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

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Acknowledgements

New simplified disclosure regulations are being implemented in Australia

Background:
- Mandatory DC retirement savings cover most Australians
- 'Choice of fund' has low impact
- Evidence of continued inefficiency
  - *More competition could reduce average $1000 p.a. in fees by 25% (Grattan Institute)*
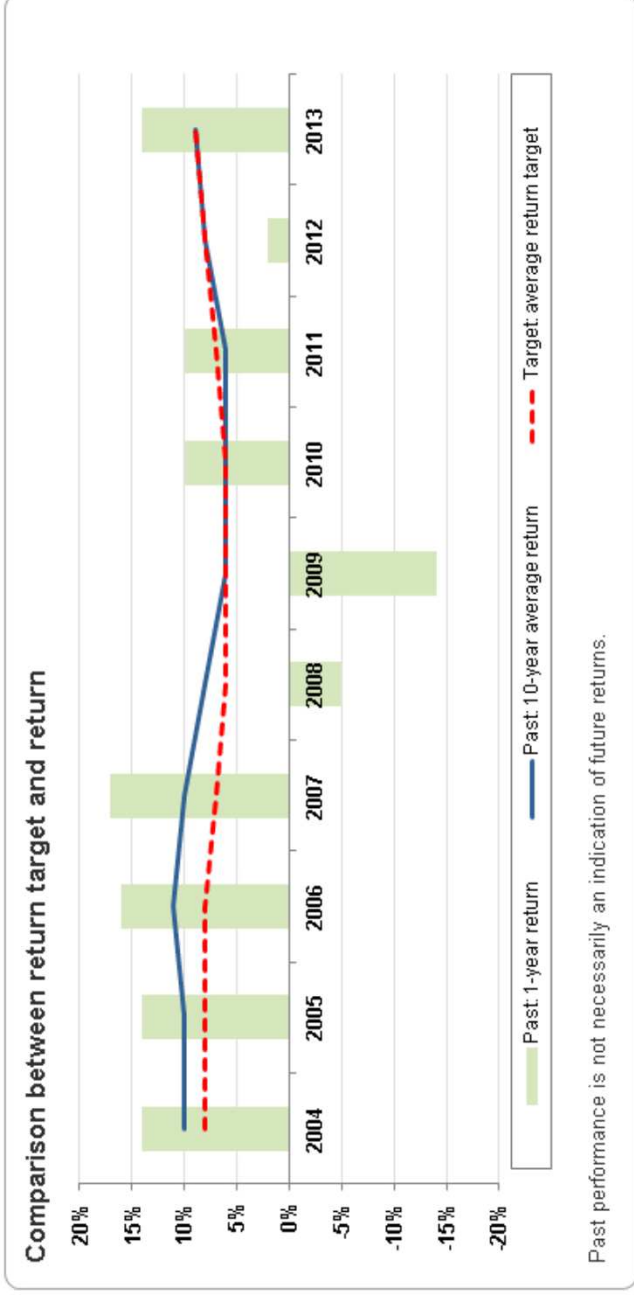
MySuper (2014) – recommended by following a review of the superannuation/pension system in 2010. MySuper is a regulated default fund with a default investment option
- Every MySuper (default) fund must have a *dashboard*
- The dashboard must contain prescribed information
- Must be on website of superannuation/pension fund

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.

Comparison between return target and return

Legend:
- Past: 1-year return
- Past: 10-year average return
- Target: average return target

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.

