Flicking the Switch: How Fee and Return Disclosures Drive Retirement Plan Choice

Susan Thorp (USyd)

Hazel Bateman, Isabella Dobrescu, Ben R. Newell, Andreas Ortmann, (UNSW)

Acknowledgements

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Market failures in Australian retirement savings system.

- Price dispersion (fees vary)
- Product complexity (advice; investment menus; insurance)
- Very few voluntary plan switches
- High search and switching costs
- Estimates of inefficiencies:
  - *More competition could reduce average $1000 p.a. in fees by 25% (Grattan Institute)*

XYZ MySuper Dashboard

Use this dashboard to compare this XYZ MySuper with other MySuper products. Go to ASIC's MoneySmart website for more information on how to pick the right MySuper fund for you.

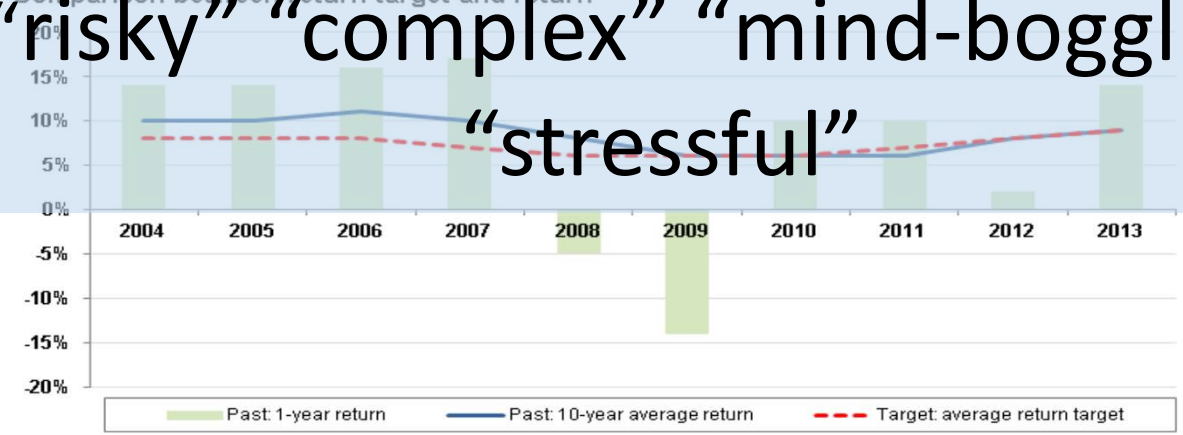
Return

10 year average return of 7.1% as at 30 June 2013.

Return target

Return target for 2014-2023 of 3% per year above inflation, after fees and taxes. Future returns cannot be guaranteed. This is a prediction.

"risky" "complex" "mind-boggling" "stressful"



Past performance is not necessarily an indication of future returns.

Level of investment risk

High
Negative returns expected in 5 out of every 20 years

The higher the expected return target, the more often you would expect a year of negative returns.

Statement of fees and other costs

$437 per year

Fees and other costs for a member with a $50,000 balance.

Policy response: standardise products and information.

- Regulate simple, low-fee, scalable default product in pension plans
- Called “MySuper”
- Every MySuper product must have a *dashboard*
- Must contain required information
- Must be on plan website

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Net return for 10 past financial years

Mean annualised estimate of net return above CPI (with warning)

