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Discussion

Pension Projections and Risk Indicators

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Summary

- Aim: define “best” information to be provided to pension plan members
- Focus: **risk** and return
- Plan: account of international experience (extremely diverse and sometimes puzzling),

  discussion of best model to get forecast of risk and return,

  proviso on current low-yield trap (incentive to risk-taking on the part of funds) & on uncertainty for the long run (not short)
- Conclusion: **model open**, priority is to **make people aware** of uncertainty at given horizon (term structure)

Comments:
Model conundrum

- Paper claims that Black-Scholes model is not appropriate, long-run risk or disaster risks are much better, but no ultimate preference is given
- Alternatives: historical averages = risk premium 6%, vol 19% versus – say – Bansal and Yaron (2004) = risk premium 6.84%, vol 18.65%
- But analytic model permits to have term structure

Comments: make people aware

- The take-home of pension plan members, out of a given content, depends on financial literacy and cognitive traits, psycological traits (from risk aversion to ratchet, conservatism, overconfidence)
- We can NUDGE investors, but should also accept that their **expectations** (beliefs), out of a given info, are **heterogeneous,** that **elasticity of intertemporal substitution** is relevant, and work on that.
- Two lessons on risk and return …..

Heterogeneity

Evidence of heterogeneity of beliefs

- even among professional investors (De Bondt and Thaler (1990), Graham and Harvey (2013), Cookson and Niesser (2016), Carlin et al. (2016)),
- even after public announcements (Kandel and Pearson (1995), Dumas et al. (2016)),
- countercyclical (Dumas et al. (2016)),

that raises risk premia and risk perception at the macro level. Collin-Dufresne et al. (2016) take this as THE explanation of macro behavior!!

Elasticity of intertemporal substitution

- Investors prefer early versus late resolution of uncertainty
- that raises risk premia and risk perception at the macro level (Bansal ad Yaron (2004))
- and explains the term structure for risk premia (Lettau and Ludvigson (2005, 2014), Marfe' (2016))

Methodological design to define a communication plan

- Define target group: who contributes most to the plans? Affluent, at least high-school education, middle aged, with offsprings, males
- Include horizon-based risk
- Lab experiments: give risk/return info and assess their take-home, in terms of expectations and risk
- Measure heterogeneity of beliefs out of that given form, and degree of preference for early resolution of uncertainty
- Fine-tune info

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