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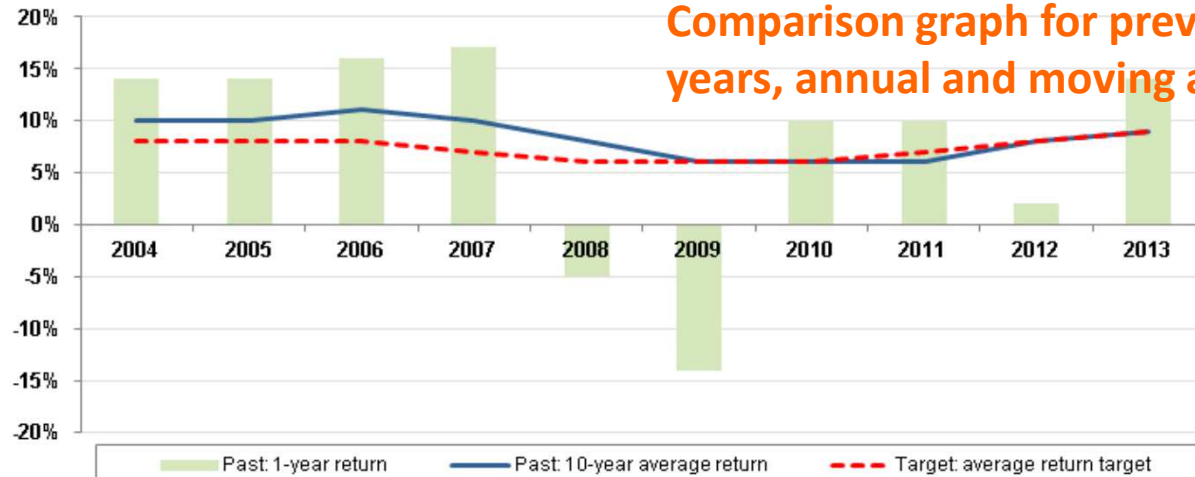
Comparison graph for previous 10 financial years, annual and moving average

| Past: 1-year return | Past: 10-year average return | Target: average return target |

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.

Our research question - do simplified disclosures help?

- Disclosure standards aim for:
  - Transparency and comparability
  - Free markets and autonomy
  - Efficiency

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

Do people overlook fees and chase returns?

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 changes.

Do people overlook fees and chase returns?

- 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

Tests of returns information have been incomplete. We compare short and long term returns, and low and high volatility returns.

Preview – The MySuper dashboard not well understood: 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'

- Further simplifications of the MySuper dashboard are likely to be welfare improving

Design

We conducted incentivised 'choice of fund' experiments

- Subjects from commercial online web panel (1,800)
- Make 20 choices between 2 superannuation/pension funds (using MySuper dashboard)
- Fund performance differences from either
  - Fees (i.e., high expenses)
  - Returns (i.e., low skill)

- Risk level and SAA are the same for both funds and constant

- Collected information on demographics, personal characteristics, financial literacy, numeracy, system knowledge

Vary performance information, framing and format

Treatment Number (n)	Date	Dashboard Type	Changing Information	Returns Volatility	Returns Display Format
1 (286*)	Jul 2014	Prescribed	Fees	High	Graph
2 (274)	Sep 2014	Prescribed	Returns	High	Graph
3 (252)	Feb 2015	Prescribed	Returns	High	Table
4 (247)	Jun 2015	Prescribed	Returns	Low	Graph/Table
5 (251)	Aug 2015	Simplified	Fees	High	N/A
6 (250)	Oct 2015	Simplified	Returns	High	N/A
7 (258)	Oct 2015	Simplified	Returns	Low	N/A

Based on typical SAA and bootstrapped historical returns

T4 and T7 show low volatility return (cash investment)

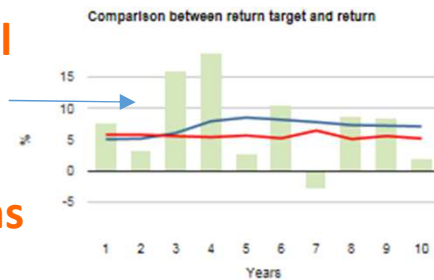**Calibrated to average MySuper fees**

Trial 1 of 20

XYZ 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.

Return:
10 year average return of 7.1%

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 target and return

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.

HIJ MySuper fund
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 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.

Comparison between return target and return

Years

Years

Past: 1 year return   Past: 10 year average return   Target: average return target
Past performance 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.

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

We tested returns in a table rather than the graph

We re-ran fee, high volatility returns and low volatility returns treatments in a simplified format

Trial 1 of 20

XYZ MySuper fund Use this dashboard to compare this **XYZ** MySuper with other MySuper products		**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	1.8%	**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)	7.1%	**10 year average return (after fees and costs)**	6.7%
Current fees and costs as a percentage of a $50,000 balance	1.1%	**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	**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

| << | >> |

Results

Do people understand the dashboard?

