

Financial Decision Making and Retirement Security in an Aging World

Financial Decision Making and Retirement Security in an Aging World

EDITED BY

Olivia S. Mitchell,
P. Brett Hammond, and
Stephen P. Utkus

OXFORD
UNIVERSITY PRESS

OXFORD

UNIVERSITY PRESS

Great Clarendon Street, Oxford, OX2 6DP,
United Kingdom

Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
and education by publishing worldwide. Oxford is a registered trade mark of
Oxford University Press in the UK and in certain other countries

© Pension Research Council, The Wharton School, University of Pennsylvania 2017

The moral rights of the authors have been asserted

First Edition published in 2017

Impression: 1

All rights reserved. No part of this publication may be reproduced, stored in
a retrieval system, or transmitted, in any form or by any means, without the
prior permission in writing of Oxford University Press, or as expressly permitted
by law, by licence, or under terms agreed with the appropriate reprographics
rights organization. Enquiries concerning reproduction outside the scope of the
above should be sent to the Rights Department, Oxford University Press, at the
address above

You must not circulate this work in any other form
and you must impose this same condition on any acquirer

Published in the United States of America by Oxford University Press
198 Madison Avenue, New York, NY 10016, United States of America

British Library Cataloguing in Publication Data

Data available

Library of Congress Control Number: 2017935043

ISBN 978-0-19-880803-9

Printed and bound by

CPI Group (UK) Ltd, Croydon, CR0 4YY

Links to third party websites are provided by Oxford in good faith and
for information only. Oxford disclaims any responsibility for the materials
contained in any third party website referenced in this work.

Preface

As the world's population lives longer, it will become increasingly important for plan sponsors, retirement advisors, regulators, and financial firms to focus closely on how older persons fare in the face of rising difficulties with cognition and financial management. This book offers state-of-the-art research and recommendations on how to evaluate when older persons need financial advice, help them make better financial decisions, and to identify policy options for handling these individual and social challenges efficiently and fairly. This, our newest volume in the Pension Research Council/Oxford University Press series, draws lessons from theory and practice, and we are confident that the book will interest employees and retirees, consumers and researchers, and financial institutions working to design better retirement plan offerings.

In the process of preparing this book, many people and institutions played key roles. Co-editors P. Brett Hammond and Steve Utkus provided numerous excellent suggestions as we organized and edited the analysis herein. We also thank our Advisory Board and Members of the Pension Research Council for intellectual and financial support. Additional support was received from the Pension Research Council, the Boettner Center for Pensions and Retirement Research, and the Ralph H. Blanchard Memorial Endowment at the Wharton School of the University of Pennsylvania. We greatly appreciate the Oxford University Press which publishes our series on global retirement security. The manuscript was expertly prepared and carefully edited by Joseph Brucker.

Our work at the Pension Research Council and the Boettner Center for Pensions and Retirement Research of the Wharton School of the University of Pennsylvania has been dedicated to furthering pensions and retiree well-being for more than 60 years. We are delighted that this volume continues our effort to produce excellent new research and disseminate it to all who seek to learn.

Olivia S. Mitchell
Executive Director, Pension Research Council
Director, Boettner Center for Pensions and Retirement Research
The Wharton School, University of Pennsylvania

Contents

<i>List of Figures</i>	ix
<i>List of Tables</i>	xi
<i>Notes on Contributors</i>	xiii
1. Introduction: Financial Decision Making and Retirement Security in an Aging World <i>Brett Hammond, Olivia S. Mitchell, and Steve Utkus</i>	1
Part I. The Aging Brain and Financial Decision Making	
2. Aging and Competence in Decision Making <i>Wändi Bruine de Bruin</i>	15
3. Challenges for Financial Decision Making at Older Ages <i>Keith Jacks Gamble</i>	33
4. Retirement and Cognitive Functioning: International Evidence <i>Raquel Fonseca, Arie Kapteyn, and Gema Zamarro</i>	46
Part II. Tools for Retirement Planning and Decision Making	
5. Choosing a Financial Advisor: When and How to Delegate? <i>Hugh Hoikwang Kim, Raimond Maurer, and Olivia S. Mitchell</i>	86
6. Advice in Defined Contribution Plans <i>Gordon L. Clark, Maurizio Fiaschetti, and Peter Tufano</i>	96
7. Seven Life Priorities in Retirement <i>Surya Kolluri and Cynthia Hutchins</i>	115
8. Worker Choices About Payouts in Public Pensions <i>Robert L. Clark and Janet Raye Cowell</i>	130

