Optimal Default Retirement Saving Policies: Theory & Evidence from OregonSaves

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Impact of COVID-19 on Retirement Savings

- Since the COVID-19 pandemic:
  - Many unemployed workers have lost access to employment-based retirement plans;
  - A third of U.S. population have used money from savings/retirement accounts to pay bills (survey in August 2020, Pew Research Center)

- State-level policy before the pandemic:
  - States are launching state-sponsored retirement plans

New State Mandates

- Employers **must** provide either an employer-sponsored retirement plan or access to a state-sponsored retirement plan

- 7 states have passed the legislation to launch a state-sponsored retirement plan (OR, CA, IL, MD, CT, NJ, CO)
  - OregonSaves (2017), 5% default saving rate +1% auto-escalation/year up to 10%
  - Employees can opt out of the default rate (or the plan entirely)

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- Research question: What is the optimal default saving rate in state-sponsored retirement plans?

Preview of Findings

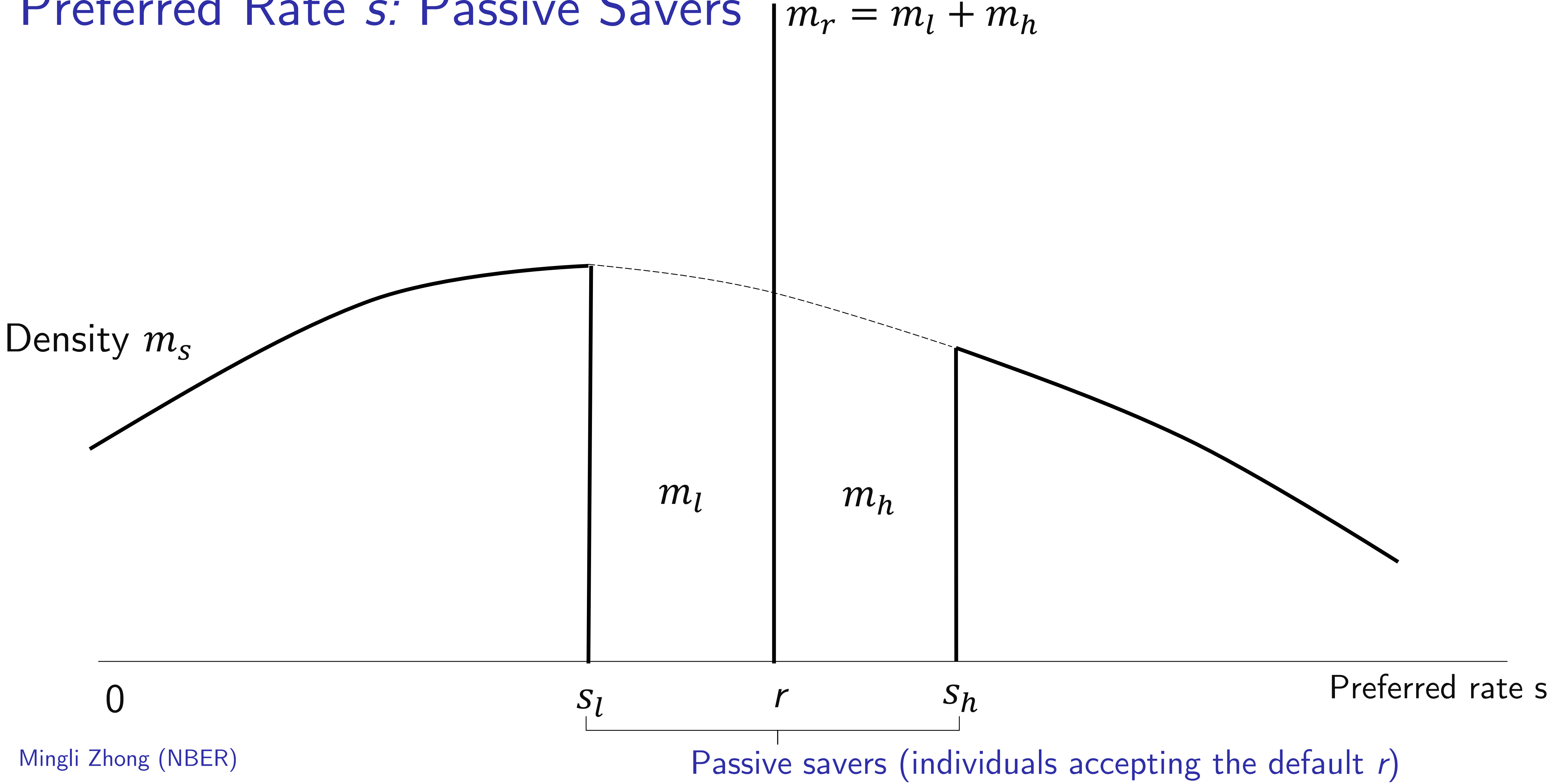
- Determinants of optimal default rate:
  - How people respond to the default rate:
    - Half of passive savers stop saving at default when it rises 1 percentage point
  - High default rate when savers are reluctant to make an active choice
  - Low default rate when active undersavers
    - Little evidence of present bias