Do they switch optimally?

What does it cost to make mistakes?

MySuper Dashboard is not well understood

Topic	% correct *Prescribed Dashboard*	% correct *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

People should switch funds once, around choice 11 or 12

	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:

- High numeracy => 6-11 % pts higher single switch

- BUT only in simplified (T5-7) or fee (T1) treatments

- *More numerate subjects helped* by simplifications

Fee signals picked up quickly
Returns picked up slowly

Set	Fee (Treatment 1)		Returns/Graph (Treatment2)		Returns/Table (Treatment3)		Returns/Low vol (Treatment4)	
	I	D	I	D	I	D	I	D
11	2	**52**						Best switch
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

Panel estimates of effects of information on switches confirm the influence of average returns

Panel A	First switch						
	Δ1 yr ret	Δ10 yr ret	ΔFee	Single	Graph	Ps. R2	Obs.
Full dashboard							
Treatment 1 (FEE, GRAPH)							
Increasing			-0.002***	-0.024*		0.433	2780
			0.000	*0.070*			
Decreasing			-0.002***	-0.156*		0.595	2940
			0.000	*0.049*			
Treatment 2 (RETURNS, GRAPH)							
Increasing	0.515	0.318	0.002	0.058		0.232	2720
	0.325	*0.364*	*0.001*	*0.037*			
Decreasing	0.269	0.727***	-0.005***	-0.228***		0.267	2760
	0.245	*0.283*	*0.001*	*0.034*			
Treatment 3 (RETURNS, TABLE)							
Increasing	0.473*	0.440	-0.004*	0.055		0.287	2520
	0.255	*0.315*	*0.001*	*0.044*			
Decreasing	0.258	0.693**	-0.004***	-0.149***		0.261	2520
	0.255	*0.293*	*0.001*	*0.046*			
Treatment 4 (LOW VOLATILITY RETURNS, GRAPH or TABLE)							
Increasing	0.187	0.751**	-0.005***	0.250***	-0.148***	0.395	2460
	0.293	*0.331*	*0.001*	*0.044*	*0.042*		
Decreasing	0.193	0.805**	0.003***	-0.180***	0.039	0.315	2480
	0.280	*0.318*	*0.001*	*0.047*	*0.047*		

Panel estimates of effects of information on switches confirm the influence of average returns

	Δ1 yr ret	Δ10 yr ret	ΔFee	Single	Graph	Ps. R2	Obs.
Simplified Dashboard							
Treatment 5 (FEE)							
Increasing		0.505***	-0.556***	0.073		0.395	2460
		0.081	0.063	0.059			
Decreasing		-0.313***	-1.270***	-0.101*		0.518	2620
		0.079	0.061	0.054			
Treatment 6 (RETURNS)							
Increasing	0.984***	-0.020		0.032		0.414	2460
	0.041	0.046		0.062			
Decreasing	-0.019	1.189***	-1.843***	-0.215***		0.481	2540
	0.088	0.100	0.220	0.057			
Treatment 7 (LOW VOLATILITY RETURNS)							
Increasing	-0.041	1.030***	-1.399***	0.032***		0.413	2460
	0.068	0.086	0.095	0.055			
Decreasing	2.551***	6.094***	1.678	-0.131		0.419	2700
	0.451	0.622	1.266	0.400			

Cost of mistakes?

Prescribed Dashboard, average loss as % of final balance

% Loss	Fee		Returns/Graph		Returns/Table		Returns/Low vol	
	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

% Loss	Fee		Returns		Returns; Low vol	
	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
  - People consider 1 yr and 10 yr returns
  - Look for **several years of outperformance** and then switch
  - Same for very low volatility returns
  - People are 'returns sceptics'

Was the MySuper dashboard used as expected?

- Poor comprehension of most information (less for fees)
- 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
  - More responsive to table then current graph

- Simplifications are likely to be welfare improving

DISCLOSURE FORMATS NEED LARGE SCALE FIELD TESTING