Asset Allocation in Tax-Deferred Pensions and the Role of Employer Matches

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Abstract

This study estimates an intertemporal life-cycle model to explain the observed asset allocation and location decisions for households making taxable and tax-deferred investment. The findings suggest that the employer cash matching policies in the pension account encourage households to hold more wealth in the tax-deferred pension account and less wealth in the taxable account. In the presence of uninsurable labor income risks and imperfect liquidity of pension wealth, borrowing-constraint households would like to hold more safe assets in the taxable account for precautionary saving purposes, and they tend to boost equity holdings in the tax-deferred account to maintain an optimal portfolio mix. The effect of employer matches is more significant among young households (age 25–45), yielding an average elasticity of equity ownership with respect to the match rate of 2.6 in the pension account, compared with an elasticity of 0.04 for older households. In the case of employer stock matches whose returns are positively correlated with labor income shocks, the study shows that the precautionary saving concern reduces the equity investment in the taxable account to an even lower level, and results in a higher concentrated equity holding in the pension account.

Key words: Asset allocation, asset location, life cycle, tax-deferred pension, employer match, method of simulated moments
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