- Policy recommendation: Implied OregonSaves optimal default rate 7%

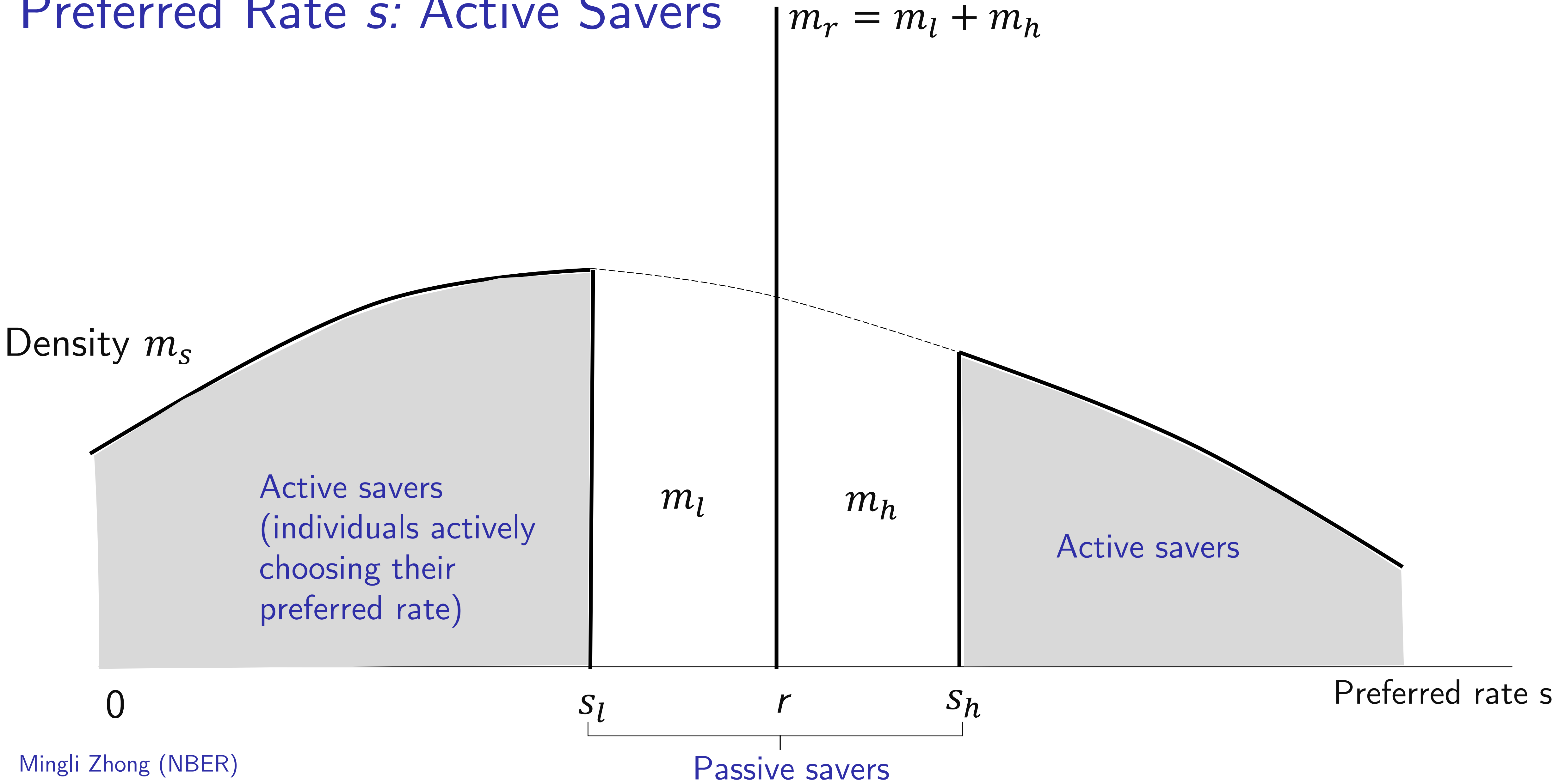
Optimal Default Saving Rate: Model

- Individuals decide between default saving rate r and preferred rate s
- Given individual choices, the policymaker sets the optimal default rate r^* to maximize the sum of individual lifetime well-being
- Objective: Derive a formula for the optimal default rate depending on statistics that can be empirically estimated

