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ARTICLE REVIEW

'Are Retirement Planning Tools Substitutes or Complements to Financial Capability?'

BY GOPI SHAH GODA, MATTHEW LEVY, COLLEEN FLAHERTY MANCHESTER, AARON SOJOURNER, JOSHUA TASOFF, AND JIUSI XIAO

Reviewed by Arun Muralidhar, PhD

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Defined contribution plans present interesting and complex questions about how much to save and when, what to invest in and how much to invest, and finally how best to decumulate. The answers to these questions are based on calculations that typically are beyond the scope of even sophisticated investors because they require forecasting variables as diverse and uncertain as wage growth, inflation, and investment returns, not to mention understanding the effects of long-term compounding. But could individuals benefit from online retirement-planning tools that facilitate such calculations? Given the low marginal cost involved, such tools, if proven successful, could extend a degree of financial literacy about the potentially complicated and uncertain task of saving for retirement.

The paper titled "Are Retirement Planning Tools Substitutes or Complements to Financial Capability?" addresses this question by conducting a randomized controlled trial among employees at the U.S. Office of Personnel Management, a federal agency. The goal was to better understand how a web-based retirement-savings calculator may affect workers' retirement-savings decisions.

In addition to a defined benefit plan, the federal employees who participated in the study have an employer-sponsored retirement savings program called the Thrift Savings Plan (TSP), which is similar to a 401(k).

To begin, the authors gathered detailed information about the participants, including an assessment of their financial literacy. Participants then were assigned randomly to one of two groups—an active control group and a treatment group.

For each group, the calculator projected workers' retirement-income goals. But for the treatment group, the calculator also provided an estimate of how much money the TSP account together with the defined benefit plan and Social Security would deliver in retirement. The treatment group participants also could use the calculator to display the gap between their projected goals and their calculated retirement incomes, and it allowed them to interactively explore how alternative, future contribution choices would affect the gap. They also were given the ability to change parameters such as the retirement age, retirement lifestyle goals, wage growth, and investment returns.

The authors found that giving investors access to a retirement-planning calculator increased annual retirement contributions by an average of $174 or 2.3 percent. Perhaps more interestingly, though, they found that those with greater financial literacy and financial capabilities were those who saved more, suggesting this type of tool is a complement and not a substitute for financial literacy engagements.

They did not find, however, much heterogeneity in tests of the exponential growth bias or the present bias, which ran contrary to their expectations; one would expect that calculators that project retirement income should help overcome these biases. Therefore, it appears that, even with a very easy-to-use online calculator, retirement planning can prove to be a challenge. Interestingly, this research suggests that people might require and benefit from the assistance of well-trained and certified retirement financial advisors, who might be more capable and better-equipped to guide them through the process of savings, investment, and decumulation, than an online tool.

So, the authors found that the retirement-savings calculator was more helpful to those who save more—whom we can assume are those already likely to achieve their retirement goals—than to those who save less. In other words, it proved to be of more help to the group that needs it less. If the retirement tool helped the high-savings group more than the low-savings group, then additional tools need to be developed, because the low-savings groups are the vulnerable populations that need to be encouraged to save more. In other words, online retirement calculators aren't a panacea for the looming retirement-income crisis.

I would like to see researchers, i.e., these authors or others, explore the reason why participants in this study chose to save more rather than using some of the other options offered through the calculator. Rather than saving more of their take-home pay, workers could just as well have chosen to project higher wage growth, alter their retirement dates, or take on more risk in their investments. Why do workers choose to reduce current consumption in order to save rather than choose one (or more) of the other available options?

But that is a topic for further investigation and discussion, one that would bring us closer to understanding and solving the retirement puzzle. As it stands, this paper provides insight and is an important addition to the literature on improving retirement preparedness for the masses. It also highlights the need for more tools, instruments, and advice to ensure that individuals at all levels of financial literacy meet their retirement-income targets.

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