Return

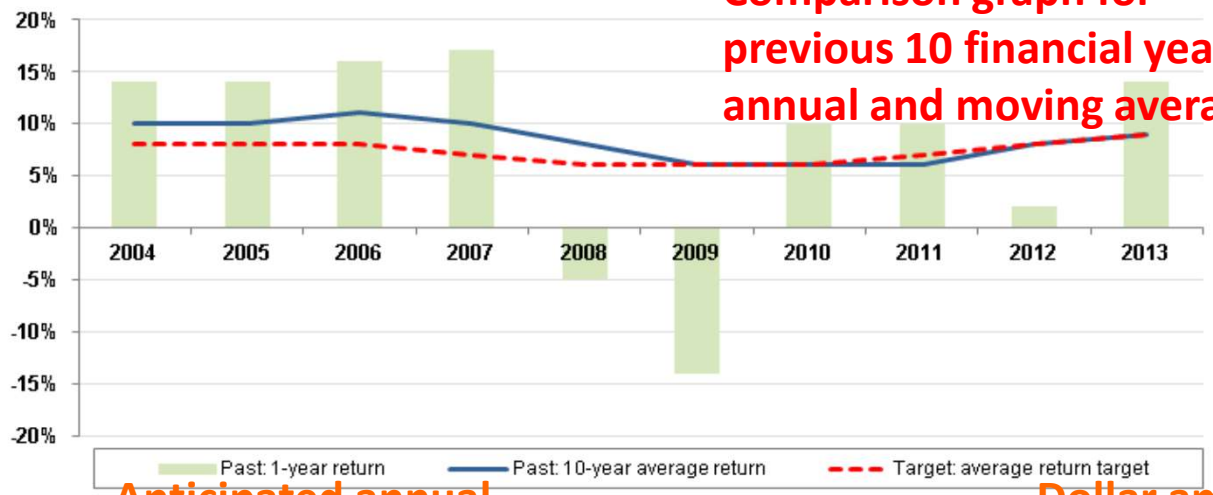
10 year average return of 7.1% as at 30 June 2013.

Return target

Return target for 2014-2023 of 3% per year above inflation, after fees and taxes. Future returns cannot be guaranteed. This is a prediction.

Comparison between return target and return

Comparison graph for previous 10 financial years, annual and moving average



Past performance is not necessarily an indication of future returns.

Anticipated annual probability of negative return multiplied by 20

Dollar amount of fees and costs for $50K balance

Level of investment risk

High

Negative returns expected in 5 out of every 20 years

The higher the expected return target, the more often you would expect a year of negative returns.

Statement of fees and other costs

$437 per year

Fees and other costs for a member with a $50,000 balance.

Do simplified disclosures help?

- Disclosure standards aim for:
  - Transparency
  - Comparability
  - Free markets
  - Consumer protection

- Do they work?
  - Ignored?
  - Misunderstood?
  - Unintended outcomes?

Do people overlook fees?

- Fees overlooked or under-weighted (Barber et al. 2005; Choi et al. 2010; Beshears et al. 2011).
- Fees minimized by more intelligent investors (Grinblatt et al. 2015)
- Investors minimize up front fees but not ongoing expense ratios (Wilcox 2003; Muller and Weber 2010)

We compare the same fees in two formats, and compare fees with equivalent returns.

Do people chase returns?

- Over-emphasise historical returns relative to predictive value (Sirri and Tufano 1998; Del Guercio and Tkac 2002).
- Reporting long term returns encourages more risk taking (Benartzi and Thaler 1999; Benartzi 2001; Choi et al. 2010)
- Investors excessively extrapolate runs of positive returns

We compare short and long term returns, and low and high volatility returns.

Results: People respond to simple fee information but are sceptical of returns.

- Fee information:
  - Noticed and acted on promptly
  - More effective as dollar amount than percentage
- Returns information:
  - *Long term* returns noticed and acted on
  - *Short term* returns not recognised or delayed response
  - Members are “returns sceptics”
  - Estimate 3 times more uncertainty of returns than fees
- Further simplifications can improve welfare

Design

We conducted incentivised “choice of fund” experiments.