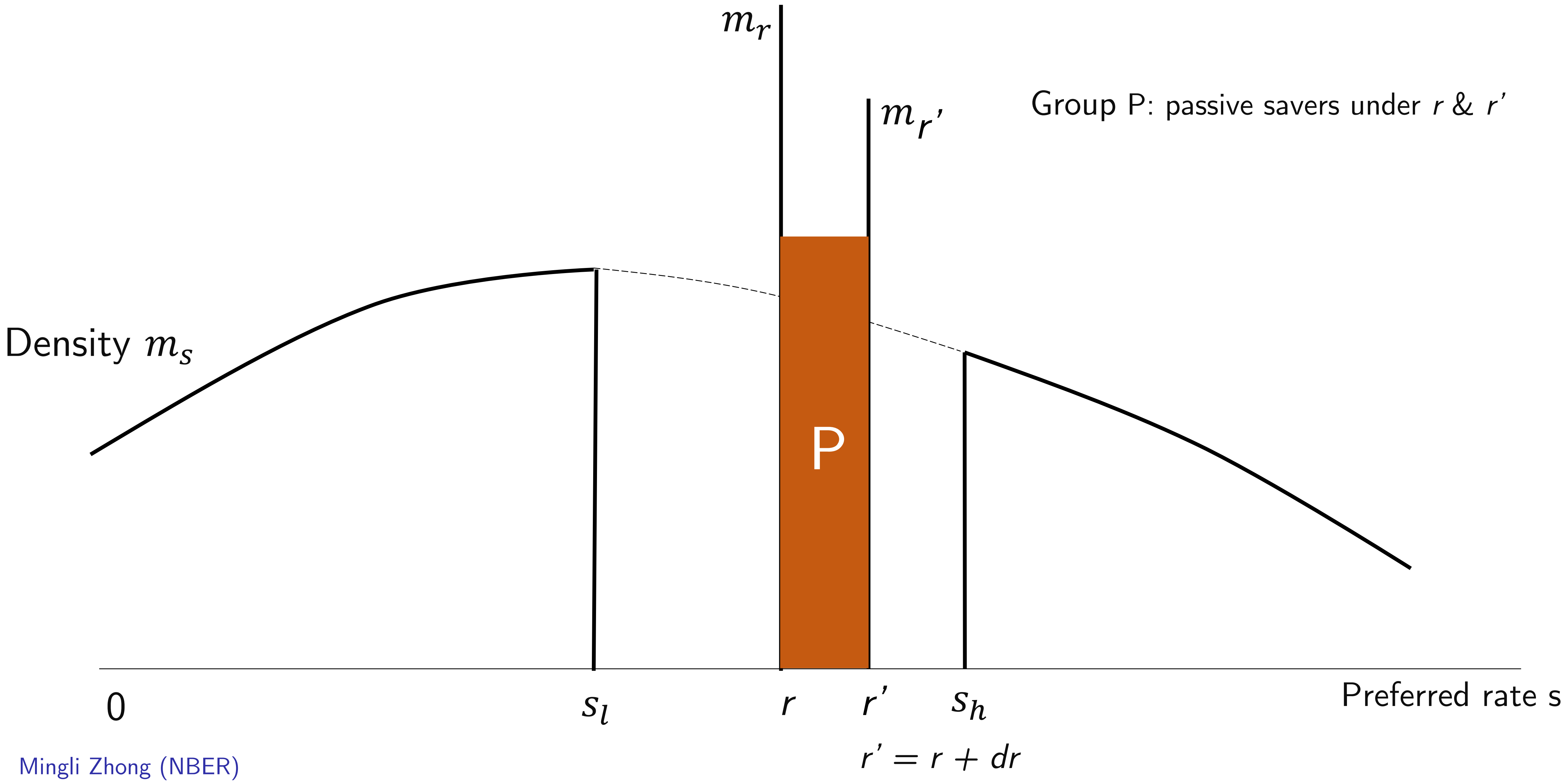
How Individuals Decide between Default Saving Rate *r* and Preferred Rate *s*: Passive Savers



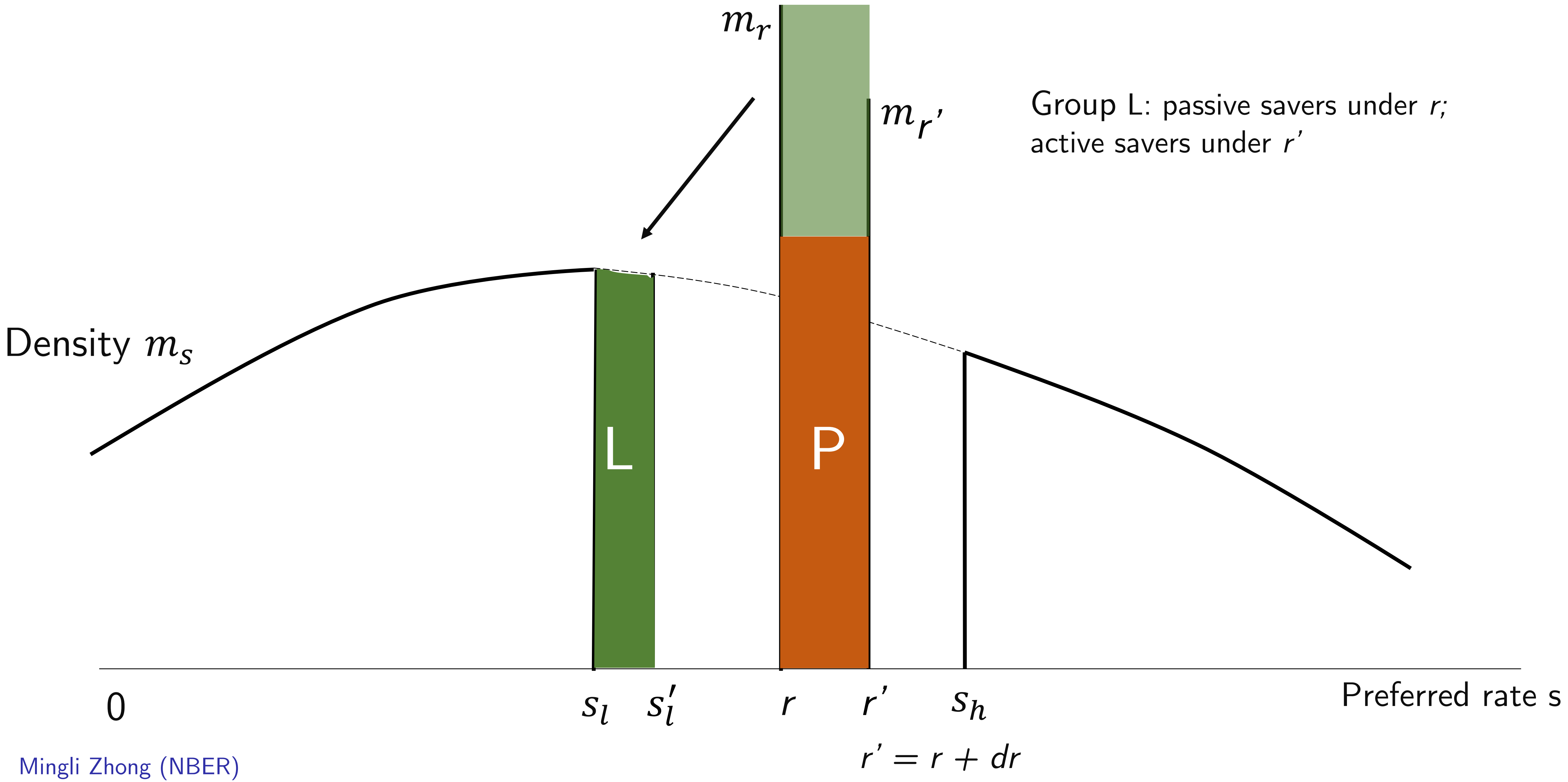
How Individuals Decide between Default Saving Rate *r* and Preferred Rate *s*: Active Savers



