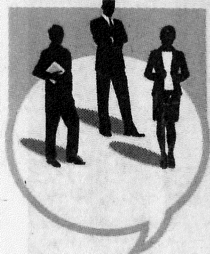

THE EXPERTS

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Insights on Pensions, Advisers

The Experts are an online group of industry and thought leaders who write about leading topics of interest in their fields. For more, go to **WSJ.com/Experts**.

Bring Back the 'Pension'

Defined-contribution plans have become the mainstay of U.S. company retirement plans, yet they haven't succeeded at delivering lifetime income benefits, as a rule: Fewer than one-fifth of all such plans today help workers convert their plan assets into retirement paychecks.

What if there was a way to "put the pension back" into retirement plans?

Even when workers do wish their retirement plans to pay them lifetime income streams, their employers have not wanted to help them do so at retirement, due to concern over fiduciary liability.

This is why the Department of the Treasury recently launched an initiative to provide firms and employers new ways to give private-sector defined-contribution plans a pension-like option. Specifically, the new tax rules now allow not only 401(k) plans but also individual retirement accounts and 403(b) tax-sheltered annuities for employees of nonprofit employers, to convert their retirement nest eggs into longevity income annuities (LIAs).

These are income streams that begin paying the buyer at some future age (e.g., age 85) and continue for life. Even in the current low interest-rate environment, a deferred single life annuity purchased at age 65 costing $50,000 can generate an annual benefit flow from age 85 onward of $24,200 ($19,400 for a woman) a year for life.

In my recent research with Raimond Maurer and Vanya Horneff, we figured out the optimal LIA purchase strategy for the average man or woman, and also for those anticipating higher-than-normal mortality rates. Overall, workers would optimally commit 8% to 15% of their plan balances at age 65 to a LIA that started paying them out from age 85 for the rest of their lives.

For people with much higher mortality than population averages, the higher annuity prices charged to them pose a challenge. Yet we also showed that, if employers converted 10% of retirement assets into a longevity annuity only for those having at least $65,000 in their retirement accounts, this solves the problem.

Including well-designed longevity annuities as defaults in 401(k)s and IRAs would make most workers better off. It is a sensible way to manage retirement risk.

—Olivia S. Mitchell, professor, director of the Pension Research Council, Wharton School, University of Pennsylvania

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Advisers Failed This Test

The world requires us to make an abundance of financial decisions every day. But by the time you learn whether a retirement strategy was the right choice, it is usually too late to change it.

In a study to analyze the quality of financial advice commonly given to clients by financial advisers, my co-authors and I sent "mystery shoppers" to financial advisers in the greater Boston area. The shoppers impersonated regular customers seeking advice on how to invest their retirement savings outside of their 401(k) plans. They also represented different levels of bias or misinformation about financial markets.

What we learned is highly troubling.

By and large, the advice our shoppers received did not correct any of their misconceptions. Even more troubling, the advisers seemed to exaggerate the existing misconceptions of clients if it made it easier to sell more expensive and higher-fee products. In addition, advisers strongly favored actively managed funds over index funds. In only 7.5% of sessions did advisers encourage investing in index funds. This is exactly counter to insights from finance research, which suggests that the average investor should choose low-cost index funds over actively managed funds. If advisers did happen to mention fees, they usually played down their importance.

To better align the interest of advisers with their clients, the Labor Department issued rules earlier this year that require any investment professional who advises clients on their individual retirement accounts to act as fiduciaries, meaning they have to put their clients' interests before their own. The new DOL rules only come into effect next year, but the industry has been aflutter with debates over these new rules. And there is still a lot of room for brokers who fall outside of the 401(k) and the rollover IRA area.

Our research suggests that the proposed fiduciary standard can be beneficial. Indeed, we found that advisers who have a fiduciary responsibility toward their clients provided better and less biased advice than those that were merely registered as brokers.

—Antoinette Schoar, professor, finance department chair, MIT Sloan School of Management

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How to Avoid Panic Selling

Let's say I have two investment accounts, each with a 60% stock allocation. One I consider my "trading account," and the other my "retirement account." Now assume the markets fall. The question: Will I be less likely to pull money out of stocks in my "retirement account" than out of the "trading account?"

In other words, can I change how I behave by simply telling myself that one account is for a future goal?

The answer is yes: How we view a pot of money can help us become more successful investors. Research shows that the mere act of assigning a label to an investment portfolio, and associating it with a future goal, makes us less likely to respond emotionally to experiencing a loss.

Psychologists refer to this as reinterpretation. Instead of seeing two investment accounts, I can reinterpret one account by linking it to a future goal.

Although the trend in investments is toward aggregating investment accounts to make them easier to manage, there may be an advantage in keeping the accounts separate and associating each account with a specific future goal.

—Michael Finke, chief academic officer, American College of Financial Services