- Subjects from online panel (1800)
- 20 “annual” choices between 2 retirement plans
- Fund performance differences arise from either
  - Fees (i.e., high expenses)

    or equivalent
  - Returns (i.e., low skill)
- Risk level and asset allocation are the same for both plans and constant over

Trial 1 of 20

XYZ MySuper fund	HIJ MySuper fund
Use this dashboard to compare this **XYZ** MySuper with other MySuper products. Go to ASIC's Money Smart website for more information on how to pick the right MySuper fund for you.	Use this dashboard to compare this **HIJ** MySuper with other MySuper products. Go to ASIC's Money Smart website for more information on how to pick the right MySuper fund for you.
Return: 10 year average return of 7.1%	**Return:** 10 year average return of 6.7%
Return target: Return target for the next ten years of 3% per year above inflation after fees and taxes. Future returns cannot be guaranteed. This is a prediction.	**Return target:** Return target for the next ten years of 3% per year above inflation after fees and taxes. Future returns cannot be guaranteed. This is a prediction.

Level of investment risk: ***Medium to High*** Negative returns expected in every 3-4 out of 20 years. *The higher the expected return target, the more often you would expect a year of negative returns.*	**Level of investment risk:** ***Medium to High*** Negative returns expected in every 3-4 out of 20 years. *The higher the expected return target, the more often you would expect a year of negative returns.*
Statement of other fees and costs: $528 per year *Fees and other costs for a member with a $50,000 balance.*	**Statement of other fees and costs:** $772 per year *Fees and other costs for a member with a $50,000 balance.*

If you want to review terms on this page, please click here.

Which of the two MySuper funds do you prefer?