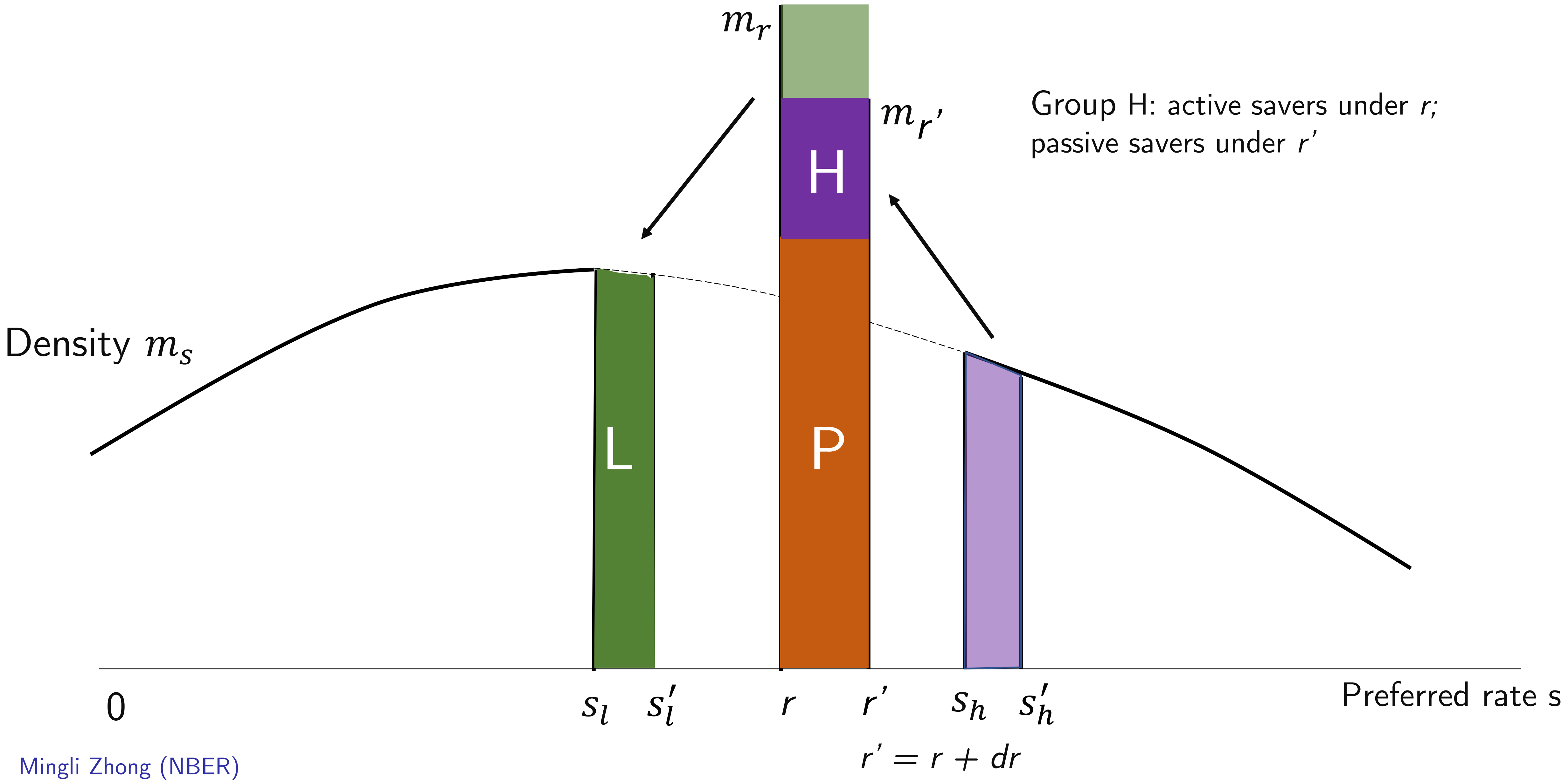
Shifting Composition when Default Changes from r to r'



