



on the future  
of retirement



# **“Encouraging Adaptation”**

**The Next Generation of Life-Cycle Investment Products**

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## Key Points



- **Life-cycle investing in the future will be about choosing among features of products designed for consumers by financial engineers.**
- **Technological progress and market competition will make these products affordable for middle-class consumers, not just the wealthy.**
- **Consumer education will focus on helping people choose appropriate product features they can afford.**

## Life-cycle investment products today



- **Target-date retirement accounts**
- **Target-date college tuition accounts**
- **Health saving accounts**
- **Common characteristics**
  - ▶ **Specific purpose**
  - ▶ **Specific maturity date**
  - ▶ **Tax advantaged because society wants to encourage saving for this purpose**
- **Most of the money in these accounts is invested in mutual funds**

## The trouble with target-date mutual funds



- **Not matched to the purpose or the target date of the account**
- **For a matching strategy, the basic building blocks must be denominated in units that match the purpose and have known maturities.**

## Examples of matching



- **Annuities linked to cost of living to achieve a target standard of living in retirement.**
- **Contracts linked to college tuition.**
- **Contracts linked to health care costs.**

## The role of guarantees



- Risk is most efficiently managed by firms, not by consumers.
- A money-back guarantee transfers risk from the consumer to the firm.
- *Caveat emptor* -- Can a consumer trust a firm that does not guarantee its products?
- If risk is truly small, then the cost of the guarantee will be low.
- If the cost of the guarantee is high, then the risk is *not* small.

## The role of government



- **Help to complete the financial markets for basic hedging instruments by providing default-free debt instruments linked to key indexes. Let competitive market forces price them.**
- **Enforce truth in advertising by financial intermediaries selling products to consumers.**
- **Safe harbor default choices should be safe and efficient.**

# Role of universities



- **To provide scientific research in the public interest.**
- **To provide unbiased educational programs based on science.**