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Financial Decision-Making and Aging: Observations About the 2016 Pension Research Council Conference

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By Anna Rappaport and Monica Dragut

The 2016 Pension Research Council Conference focused on "Financial Decision Making and Retirement in an Aging World" and took a big picture point of view. We were very pleased to have the privilege to attend the conference. For us and probably for virtually all of the attendees, there was new information and there were new ideas.

> The Pension Research Council[1] is a multidisciplinary retirement research center at the Wharton School at the University of Pennsylvania. It includes representation from leading academics who conduct pension-related research studies, business, labor and the policy community. Disciplines represented include economists, attorneys, actuaries and others. The Pension Research Council holds an annual research conference and publishes working papers and books. The conference papers will be published as working papers later in 2016. Anna Rappaport serves on the Advisory Board of the Pension Research Council. The Society of Actuaries is an associate level member of the Pension Research Council.

SOCIETAL IMPLICATIONS OF LONGER LIFE SPANS

The keynote speaker, Ursula Staudinger from Columbia University, focused on how much life spans have increased in the last 200 years. She took an international perspective and pointed out that it is entirely new for countries to have large aging populations. She talked about long periods of retirement and the importance of rethinking life at the older ages, and how to make it more productive. The aging population has implications for the role of older people in society, sensible retirement ages, families, housing, health, work, assets needed for retirement, and life planning.

COGNITIVE DECLINE, POOR DECISIONS AND FRAUD

We frequently hear that there are concerns about cognitive decline. At this meeting the presenters shared substantial research about cognitive change and age. Some cognitive decline is related to illness. There are two different types of cognitive skill: fluid, cognitive deliberation and crystalized cognitive ability. On average, cognitive deliberation shows decline by age while the other tends to be flat or increase with experience. We also learned about signs of cognitive decline and measuring cognitive skill. The papers from this conference are well worth reviewing by those who want to learn more about this topic. One of the papers focused on the question of whether retirement leads to cognitive decline. Cognitive skills, just like physical skills, have some element of "use it or lose it." Along with the discussion about cognitive decline, we heard about vulnerability to poor decisions and to fraud. Discussants raised great questions about interventions, when and how much, and how this translates into retirement products. Automatic opt-out policies are common during accumulation. It was suggested that maybe industry will be looking at parallel products and approaches for the decumulation phase. A parallel was drawn between some medical interventions and old age issues in retirement; retirement professionals perhaps could be looking at models from medical decision-making. People interested in learning more about cognitive decline can read the papers that deal with this topic.

From another panel, we learned much more about fraud and about efforts to prevent and deal with fraud, including investment fraud and financial exploitation, misappropriation of assets by family members and caretakers. (Of course there are also many other types of fraud.) Financial firms are encouraged to use an "in case of emergency" procedure (and a form is available for this) to have their clients provide them with the name of a family member or trusted friend who the adviser or firm representative can contact in case of emergency. Emergency may include a discrete event or some evidence of confusion or decline. The designated person would not have authority to execute transactions but is someone the adviser can talk with to see what is going on, and to engage in a conversation if things do not seem to be going well. Merrill Lynch and Wells Fargo were cited as examples of firms that use these procedures. In many cases, this is a more effective and easier route than going to the authorities.

One type of fraud prevention is training the individual to recognize "red flags" to help avoid fraudulent investments or deals. The FINRA Investor Education Foundation has done considerable research on recognizing fraudulent investments and on strategies to educate people about the "red flags." They offer educational materials. There are also efforts within financial service companies—both brokerage firms and banks to identify cognitive problems and financial exploitation. Sometimes these occur together and sometimes not. The Stanford Center on Longevity has done research with both financial firms and regulators to understand these efforts. The conference papers include papers from both FINRA and the Stanford Center on Longevity.

Some financial firms train their advisers and others who come in contact with clients to recognize signs of cognitive decline and/or exploitation. Examples would be asking the same question repeatedly, asking strange questions, and strange patterns of withdrawal of funds. Some firms may also utilize automated programs to flag strange patterns of withdrawal. Firms having the "in case of emergency" procedure in place can then discuss the situation with the designated person or persons. Of course in some cases that person might be the problem, so this does not always work, but it often can. Within state governments, Adult Protective Services are agencies that can be called in when there is a suspected problem. Some firms will delay payouts for a short period when they suspect a problem.

States have different laws with regard to these matters. The firms may be concerned about liability if they report suspicious activity. The state laws require reporting in some cases and authorize it in others, and they generally protect the firms from liability. The paper by Ryan Wilson, an attorney expert in these matters, outlined six characteristics of a good law to support financial firms dealing with exploitation:

> *A reasonable initial hold period to allow the firm to stop a transaction before the money is gone. Most proposals have a period of up to 10 days for the initial hold at the firm's discretion. Firms are in the best position to quickly stop a transaction when they suspect financial abuse. Having an initial hold period longer than 10 days may rest too much discretion with the firm.*
>
> *Mandatory reporting of suspected cases of financial exploitation. Mandatory reporting is the strongest incentive to encourage financial services firm to report these cases to authorities.*

Individuals at retirement age and during retirement have a wide variety of decisions to make.

