

New Evidence on the Demand for Advice within Retirement Plans*

Jonathan Reuter

Associate Professor of Finance
Boston College

TIAA Institute Fellows Symposium

June 23, 2016

** Joint work with **David Richardson** at TIAA Institute and his excellent team of research assistants*

Motivation

- Although individuals are largely responsible for retirement savings decisions, financial literacy rates remain low
- Three options for potentially improving savings decisions
 - Financial Education
 - Defaults
 - **Financial Advice**
- Existing research suggests defaults are more cost-effective option than financial education
- But, we know relatively little about demand for financial advice inside defined contribution plans

Research Questions

Today, we focus on participant engagement:

1. Which participants are most likely to seek advice within their DC retirement plan?
2. When are participants most likely to seek advice?

Later, we will consider the role of menu design:

3. How does demand for advice vary with the size of the investment menu? With the type of default investment option?

Administrative Data

- We analyze anonymous individual-level data on demand for financial advice between **2009** and **2014**
- Data come from **82** DC retirement plans offered by **23 (large)** institutions where **TIAA** is **sole record keeper**
- Sample includes contributors and former contributors
2009: **73,890** contributors **60,383** non-contributors
2014: **83,649** contributors **75,873** non-contributors
- Increasingly common for contributors to invest solely in default investment option... which is almost always a **target date fund** in our sample of plans

Summary Statistics in 2014

- **159,522** participants
- Average age of **50.3 years** (std. dev. of **13.4** years)
- **45.7%** male and **51.9%** married
- **13.4%** joined the plan in 2014
- Contributors:
 - Annual contribution of **\$11,512** (median **\$7,744**)
 - Account balance of **\$151,914** (median **\$58,473**)
 - **41.9%** invest solely in default investment option
 - Jumps to **63.6%** for new participants since 2009
- Non-Contributors: Balance of **\$91,051** (median **\$22,760**)

Three Types of Advice

Asset Allocation

- Uses “human capital” model developed by Ibbotson to recommend appropriate asset allocation
- *Recommendation for me:* reduce allocation to equity funds (and purchase additional life insurance)

Income Planner (rolled out in late 2011)

- Uses current account balance and target retirement date to estimate inflation-adjusted life annuity income

Naviplan (wealth management service)

- Uses “risk tolerance model” to determine allocation

Annual Demand for Advice, Full Sample

- Fraction with positive demand grown from **2.5%** to **10%**

	Asset Allocation	Income Planner	Naviplan	Any Advice
2009	1.43%		0.99%	
2010	1.30%		0.86%	
2011	1.72%		0.99%	
2012	6.58%	4.42%	1.06%	9.99%
2013	6.43%	5.97%	1.30%	11.07%
2014	4.89%	5.01%	1.75%	9.71%
2012-2014	5.95%	5.14%	1.38%	10.25%

Contributor Demand, by Age Cohort

- Steep age gradient, especially for income planner
- Naviplan gradient partially reflects growing assets

	Asset Allocation	Income Planner	Naviplan	Any Advice
20-30	4.02%	3.80%	0.00%	4.86%
30-40	4.76%	4.01%	0.04%	5.81%
40-50	5.54%	4.72%	0.26%	7.01%
50-60	6.38%	7.17%	1.14%	9.40%
60+	6.52%	13.21%	4.12%	14.78%
All	5.62%	6.54%	1.05%	8.45%

Non-Contributor Demand, by Age Cohort

- Significant reduction in demand for asset allocation and income advice; modest reduction for Naviplan

	Asset Allocation	Income Planner	Naviplan	Any Advice
20-30	0.65%	0.51%	0.00%	0.83%
30-40	1.10%	0.64%	0.00%	1.36%
40-50	1.41%	1.38%	0.09%	2.04%
50-60	2.06%	3.32%	0.60%	3.87%
60+	2.32%	6.92%	3.64%	8.62%
All	1.80%	3.60%	1.32%	4.44%

Empirical Specification

- Basic empirical approach is to estimate demand for advice by **participant i** in **calendar year t** using linear probability models
 - Baseline regressions include demographic controls
 - Regressions that include portfolio returns and volatility of portfolio returns allow the sensitivity to portfolio returns to differ across “Defaulters” and “Non-Defaulters”
- All regressions include calendar year fixed effects (i.e., we only exploit cross-sectional variation in portfolio returns)
- All regressions include fixed effects for age groups (20-30, ..., 60+), contribution decile groups (1-5, 6-9, 10), and account balance groups (1-5, 6-9, 10)

Demand for Advice and Demographics

- Baseline regressions predicting demand for asset allocation or income advice in **calendar year t**

Type	Allocation	Income
Sample period	2009-2014	2012-2014
Male?	0.0054 *** (0.0008)	0.0203 *** (0.0013)
Married?	-0.0016 ** (0.0008)	0.0019 (0.0012)
New contributor?	0.0106 *** (0.0010)	0.0013 (0.0014)
Primary plan only?	-0.0434 *** (0.0009)	-0.0545 *** (0.0014)
Defaulter?	-0.0188 *** (0.0010)	-0.0161 *** (0.0014)

Demand for Advice and Performance

- Regressions now also include **personal rate of return (PRR)**, std. dev. of PRR, and interactions with “defaulter?” dummy

Type	Allocation	Income
Sample period	2009-2014	2012-2014
Defaulter?	-0.0159 *** (0.0020)	-0.0175 *** (0.0029)
PRR	0.0138 ** (0.0065)	-0.0049 (0.0158)
Std. Dev. PRR	0.0267 * (0.0141)	-0.4455 *** (0.0555)
PRR * Defaulter?	-0.0774 *** (0.0079)	-0.0320 ** (0.0153)
Std. Dev. PRR * Defaulter?	0.1416 *** (0.0231)	0.2903 *** (0.0659)

Summary

- Demand for advice is higher for current plan contributors, and tends to increase with age
- Demand for asset allocation advice is (slightly) higher for new contributors
- Demand for both types of advice is much lower for those who participant only in the primary plan and for those who accept the default investment option → **when do they engage?**
- **Contemporaneous** correlations between annual advice seeking and portfolio returns are **stronger for defaulters**
 - Higher returns reduce demand for both types of advice
 - More volatile returns increase demand for advice

Extensions

1. How does demand for advice in quarter t respond to portfolio returns in quarter $t-1$?
2. How often is advice in quarter $t-1$ associated with changes to contributions and balances in quarter t ?
With changes in savings rates?
3. How is demand for advice correlated with menu size and menu composition (e.g., fraction non-TIAA funds)?
4. If we expand the sample of plans, we can ask whether individuals defaulted into TDFs seek more or less advice than individuals defaulted into other funds (e.g., MMFs)