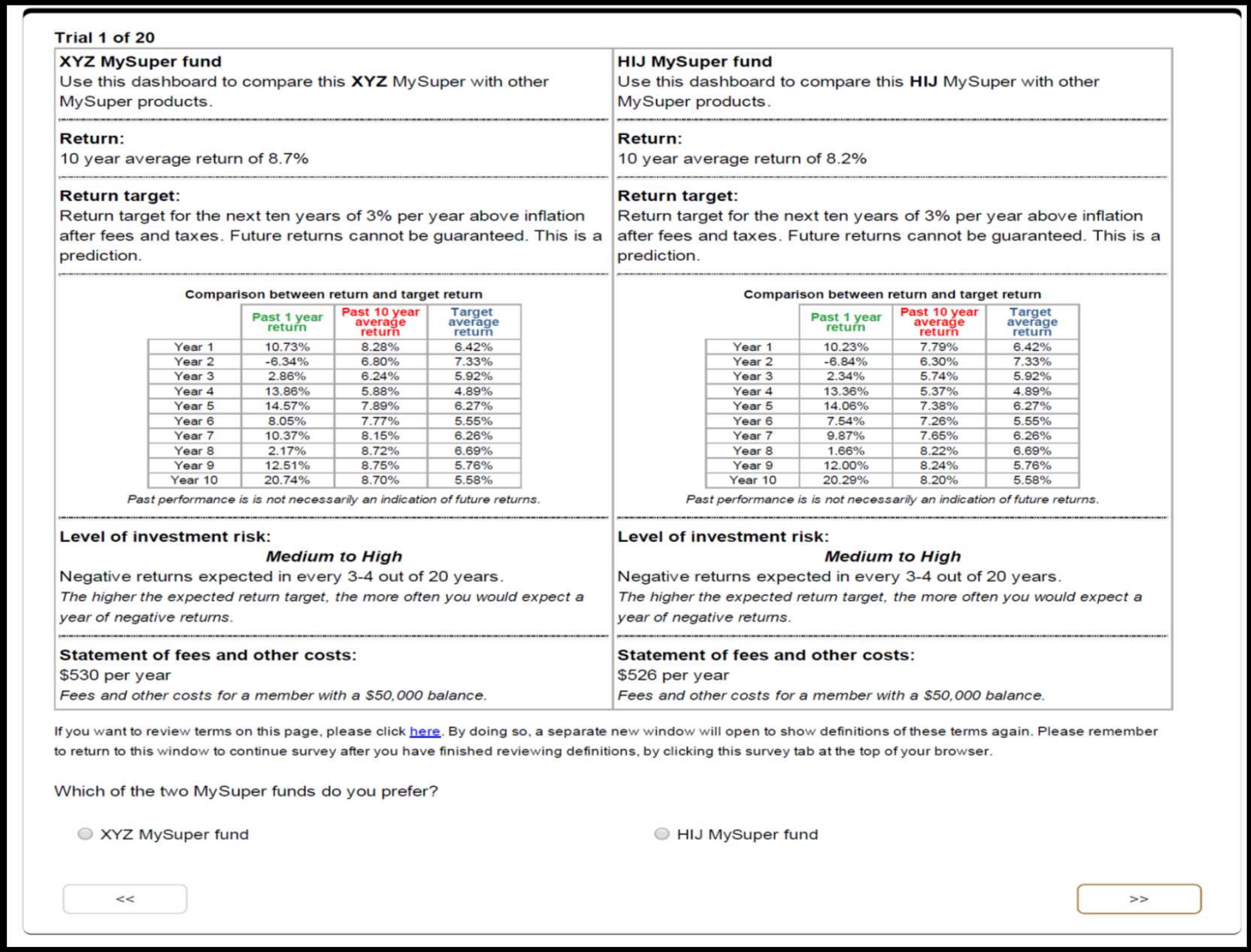
○ XYZ MySuper fund ○ HIJ MySuper fund

Based on typical SAA and bootstrapped historical returns

Calibrated to average MySuper fees

T4 and T7 show low volatility return (cash investment)

We tested returns in a table not graph.



Trial 1 of 20

XYZ MySuper fund	**HIJ MySuper fund**
Use this dashboard to compare this **XYZ** MySuper with other MySuper products.	Use this dashboard to compare this **HIJ** MySuper with other MySuper products.
Return: 10 year average return of 8.7%	**Return:** 10 year average return of 8.2%
Return target: Return target for the next ten years of 3% per year above inflation after fees and taxes. Future returns cannot be guaranteed. This is a prediction.	**Return target:** Return target for the next ten years of 3% per year above inflation after fees and taxes. Future returns cannot be guaranteed. This is a prediction.

Comparison between return and target return

	Past 1 year return	Past 10 year average return	Target average return
Year 1	10.73%	8.28%	6.42%
Year 2	-6.34%	6.80%	7.33%
Year 3	2.86%	6.24%	5.92%
Year 4	13.86%	5.88%	4.89%
Year 5	14.57%	7.89%	6.27%
Year 6	8.05%	7.77%	5.55%
Year 7	10.37%	8.15%	6.26%
Year 8	2.17%	8.72%	6.69%
Year 9	12.51%	8.75%	5.76%
Year 10	20.74%	8.70%	5.58%

Past performance is is not necessarily an indication of future returns.

Comparison between return and target return

	Past 1 year return	Past 10 year average return	Target average return
Year 1	10.23%	7.79%	6.42%
Year 2	-6.84%	6.30%	7.33%
Year 3	2.34%	5.74%	5.92%
Year 4	13.36%	5.37%	4.89%
Year 5	14.06%	7.38%	6.27%
Year 6	7.54%	7.26%	5.55%
Year 7	9.87%	7.65%	6.26%
Year 8	1.66%	8.22%	6.69%
Year 9	12.00%	8.24%	5.76%
Year 10	20.29%	8.20%	5.58%

Past performance is is not necessarily an indication of future returns.

Level of investment risk: ***Medium to High*** Negative returns expected in every 3-4 out of 20 years. *The higher the expected return target, the more often you would expect a year of negative returns.*	**Level of investment risk:** ***Medium to High*** Negative returns expected in every 3-4 out of 20 years. *The higher the expected return target, the more often you would expect a year of negative returns.*
Statement of fees and other costs: $530 per year *Fees and other costs for a member with a $50,000 balance.*	**Statement of fees and other costs:** $526 per year *Fees and other costs for a member with a $50,000 balance.*

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Which of the two MySuper funds do you prefer?

