatory public plans (CPP/QPP)
- Proposed voluntary defined contribution Pooled Registered Pension Plans (PRPPs)
- Strengthening financial literacy
- Modifying voluntary, employment-based plan designs with a view to increasing participation and savings:
  - Simplifying enrolment procedures
  - Providing effective options for contribution and investment allocation

The Retirement Saving Decision

- **Life-cycle theory** assumes full information and rationality
- But, **financial literacy literature** proposes that a substantial proportion of the population lacks basic numeracy skills and knowledge of fundamental financial principles.
- And the **behavioural economics literature** suggests that saving decisions are often characterized by myopia, procrastination, anchoring and loss aversion.

Plan Design Matters

- Ample empirical evidence that low saving rates stem, at least in part, from the way choices are offered and presented
- Standard enrolment:
  - Default = no savings
  - Active decision required to **join** plan
  - Among those who join, a variety of contribution rates and investment allocations
- Automatic enrolment: (USA, New Zealand, UK)
  - Default = savings at a pre-set contribution rate and investment allocation
  - Active decision required to **leave** plan → higher participation
  - But...those who passively enrol tend to anchor at default contribution rates (usually low) and allocation (in the past ultra-conservative, but increasingly life-cycle or target-date)

Evidence on Automatic Enrolment – Huge increases in participation

Madrian and Shea (2001) – case study	➢ Participation jumped from 37% to 86% for new hires after introduction of automatic enrolment
Beshears et al (2006) – case study	➢ Participation up 35 percentage points for new hires and non-participating employees
Nessmith et al (2007) – Quasi-experiment, 50+ firms with automatic enrolment vs. 500+ without	➢ Participation rate among new hires almost doubled in firms that offer automatic enrolment (86 % vs. 45%)
	➢ Difference decreases with time but still greater than 20 percentage points 36 months after hire

Differences more pronounced for younger and lower-earning employees

Evidence on Automatic Enrolment – Contribution rates influenced by default

New Zealand KiwiSaver (2010)

- Default contribution rate shifted from 4 % to 2%. Prior to the shift, only ¼ of members contributed 2%; afterwards, more than three-quarters.

Nessmith et al (2007)

- Automatically enrolled new hires contributed a median of 2.9% of their earnings, those who enrolled voluntarily contributed a median of 5%

Auto-escalation of contributions offers a possible solution

Hybrid plans – a mix of active decision making and automation

- Auto-enrolment leveling off in the U.S.?
  - Concern over costs - associated with lower employer match rates
  - Philosophical opposition from employers and employees

- Hybrid plan designs - combine auto-features with active decision making (Carroll et al. 2009)
  - Simplified form, active yes-or-no enrolment decision required within prescribed time limit
  - Active contribution decisions optimal when there is even a small amount of heterogeneity in savings preferences, but savers have a strong tendency to anchor themselves to contribution defaults for prolonged periods of time.
  - For allocation, well-chosen defaults may work better than active decisions

The Canadian landscape

- Automatic enrolment is rare, as:
  - Most DC plans (and many group RRSPs) require mandatory participation
  - Federal and provincial employment standards legislation prohibits automatic paycheque deductions without express employee consent, except in limited circumstances such as authorization by collective agreement
- A systematic consideration and rigorous evaluation of simplified enrolment options would have important implications for the design of future plans
- Recent proposal of defined contribution Pooled Registered Pension Plans (PRPPs) targeted to attract employers that might not have otherwise offered a pension plan
  - Member decision-making will be crucially important determinant of the success of any plan that is based on a voluntary, capital accumulation model

Proposed interventions

- We propose a randomized field experiment to:
  - a) test the impact of **simplified enrolment procedures**
    - Reduce costs of opting in, accelerate decision making → increased participation rates
  - b) test the impact of allowing **active choice of contribution** rate versus provision of a default rate
    - Less clustering → higher average saving rates among participants

Experimental design

A) **Standard enrolment (control group)**:

- Need to opt-in through a toll-free call to the benefit administrator or through the benefits administration website

B) **Simplified enrolment, with default contribution rate**:

- Employees required to submit a form with “yes or no” decision to enrol, within a prescribed deadline
- Those who say “yes” provided with:
  - an array of possible contribution rates, including a default rate
  - same investment options as would be available under standard enrolment (anticipate that most employers will provide a default option)

C) **Simplified enrolment, with active choice of contribution rate**:

- Same enrolment procedure as for B), except no default contribution rate

Experimental Design

***A)* Control group** - Standard enrolment procedure

***B)* Simplified enrolment procedure, default contribution rate**

***C)* Simplified enrolment procedure, active choice of contribution rate**

Hypothesis 1 (A vs. B): Higher participation rates in B, but lower contribution rates among participants if B participants anchor to the default rate provided

Hypothesis 2 (C vs. B): Higher contribution rates among participants in C but higher participation rates in B

Target Population

- Population of interest is middle-income Canadians with no pension coverage
- Currently, only possibility to reach this population is in the context of **employer-sponsored pension plans** as there does not exist a provincial or national scheme at this time
- Target newly hired employees in firms with existing, **voluntary** pension plans
- Results would have important implications for proposed plans to broaden pension coverage on a national scale (e.g. PRPP), since such plans are likely to be based on a **voluntary, capital accumulation model**

Rationale for Random Assignment

- Need a counterfactual to isolate the effects of the intervention from all other factors and variables that can influence employees' decisions
- Random assignment ensures that program and control group do not differ systematically in terms of any other characteristics, even if these characteristics are unobserved
- The only systematic difference is that one group is eligible for the intervention and the other is not
- Any differences observed over time can be attributed solely with confidence to the intervention

Unit of random assignment

- Focus is on individual-level outcomes
- Not practical to do RA at individual level, as it would imply different enrolment procedures for employees of same firm
  - Would also lead to potential problem of contamination

- Hence, RA at the level of the firm would be required:
  - Drawback is loss of statistical power for detecting impacts, and increased probability of chance differences arising between experimental groups despite random assignment
  - A large number of firms or worksites would be required
  - Firms may balk at being assigned to the control group; make offer to firms with multiple worksites and **randomly assign by worksite**
  - Feasibility would likely depend on working in collaboration with a large service provider

PROJECT FLOWCHART

Recruitment of eligible, multi-site, firms (135 worksites)

Information to participating firms, development of instruments, including pension enrolment forms, baseline and follow-up questionnaires, consent procedures, legal implications

Group A: Standard Enrolment Procedure (45 worksites – 900 employees

Group B: Simplified Enrolment, Default Contribution Rate (45 worksites – 900 employees)

Group C: Simplified Enrolment, Active Contribution Rate Decision (45 worksites - 900 employees)

Enrolment of a total sample of 2,700 new hires into the study
(10-month period assuming 2 new hires per month per worksite)

Baseline data on employees' characteristics (gender, age, gross income, tenure), firms' characteristics (location, size, industry) and pension plans' characteristics (pre-intervention participation & contribution rates, investment allocation options, employer matching contribution rates, waiting period for eligibility)

Baseline data on employees' attitudes towards saving, risk aversion, level of financial literacy and savings in other saving products

Collection of data on participation rates and contribution rates from month 1 to month 11 – Data quality control, impact analyses

Short-term Impact Report (12 months)

Collection of 18-month follow-up data on participation rates and contribution rates from month 19 to month 29 – Data quality control, implementation research and impact analyses

Long-term Impact Report (30 months)

Conclusion

- Available evidence (mostly from the US) suggests that participation rates in pensions schemes are influenced by enrolment procedures and default choices
- We propose a randomized field experiment to asses the potential impacts of (1) a simplified enrolment procedures, and (2) active choice of contribution rates
- Such an experiment would be feasible with the participation of one or several large service providers of registered pension plans
- Results obtained could be used to:
  - Revisit the approaches used in existing RPPs with a view to improving participation and savings
  - Inform the design of new Pooled Registered Pension Plans across Canada
  - Inform future debates on existing legislative barriers for the use of auto-features in pension plans