viii Contents

Part III. Solutions and Opportunities

9. Aging and Exploitation: How Should the Financial Service Industry Respond?	153
<i>Marguerite DeLiema and Martha Deevy</i>	
10. Understanding and Combating Investment Fraud	185
<i>Christine N. Kieffer and Gary R. Mottola</i>	
<i>The Pension Research Council</i>	213
<i>Index</i>	217

List of Figures

2.1	Age differences in judgment and decision tasks	16
2.2	Overview of skills relevant to understanding age differences in decision making competence	17
4.1	Cognitive functioning and gender differences	59
5.1	Life cycle profiles of key variables from a baseline model	87
6.1	Australian rates of retirement by age and sex	103
6.2	Proportion of topics raised on calls by category over time	106
6.3	Frequency of calls by category and age over time	108
7.1	Percentage identifying the most frightening disabling prospect in later life	118
7.2	Reasons for moving in retirement	119
7.3	Percentage of older respondents providing financial support to family members in the last five years	121
7.4	Financial support provided by people age 50+ to family members in the last five years, by investable assets	123
7.5	Percentage of working retirees who agree to each statement	125
7.6	Percentage by age of respondents who give money/goods to charities, non-profits, or other causes	125
8.1	Annuity options in state-managed retirement plans: number of plans with each option	132
9.1	Increase in SAR filings containing the phrase ‘Elder Financial Exploitation’ following FinCEN Advisory FIN-2011-A003 (August 2010–August 2011)	166
9.2	Increase in SARs filings containing the phrase ‘Elder Financial Exploitation’ from 2012 to 2015 by type of financial service institution	167
9.3	Regulatory oversight of select financial service providers	172
10.1	Number of different fraudulent investments that survey respondents were targeted to participate in	195
10.2	Number of times identified influence tactics appeared in analysis of fraud pitch transcripts	198

List of Tables

2.1	Applying decision rules: an experimental presentation	18
2.2	Resistance to sunk costs: an experimental presentation	19
2.3	Credit card repayment decision: an experimental presentation	20
2.4	Numeracy: an experimental presentation	21
4.1	Dataset, samples, dependent and independent variables in the reviewed papers	50
4.2	Instrument and different instrumental approaches: results	54
4.3	Effects of retirement on cognition for all countries	58
4.4	Effect of retirement on cognition for all countries by gender	60
4.5	Effect of retirement on cognition for all countries by skill education	62
4.6	Effect of retirement on cognition for all countries by physically demanding job	63
4A.1	Descriptive statistics	67
4A.2	Early and full retirement ages across the OECD nations	69
4A.3	First stage results, pooled data	70
4A.4	First stage results by skill group, pooled data	71
4A.5	First stage results by physical demanding jobs groups, pooled data	72
4A.6	First stage results by blue-collar jobs and white-collar jobs, pooled data	73
4A.7	Effect of retirement on cognition by survey	74
4A.8	Effect of retirement on cognition, pooled data by occupation	76
5.1	Impact of introducing a delegation option at alternative ages: investor gains in well-being	89
5.2	Welfare consequences of financial advice provision for alternative minimum fees	90
5.3	Impact of introducing plain-vanilla portfolios in lieu of investor inertia: how the change in investor well-being compares to benchmark, for alternative management fees and equity glide paths	91
5A.1	Summary of calibrated parameters for the baseline model	93
6.1	Relationship between call volume by topics and macroeconomic factors	104
8.1	Percentage of state retirees selecting annuity options	135
8.2	Impact of deferred annuity on annual payouts and pension present values (PV)	138

xii List of Tables

8A.1	Percentage of state plan retirees selecting annuity options	142
8A.2	Annuity payout options offered by state retirement plans	143
9.1	Mandatory reporting laws for financial service institutions and employees by state (2015)	169
10.1	Sample characteristics for data analysis	191
10.2	Factors associated with investment fraud victimization	193
10.3	Factors associated with investment fraud targeting	196