> *Ability to extend the hold, with court approval, and including other court-ordered injunctive relief. Requiring court oversight is good for an extension because it protects the consumer against someone at the firm holding a transaction for an unreasonably long period.*
>
> *Shielding the financial institution and its employees if they acted in good faith and with reasonable care. Shielding financial institutions and employees from civil and administrative liability if they are involved in holding the transaction or making a report is the best incentive to encourage firms and their employees to act in the consumer's best interest. The shield should be available to institutions and employees who acted in good faith and with reasonable care. Having both adds an additional layer of protection.*
>
> *Covering all financial services firms. Consumers use products and services from all sectors of the financial services industry. The best proposal covers all three sectors: banking, securities, and insurance.*
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> *Training for employees. Financial services professionals are not trained law enforcement officers or medical professionals, but there are signs of financial exploitation they should recognize and are in a position to recognize in their client before other people could reasonably do so. The training should also include state-specific information on how to file a report and the mechanics of holding the transaction. Training is essential to helping firms and their employees have a meaningful role in combating financial exploitation.*
>
> *Reasonable effort to obtain emergency contact information. Having an emergency contact on file makes the decision of which family member to contact less difficult when the firm is concerned about its client and needs good information in a hurry. Firms should not be held liable if a client refuses to provide contact information.*

It was also pointed out that in the case of family, there are often "gray situations" and exploitation is not always clear. For example, consider the situation where someone had a pattern of "gifting" to family members, and finances are now managed by a family member. If the family member continues gifting on the basis that the person would have wanted them to do so, it may be fine and it might not.

DECISION-MAKING THROUGHOUT THE LIFE CYCLE

One paper focused on a move from investment advice to more holistic lifetime financial planning. That paper identified a number of different areas that are important in people's lives, including family, housing, work and health as well as financial management. Merrill Lynch has worked with Age Wave to secure a series of research reports on these domains, and they have employed a financial gerontologist to help them integrate thinking about these areas into the development and setting of financial goals. They are training advisers to work with clients on a much more holistic basis. They are also using partner services to help clients where specific advice is needed in some of these areas. These issues are discussed in the paper "Seven Life Priorities in Retirement."

Another paper looked at the impact of advice delivered at different times during the life cycle, and concluded that the greatest impact was when advice was delivered to young adults. This happens because it can influence results over a long period of time. Another paper looked into how often defined contribution (DC) participants in an Australian plan asked administrative questions and looked for investment and retirement advice. Younger participants were much more likely to have administrative service needs whereas older employees were more likely to seek retirement advice. Men were more likely to seek investment advice.

Another paper looked at the use of different payout options in state-sponsored defined benefit plans. This paper found that the take-up rate of joint and survivor options was not that high. All of the plans seemed to offer life annuities and joint and survivor options, and beyond that options were quite limited. They included Social Security leveling and installment payouts in some of the plans. Eighty plans were analyzed. The authors provided election rates for a few plans, and they discussed some new options that are being considered in one state. Retirement often occurs before age 60 with some retirees continuing in the workforce in new roles. Deferred payout options make a lot of sense, and they are being considered.

TECHNOLOGY AND TOOLS AND HOW THEY FIT IN

Some of the ideas discussed throughout the conference and some observations about the discussion include:

Move to DC plans. It was pointed out that DC plans require individuals to make more decisions and that individuals are not equipped to do well with these decisions. This is viewed as a particular problem post-retirement. There were several comments that the retirement system has moved in the wrong direction.

Post-retirement defaults. This came up a number of times in the discussion with very different perspectives. On the one hand, there were strong proponents on more annuitization and embedding it in defaults. On the other hand, it was pointed out that this is not right for some people and payout period defaults tend to be irrevocable, unlike defaults during the accumulation periods. It was also pointed out that a 3 percent auto-enrollment default leads to inadequate savings. The default discussion did not link to Social Security as a mandatory lifetime income, but we would do that.

Participants value flexibility. This was pointed out several times.

There was discussion about the need for stronger public policy but it was not clear what those policies should be. One suggestion would be safe harbors for defaults.

I was surprised that there was not more discussion about the importance and role of Social Security. One viewpoint not discussed in the conference is that Social Security benefits should be increased because these benefits are all of the lifetime income that many people will have. It seems much more likely that these benefits will be cut. There was quite a lot of discussion about the importance of the Social Security claiming decision.

Simplicity is important. We need to find a way to simplify the system.

Communication is important and should be targeted differently based on age groups. Discussants encouraged collaboration between different professionals (including psychologists, retirement specialists and attorneys) when drafting materials.

The role of the employer was not a focus of the papers, but it came up in discussion. My experience is that many people will not have any contact with financial professionals or products beyond what is offered through their employer and the benefit plans. Participants varied in their view of the potential for the employer to be involved. One view is that people have many jobs and the employer should not be viewed as a good source of support. Many employers are now offering financial wellness programs to their employees and that was not recognized in the papers or discussion.

RESOURCES AND TOOLS

At various points during the conversation, resources and tools were discussed. These are a few examples.

- The Consumer Financial Protection Bureau offers a Social Security claiming tool.
- FINRA offers educational material on financial exploitation.
- Robo-advisers provide automated investment advice.

- The Society of Actuaries offers a set of decision briefs to help individuals nearing retirement make better decisions.
- The American Academy of Actuaries and Society of Actuaries are jointly sponsoring a longevity calculator.

CONCLUSION

Individuals at retirement age and during retirement have a wide variety of decisions to make. Considerations are often intertwined. The move to DC plans makes the decisions more complex. As individuals age, people who experience significant cognitive decline are less well-positioned to make good decisions. They also become more vulnerable to financial exploitation and fraud. Restructuring the retirement system to pay out more benefits as lifetime income would reduce the vulnerability to fraud. But such changes would have both pros and cons and would not be popular. The discussions at the symposium and the papers leave us with many questions:

- How do we understand and deal with cognitive decline?
- When do family members need to be involved with planning?
- What benefit structures would work better for longer lives?
- What tools can help people make better decisions? ■

ENDNOTE

1 http://www.pensionresearchcouncil.org/boettner/

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