Shifting Composition when Default Changes from *r* to *r'*

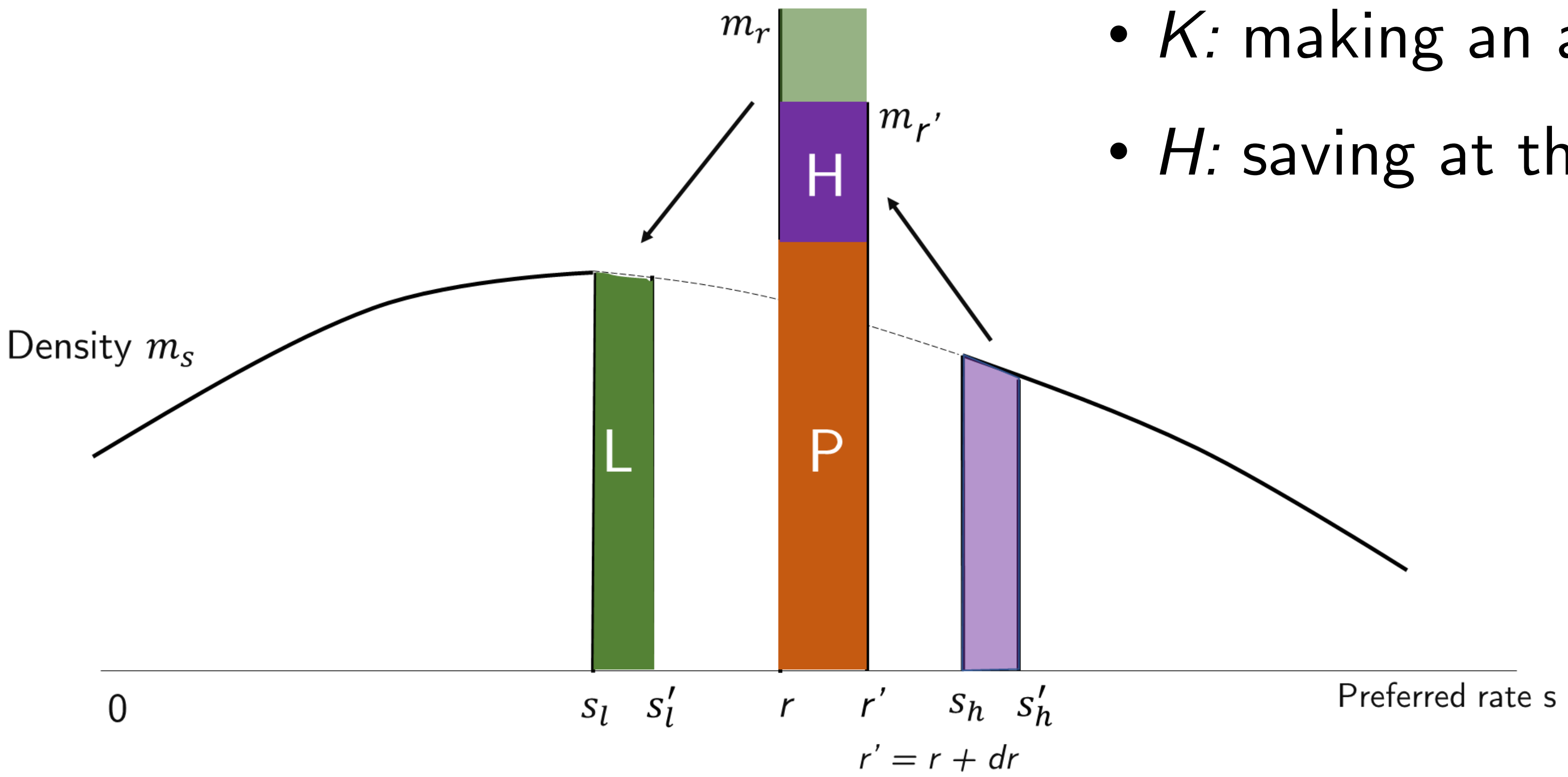


Shifting Composition when Default Changes from *r* to *r'*



Formula for the Optimal Default Saving Rate $r*$

$$r^* = \frac{P - L + K}{-H}$$



$r*$ is determined by

- P: saving at the default
- L: choosing the preferred rate
- K: making an active choice
- H: saving at the default