- XYZ MySuper fund
- HIJ MySuper fund

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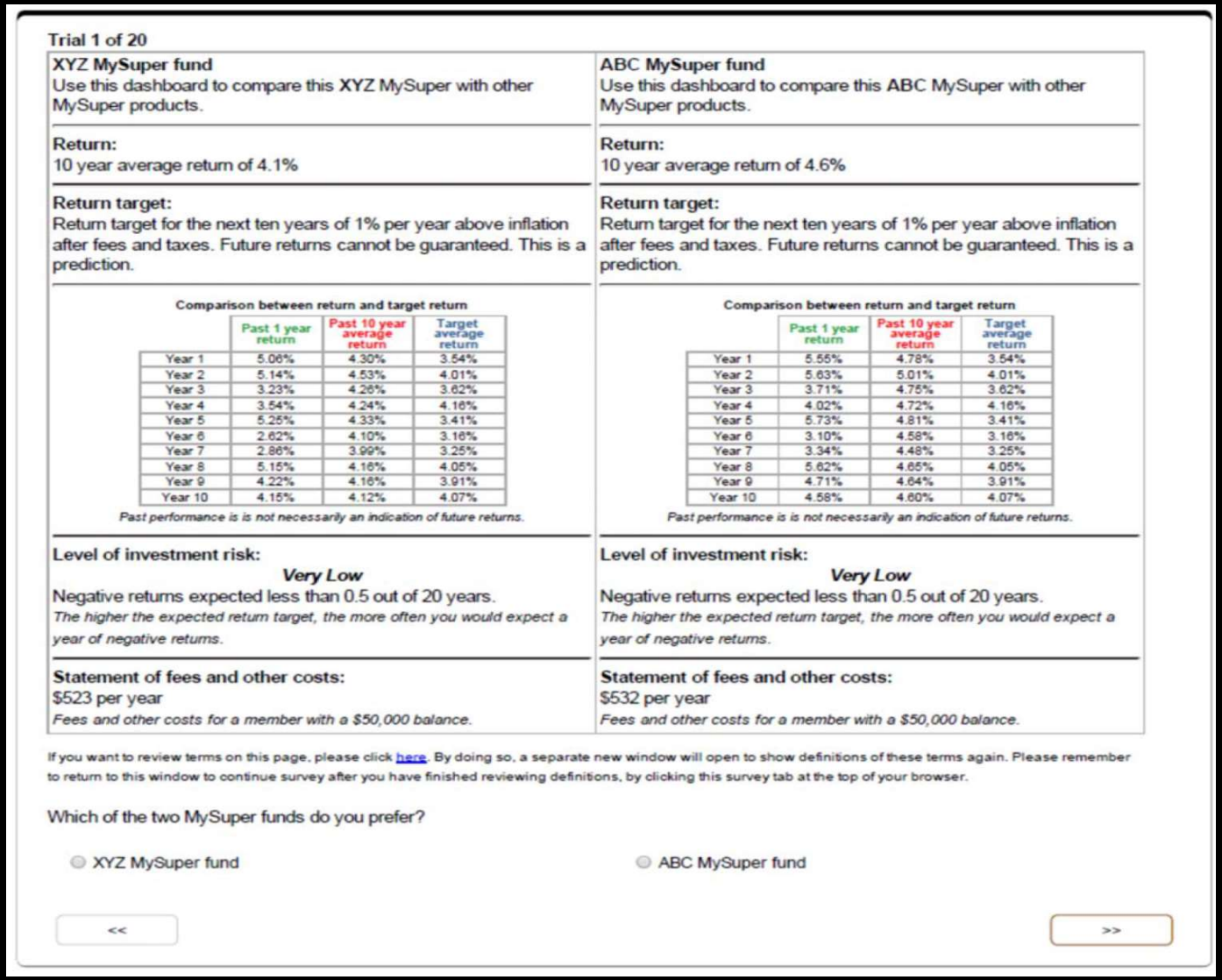
We tested low volatility returns.