Notes on Contributors

Wändi Bruine de Bruin holds a University Leadership Chair in Behavioural Decision Making at the Leeds University Business School, where she co-directs the Centre for Decision Research. She is also affiliated with Carnegie Mellon University's Department of Engineering and Public Policy, the University of California Dornsife Centre for Economic and Social Research, and the RAND Corporation. Her research focuses on individual differences in decision making competence across the lifespan, as well as consumer decisions about topics such as household finances, health, energy, and climate change. Her work with the Federal Reserve Bank of New York contributed to the design of a new Survey of Consumer Expectations. She holds a PhD in Behavioral Decision Making and Psychology from Carnegie Mellon University, an MSc in Cognitive Psychology, and a BSc in Psychology from the Free University Amsterdam.

Gordon L. Clark is Professor and Director of the Smith School of Enterprise and Environment at Oxford University, holds a Professorial Fellowship at St Edmund Hall, is the Sir Louis Matheson Distinguishing Visiting Professor at Monash University, and is a Visiting Professor at Stanford University. His research focuses on the governance and management of beneficial organizations and the behavior of participants in pension and retirement income funds. He holds a DSc and an MA in Economic Geography from the University of Oxford, as well as a PhD in Economics and an MA in Economic Geography from McMaster University. He also holds a BEcon and an MA in Economics from Monash University.

Robert L. Clark is Stephen Zelnak Professor of Economics and Professor of Management, Innovation and Entrepreneurship in the Poole College of Management, North Carolina State University. He is also Research Associate at the National Bureau of Economic Research and a member of the Pension Research Council Advisory Board. He has conducted research examining retirement decisions, the choice between defined benefit and defined contribution plans, the impact of pension conversions to defined contribution and cash balance plans, the role of information and communications on 401(k) contributions, and government regulation of pensions. He received a PhD and an MA in Economics from Duke University, as well as a BA in Economics from Millsaps College. He also holds an AA in Mathematics from Hinds Junior College.

xiv Notes on Contributors

Janet Raye Cowell is North Carolina’s popularly-elected Treasurer and is the first woman to hold the office. She oversees pension investments for North Carolina’s teachers, firefighters, and public employees. As Treasurer, she manages the 32nd largest public pension in the world and the second most solid in the nation. Under her executive leadership, North Carolina is one of only ten states in the country to earn an AAA bond rating by all three rating agencies. She was twice named one of the top 25 public pension executives in the world by Sovereign Wealth Fund Institute. She holds a BA and an MBA from the University of Pennsylvania.

Martha Deevy is a Senior Research Scholar and Director of the Financial Security Division at the Stanford Center on Longevity, where she focuses on defining new solutions that help insure long-term financial security in retirement; solutions that help individuals work longer, save more and avoid financial pitfalls. She joined the Stanford Center on Longevity after senior management positions at Apple, Charles Schwab, and Intuit. She has also served on the boards of directors of a number of publicly traded and non-profit organizations. Martha received an MBA in Finance and Management Information Systems from University of Minnesota and a BA in Economics from the University of Illinois.

Marguerite (Marti) DeLiema is a postdoctoral researcher at the Stanford Center on Longevity in the Financial Security Division. Her work focuses on identifying the socio-demographic, cognitive, and contextual factors related to elder financial exploitation using qualitative and quantitative research methods. Along with collaborators at Stanford and federal regulatory agencies, she is developing a categorization scheme for financial fraud that will inform a national victimization survey. Her prior research focused on elder abuse and neglect in community settings, and the tactics scam artists use to deceive older victims. She received her PhD in Gerontology from University of Southern California and a BS in biological psychology from UCLA.