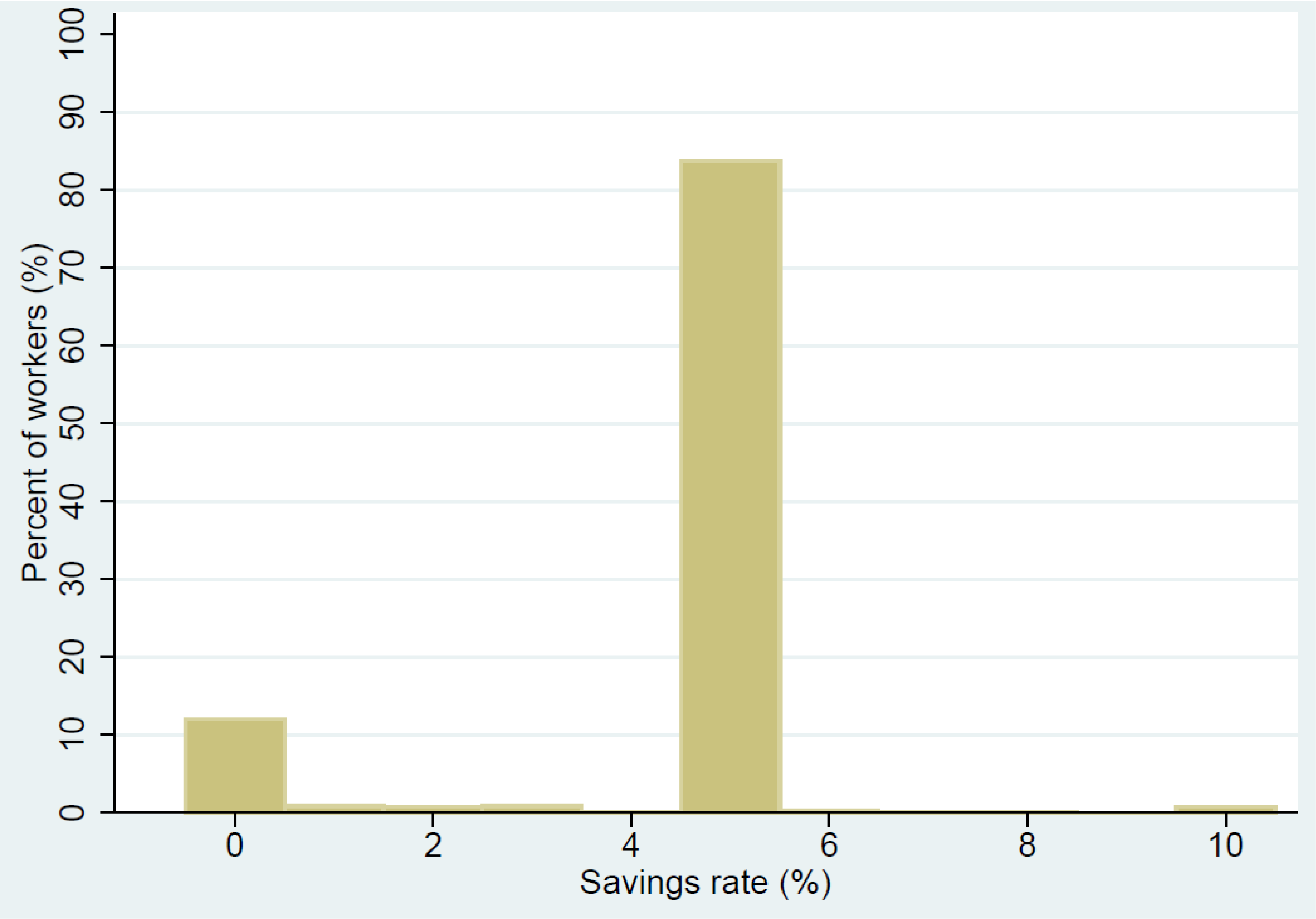
Optimal Default Saving Rate: Empirical Estimation

Key statistics:

- Fraction of passive savers becoming active savers as the default rate changes
  - Individual-level administrative records in OregonSaves
  - Exogenous increase in the default rate:
    - 5% to 6% in 2019
    - 6% to 7% in 2020

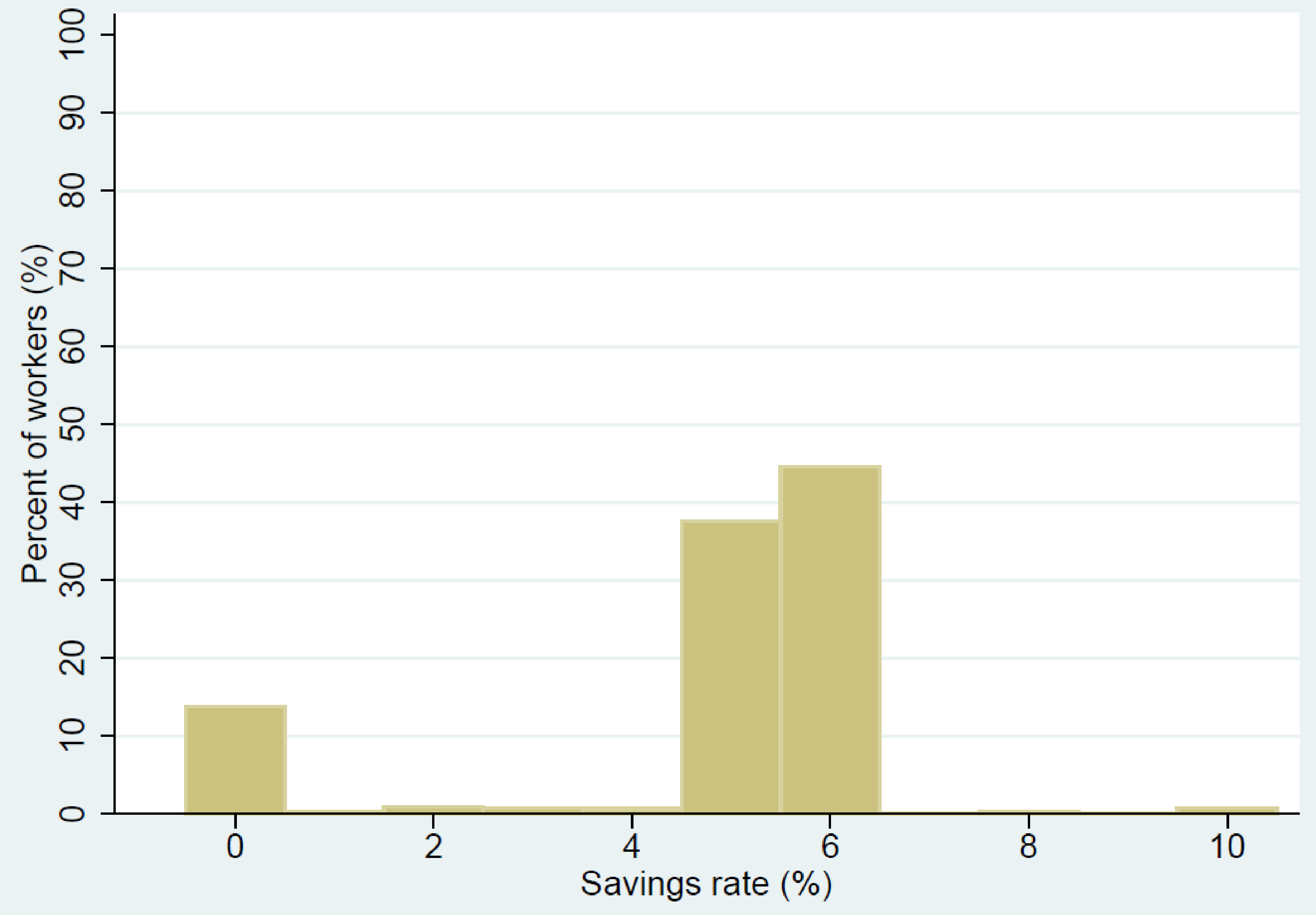
- Degree of undersaving if becoming active savers
  - Survey data to measure present bias