Trial 1 of 20

XYZ MySuper fund
Use this dashboard to compare this **XYZ** MySuper with other MySuper products.

Return:
10 year average return of 4.1%

Return target:
Return target for the next ten years of 1% per year above inflation after fees and taxes. Future returns cannot be guaranteed. This is a prediction.

Comparison between return and target return

	Past 1 year return	Past 10 year average return	Target average return
Year 1	5.06%	4.30%	3.54%
Year 2	5.14%	4.53%	4.01%
Year 3	3.23%	4.26%	3.62%
Year 4	3.54%	4.24%	4.16%
Year 5	5.25%	4.33%	3.41%
Year 6	2.62%	4.10%	3.16%
Year 7	2.86%	3.99%	3.25%
Year 8	5.15%	4.16%	4.05%
Year 9	4.22%	4.16%	3.91%
Year 10	4.15%	4.12%	4.07%

Past performance is is not necessarily an indication of future returns.

Level of investment risk:
Very Low
Negative returns expected less than 0.5 out of 20 years.
The higher the expected return target, the more often you would expect a year of negative returns.

Statement of fees and other costs:
$523 per year
Fees and other costs for a member with a $50,000 balance.

ABC MySuper fund
Use this dashboard to compare this **ABC** MySuper with other MySuper products.

Return:
10 year average return of 4.6%

Return target:
Return target for the next ten years of 1% per year above inflation after fees and taxes. Future returns cannot be guaranteed. This is a prediction.

Comparison between return and target return

	Past 1 year return	Past 10 year average return	Target average return
Year 1	5.55%	4.78%	3.54%
Year 2	5.63%	5.01%	4.01%
Year 3	3.71%	4.75%	3.62%
Year 4	4.02%	4.72%	4.16%
Year 5	5.73%	4.81%	3.41%
Year 6	3.10%	4.58%	3.16%
Year 7	3.34%	4.48%	3.25%
Year 8	5.62%	4.65%	4.05%
Year 9	4.71%	4.64%	3.91%
Year 10	4.58%	4.60%	4.07%

Past performance is is not necessarily an indication of future returns.

Level of investment risk:
Very Low
Negative returns expected less than 0.5 out of 20 years.
The higher the expected return target, the more often you would expect a year of negative returns.

Statement of fees and other costs:
$532 per year
Fees and other costs for a member with a $50,000 balance.

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Which of the two MySuper funds do you prefer?