Maurizio Fiaschetti is Lecturer in Banking and Finance at the School of Oriental and African Studies and Visiting Research Associate at the Smith School of Enterprise and the Environment, Oxford University. His research focuses on decision making and strategic interactions in the financial sector, applied econometrics, and financial economics. He holds a PhD and an MSc in International Economics; an MSc in Economics, Management, and Corporate Governance; a Diploma in Finance and Private Banking; and a BSc (Hons) in Economics of Financial Markets and Institutions, all from the University of Rome – Tor Vergata.

Raquel Fonseca is an Associate Professor at Université du Québec à Montréal, an affiliated adjunct Economist at RAND Corporation, and a fellow at the Center for Interuniversity Research and Analysis of Organizations. Her

Notes on Contributors xv

research focuses on the welfare effects of social security reforms as well as on the interaction between health, savings, and retirement patterns over the life cycle. Previously she worked as an economist at the RAND Corporation and as a Professor at the Pardee RAND Graduate School of Public Policy. She received her MA in economics from Université Catholique de Louvain, and her PhD in Economics from UCL and attended the European Doctoral Program from CORE-UCL, Belgium.

Keith Jacks Gamble is an Assistant Professor of Finance at DePaul University. Previously he was a Lecturer of Economics and Whitebox Post-Doctoral Fellow at the Yale School of Management. His research interests include financial decision making, investor behavior, and behavioral finance. His PhD in Economics is from the University of California, Berkeley and his BA in Economics from Harvard.

P. Brett Hammond is Research Leader at the American Funds for Capital Group. Previously he directed applied index and modeling research teams at MSCI, and he served as Chief Investment Strategist at TIAA-CREF. He was also a member of the senior management team at The National Academies (The National Research Council) and Adjunct Professor at The Wharton School. He also served as Board member for the Q Group. His expertise includes target-date funds, inflation-linked bonds, and individual financial advice. His BS in economics and political science is from the University of California at Santa Cruz and PhD from the Massachusetts Institute of Technology.

Cynthia Hutchins is the Director of Financial Gerontology for Bank of America Merrill Lynch, where she works to educate financial advisors on gerontological issues such as aging, retirement, and legacy planning. She has also worked to help pre-retirees and retirees prepare for retirement across seven life priorities including work, leisure, health, finance, family, giving, and home. Her degree in Business and Finance is from Towson State University and her Masters in Gerontology from the University of Southern California.

Arie Kapteyn is a Professor of Economics and the Executive Director of the Dornsife College of Letters, Arts and Sciences Center for Economic and Social Research at the University of Southern California. Previously he was a Senior Economist and Director of the Labor & Population division of the RAND Corporation. He is a pioneer in the development of new methods of data collection, using the Internet and mobile devices. His current research focuses on aging and economic decision making. His MA in econometrics is from Erasmus University Rotterdam, his MA in agricultural economics from Wageningen University, and his PhD from Leiden University, all in the Netherlands.

xvi Notes on Contributors

Christine N. Kieffer is Senior Director of the FINRA Investor Education Foundation where she manages national, state, and grassroots partnerships, and she also develops tools and programs for law enforcement, victim advocates, and consumers to advance investor protection and fraud prevention initiatives. Her research focuses on investor attitudes and behaviors, primarily related to financial fraud, and she oversees financial readiness programs for military families and other underserved audiences, and participates in implementation of the National Financial Capability Study. Her BS is from Vanderbilt University with double majors in Economics and Mathematics.

Hugh Hoikwang Kim is an Assistant Professor of Finance in the Department of Finance at the University of South Carolina. His research focuses on understanding investor behavior in a range of market settings. He previously taught at the SKK University in Korea. He received the MS and PhD degrees in Applied Economics from the Wharton School, University of Pennsylvania and the BA in Economics from the Seoul National University.