Distribution Before Increase: 5% Default, Dec. 2018



N = 15,974

Distribution After Increase: 6% Default, March 2019



N = 15,974

Eliciting Present Bias from Survey

- Ask 16 questions about how workers divide 100 tokens between a sooner time and a later time

- Convex time budget
  - Choose allocations along a continuous budget constraint
  - Distinguish time preference from risk preference

- Variations in sooner time (today, in a year), later time (in a year, in 2 years), and interest rate (0, 1%, 2%, and 5%)

Instructions: The following questions are all hypothetical, and your answers will not affect the amount of the gift card you will receive by completing the survey. In each of the following questions, please tell us how you think about tradeoffs between today and the future, by moving the slider. We ask you in each case to click the slider dividing 100 tokens between two dates. Here is an example:

Each token is worth $95 today and $100 in a year. How many tokens would you want to receive today?	0	70	100
Amount you will have today	$ 6,650		
Amount you will have in a year	$ 3,000		

This example shows how someone could divide 100 tokens between 70 today and 30 for a year from today. Each token today is worth $95, while each token for a year from today is worth $100. So this person would choose to receive 70*$95=$6,650 today and 30*$100=$3,000 a year from today.

Please use the slider to select the number of tokens you would like to receive today.

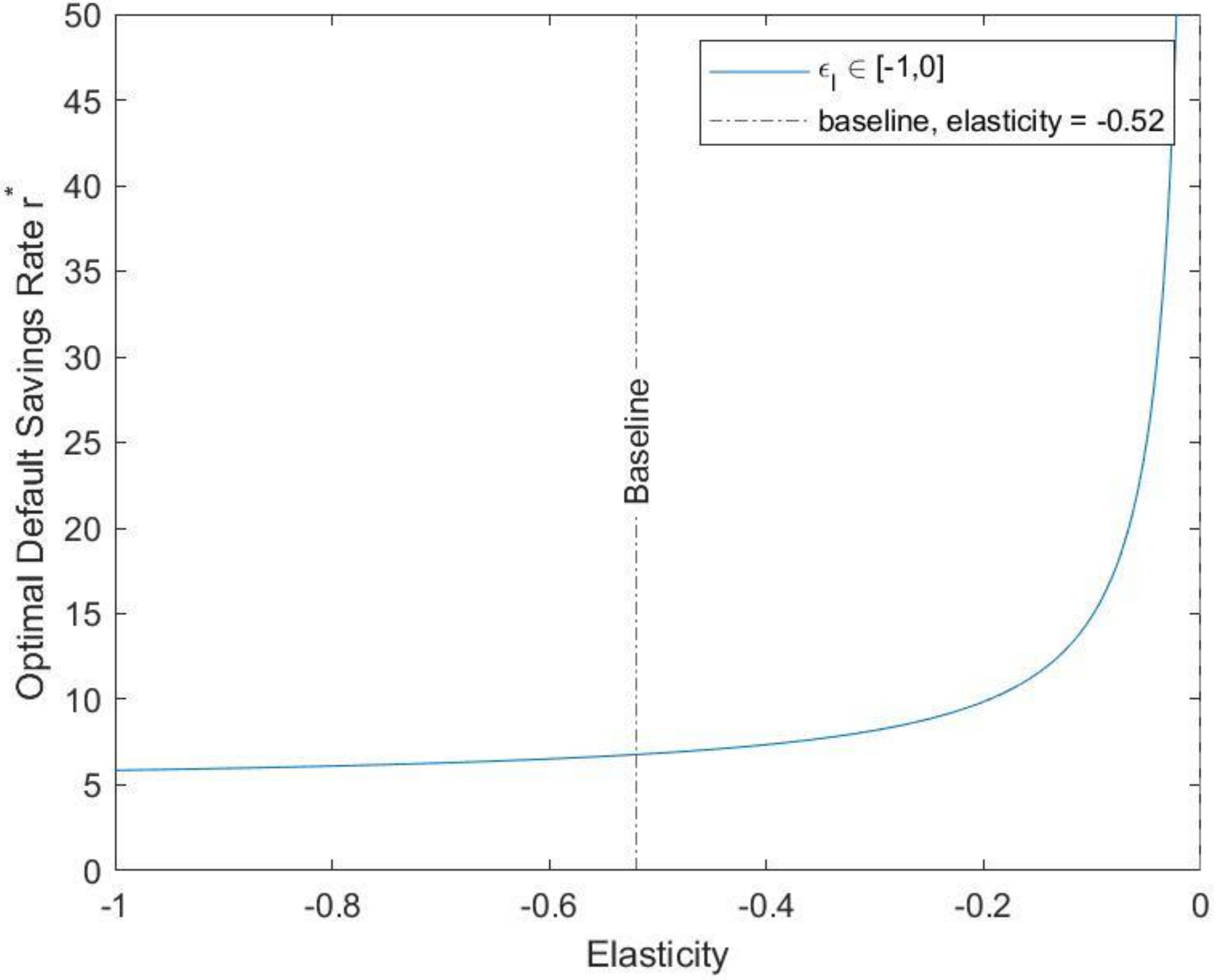
1. Each token is worth $100 today and $100 in a year. How many tokens would you want to receive today?	0	0	100
1. Amount you will have today			
1. Amount you will have in a year			
2. Each token is worth $99 today and $100 in a year. How many tokens would you want to receive today?	0	0	100
2. Amount you will have today			
2. Amount you will have in a year			
3. Each token is worth $98 today and $100 in a year. How many tokens would you want to receive today?	0	0	100
3. Amount you will have today			
3. Amount you will have in a year			
4. Each token is worth $95 today and $100 in a year. How many tokens would you want to receive today?	0	0	100
4. Amount you will have today			
4. Amount you will have in a year			