XYZ MySuper fund

ABC MySuper fund

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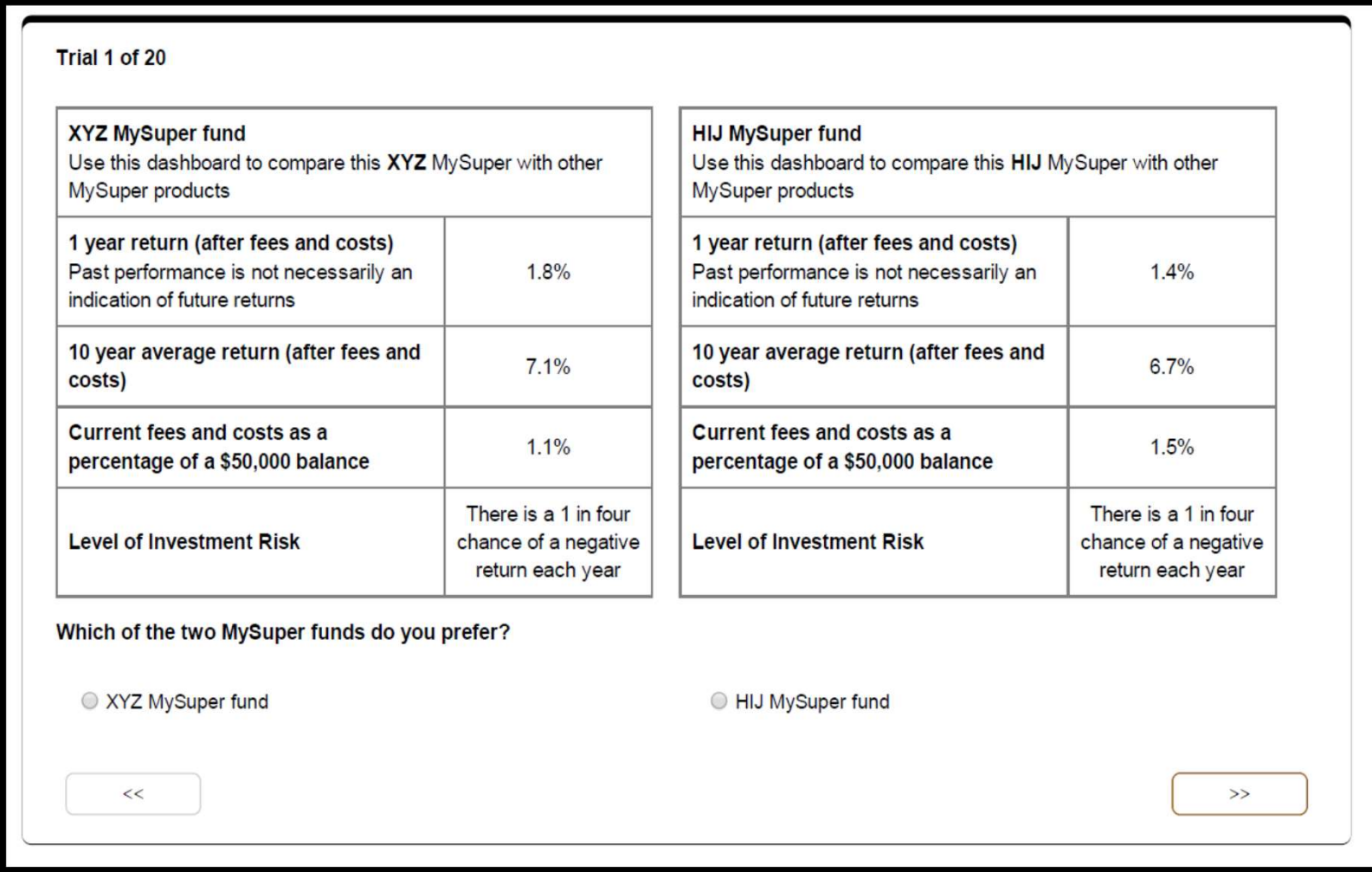
We re-tested everything in a simpler format.



Trial 1 of 20

XYZ MySuper fund Use this dashboard to compare this **XYZ** MySuper with other MySuper products	
1 year return (after fees and costs) Past performance is not necessarily an indication of future returns	1.8%
10 year average return (after fees and costs)	7.1%
Current fees and costs as a percentage of a $50,000 balance	1.1%
Level of Investment Risk	There is a 1 in four chance of a negative return each year

HIJ MySuper fund Use this dashboard to compare this **HIJ** MySuper with other MySuper products	
1 year return (after fees and costs) Past performance is not necessarily an indication of future returns	1.4%
10 year average return (after fees and costs)	6.7%
Current fees and costs as a percentage of a $50,000 balance	1.5%
Level of Investment Risk	There is a 1 in four chance of a negative return each year

Which of the two MySuper funds do you prefer?

○ XYZ MySuper fund

○ HIJ MySuper fund

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Results

Do people understand the dashboard?

Do they switch optimally?

What does it cost to make mistakes?

Dashboard is not well understood.

Comprehension quiz	% correct	% correct
Topic	***Prescribed Dashboard***	***Simplified dashboard***
Fees	56.8	56.5
Returns	48.6	**73.9**
Returns net of fees	43.9	**61.7**
Returns relative to target	46.0	-
Negative returns	47.5	-
Standard risk measure	13.2	22.3

Subjects more confused by returns information and switch repeatedly.

