MarketWatch

Retirement research: Are defaults good or bad?

By Robert Powell

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Defaults have become a popular feature in many employer-sponsored retirement plans. Workers are defaulted into investment options such as target-date funds; workers are defaulted into certain contribution rates, such as 3%; and workers are defaulted into auto-escalation plans, in which the amount they contribute to their retirement automatically rises according to a set schedule.

But are these defaults good for workers?

In a new study, Jeffrey Brown and Scott Weisbenner, both professors at the University of Illinois at Urbana-Champaign, and Anne Farrell, an associate professor at the Miami University Farmer School of Business, examined — in research-speak, heterogeneity in the responsiveness to default options in a large state retirement plan, focusing on individuals' decision-making approaches as well as their economic and demographic characteristics.

Using a survey of plan participants, the authors found that procrastination and the need for cognitive closure are important determinants of the likelihood of default. The authors also explores an important implication of defaulting: Individuals who default are significantly more likely to subsequently express a desire to enroll in a different plan. The desire to change plans is also correlated with numerous economic and decision-making characteristics, including procrastination.

In an interview, Brown addressed further the study's goals, the findings, and its implications.

What were the study's goals?

Default options have proven to be extraordinarily powerful tools for shaping behavior, and have gained widespread acceptance in the U.S. and abroad as a way of influencing behavior. Despite the popularity and the evidence that they work, however, we still know remarkably little about why the work and whether they have a bigger impact on some people than others. This paper was motivated by a desire to learn answers to these questions.

Can you describe your findings?

There are many findings of interest in the paper, as this is a complex and multifaceted issue. But the finding that stands out the most is that people who are prone to procrastination — as measured by standard psychology scales — are substantially more likely to default. This is quite intuitive, of course, but has important implications.

Importantly, we also find that people who defaulted due to procrastination are much more likely to subsequently wish they were in a different plan. This is important because it suggests that these folks did not get defaulted into their optimal choice. In an irrevocable choice setting like ours, this is especially important.

Given your findings, what advice might you have for 1) those saving/investing for retirement and 2) lawmakers?

Although I am a big fan of defaults in general, this paper does show one of the downsides of default, namely, that if defaults are irreversible then it is extremely important to "get it right." In a setting like Illinois' State Universities Retirement

System (SURS) (our setting) where the initial plan choice is lifetime irrevocable, it would likely be preferable to use a "forced choice" approach than relying on defaults.

Read Decision-Making Approaches and the Propensity to Default: Evidence and Implications.

Robert Powell is editor of Retirement Weekly, published by MarketWatch. Follow his tweets @RJPIII. Got questions about retirement? Get answers. Send him an email here.

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