Results (Preliminary)

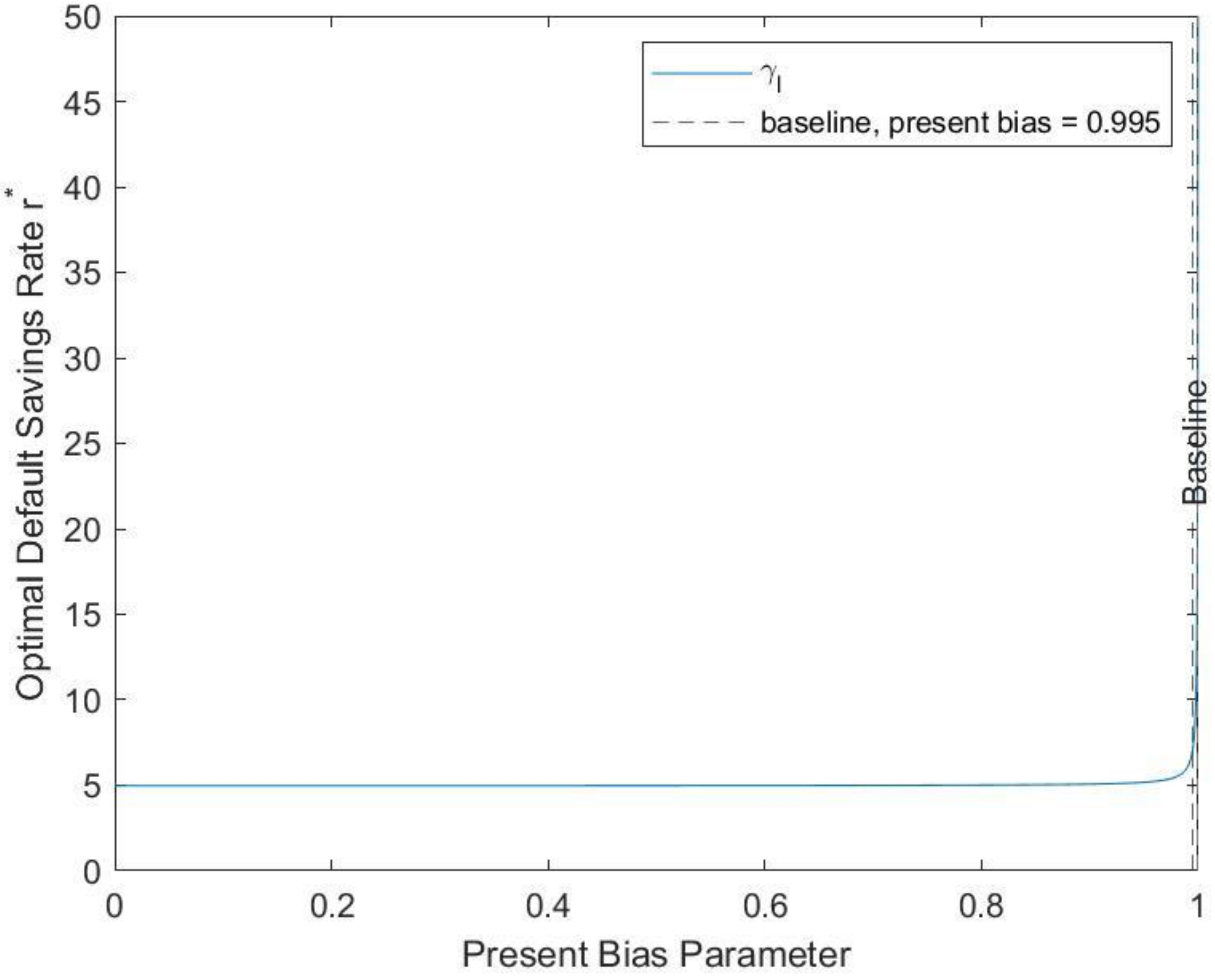
Annual discount factor	0.987
	(0.005)
Present bias parameter	0.995
	(0.006)
Observations	1,765
N. unique subjects	143

- Baseline optimal default = 7%

Sensitivity Analysis: Responsiveness to the Default



Sensitivity Analysis: Present Bias Parameter



Conclusions

- Baseline optimal default rate in OregonSaves: 7%
  - The optimal formula could be applied to any auto-enrollment plans provided by state governments or employers

- Determinants of the optimal default rate
  - Individual responsiveness to the default rate:
    - Half of passive savers stop saving at default when it rises 1 percentage point
  - Little present bias
    - Present bias parameter = 0.995