	Full Dashboard				Simplified Dashboard		
	Fee	Return (Graph)	Returns (Table)	Returns (Low Vol)	Fee	Returns	Returns (Low Vol)
Single switchers (%)	**76**	**21**	**35**	**40**	**71**	**71**	**64**

Logit estimations of probability of single switching:

- People should switch funds once, around choice 11 or 12 .
- High numeracy => 6-11 % pts higher single switch
- BUT only in simplified (T5-7) or fee (T1) treatments

- *More numerate subjects helped* by simplifications

Subject see fee signals quickly; returns slowly.

	Fee (Treatment 1)		Returns/Graph (Treatment2)		Returns/Table (Treatment3)		Returns/Low vol (Treatment4)	
	I	D	I	D	I	D	I	D
Choice Set								
11	2	**52**						
12	29	17			2			
13	**34**	21						2
14	19	6			1	2	22	10
15	16	10	4		**29**	4	16	4
16		1	**37**		11	1	**80**	**12**
17	1		3	**8**	4	**14**	10	10
18			2		7		6	4
19			1	2	3	4	4	8
20					3	2		2

Best switch

Subject see returns signals faster in simpler dashboard.

	Fee (Treatment 5)		Returns; (Treatment6)		Returns; Low vol (Treatment7)	
	Single		Single		Single	
	I	D	I	D	I	D
Choice Set						
11	1			2		
12	**29**	13			9	
13	16	**44**	6	6	1	14
14	13	9	1	**70**		**56**
15	18	24	**60**	2	10	5
16	1	1	6		**49**	2
17	1	1	1	8	12	2
18	2	2	3	1		1
19						
20				1		

Panel estimates confirm delayed response to returns differences.

- Estimate panel logit models of preferred plan
- Fee treatments
  - $100 lower fee => 20% more likely to be preferred
- Returns treatments
  - 1 yr return differences not significant
  - 0.5% p.a. higher 10 yr return =>35% more likely preferred
- Simpler dashboard
  - 10 yr return significant
  - 1 yr return significant
  - Fees less important

Subjects treat returns as 3 x more noisy than fees; low and high vol. same.

Estimated noise to signal ratio	Increasing	Decreasing
Panel A: Summary Statistics	Median	Median
T1: Full Dashboard; Fee	1.3	1.2
T2: Full Dashboard; Return; Graph	3.6	3.6
T3: Full Dashboard; Return; Table	2.5	3.6
T4: Full Dashboard; Return; Low vol.	2.0	3.3
T5: Simple Dashboard; Fee	1.7	2.1
T6: Simple Dashboard; Return	2.1	2.0
T7: Simple Dashboard; Return; Low vol.	2.0	1.9

Simplify more?

Prescribed Dashboard, average loss as % of final balance

	Fee		Returns/Graph		Returns/Table		Returns/Low vol	
% Loss	**I: -0.26****	**D: -0.29***	I: -0.98	D: -1.20	I: -0.82	D: -1.30	I: -0.78	D: -0.95

Simplified Dashboard, average loss as % of final balance

	Fee		Returns		Returns; Low vol	
% Loss	I: -0.40	D: -0.45	**I: -0.59*****	**D: -0.75*****	**I: -0.81**	**D: -0.49*****

- Compute final account balance after 20 years (choices), starting with $50K; compare with optimal account balance; compute average loss

Flicking the switch: Key results

- Fund members prefer low fees and high returns
- Fee differences => quick switch
  - Fee framing matters ($ better than %)
- Returns => slow switch
  - Look for **several years of outperformance** and then switch
  - Same for very low volatility returns
  - Responses consistent with 3 times more noise in returns than fees
  - People exhibit “returns scepticism”

Disclosure or Communication?

- Consumer meanings, not legal meanings
- Promote comparison by attribute not alternative
- Simplifications matter – both content and framing
- Need large scale field testing