Surya Kolluri manages Policy and Market Planning for the Merrill Lynch BAC-ML Global Wealth and Retirement Solutions Business, where he oversees incubation and commercialization of social impact and environmental programs. He also manages external relationships with regard to research and policy development in the areas of aging and longevity. Previously he worked at Bain & Company. He serves on the boards of Rebuilding Together Boston, the CEO Initiative for Alzheimer's, and the Global Coalition on Aging. His MBA is from the Wharton School at the University of Pennsylvania and his MS from Drexel University, Philadelphia.

Raimond Maurer is the Chair of Investment, Portfolio Management, and Pension Finance at the Finance Department of Goethe University Frankfurt. His research focuses on asset management, lifetime portfolio choice, real estate, and pension finance. He also serves on the Advisory Board of the Pension Research Council, and on the boards of the Union Real Estate Investment group, the Society of Actuaries, the Association of Certified International Investment Analysts, and the Faculty Senate of Goethe University. Previously he was Visiting Professor and Metzler Exchange Professor at the Wharton School. He earned his Habilitation, PhD, and Diploma in business administration from Mannheim University, and he received an honorary doctorate from the State University of Finance and Economics of St. Petersburg.

Olivia S. Mitchell is the International Foundation of Employee Benefit Plans Professor, as well as Professor of Insurance/Risk Management and Business Economics/ Policy; Executive Director of the Pension Research Council; and Director of the Boettner Center for Pensions and Retirement Research,

Notes on Contributors xvii

all at the Wharton School of the University of Pennsylvania. Concurrently she serves as a Research Associate at the NBER; Independent Director on the Wells Fargo Advantage Fund Trusts Board; Co-Investigator for the Health and Retirement Study at the University of Michigan; Member of the Executive Board for the Michigan Retirement Research Center; and Senior Scholar at the Centre for Research on the Economics of Aging at Singapore Management University. She received MA and PhD degrees in Economics from the University of Wisconsin-Madison, and a BA in Economics from Harvard University.

Gary R. Mottola is Research Director of the FINRA Investor Education Foundation and a social psychologist with expertise in the financial services industry. His research projects seek to better understand financial capability in America, protect investors from financial fraud, and improve financial disclosure statements. He is also an Adjunct Professor of Statistics in Villanova University's Economics Department. He received his BA from the University at Albany, his MA from Brooklyn College, and his PhD from the University of Delaware.

Peter Tufano is the Peter Moores Dean and Professor of Finance at the University of Oxford's Said Business School. He is also a Research Associate at the NBER, where he co-founded the Household Finance Working Group, and a Research Fellow of the CEPR. His research focuses on household finance issues, especially savings decisions of low-to-moderate income households, and he has also worked on tax-time savings and removing legal barriers to prize-linked savings. Previously he was a taught at Harvard Business School. He received his AB in economics, MBA, and PhD in Business Economics from Harvard University.

Steve Utkus is Principal and Director of the Vanguard Center for Retirement Research, where he is also a member of Vanguard's institutional retirement and investment business senior leadership team in the US. He also serves on the company's Strategic Asset Allocation Committee, and on the Advisory Board of Wharton's Pension Research Council. Concurrently he serves as Visiting Scholar at The Wharton School of the University of Pennsylvania, and on the Board of Trustees of the Employee Benefit Research Institute. He earned his MBA in Finance from the University of Pennsylvania and his BS in Computer Science from MIT.

Gema Zamarro is an Associate Professor and holds the 21st Century Endowed Chair in Teacher Quality at the Department of Education Reform at the University of Arkansas. She also directs Charassein: The Character Assessment Initiative, a research group for the study of measures and development of character skills; and she is adjunct Senior Economist at the USC Dornsife Center for Economic and Social Research and adjunct

xviii Notes on Contributors

Economist at the RAND Corporation. Previously she worked as an economist at the RAND Corporation and Professor of Econometrics at the Pardee RAND Graduate School of Public Policy; she also taught econometrics at Tilburg University in the Netherlands. Her research explores the causal effect of retirement on health, the gender gap and financial literacy and the relationship between financial literacy and food security. Her PhD in Economics is from CEMFI & UNED, her MS in Economics and Finance from CEMFI, and her BA in Economics from Universidad Carlos III de Madrid.