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BOOK REVIEW

Financial Decision-Making and Retirement Security in an Aging World

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Editor's Note: Financial Decision Making and Retirement Security in an Aging World, *edited by Olivia S. Mitchell, P. Brett Hammond, and Stephen P. Utkus, is a collection of research papers sponsored by the Pension Research Council of The Wharton School.*

Retirees face a declining defined benefit (DB) system, at the same time as the average age of the U.S. population is rising, and many people are financially illiterate. Mitchell et al. (2017) focuses on a critical topic that does not receive enough consideration when advisors develop and implement financial planning paradigms.

The book recognizes the interaction of capabilities, context, and tools and discusses the aging brain, the use of advice, and other options for achieving goals and policy. The main takeaways are:

- About one-half of adults over age eighty either have dementia or a milder form of cognitive impairment.
- Many retirees also experience changes in hearing, vision, and mobility, and feel the cost of increased prescription medication.
- Research shows that people seldom recognize the decline in their own decision-making ability.
- Investment management strategies need to be adapted to fit the needs of people when their cognitive skills decline.
- Older people often have more money and are more vulnerable to scams and fraud.
- Scams are a multi-faceted problem, and elders are vulnerable to fraud from strangers and from those close to them whom they trust.
- Although it is possible to shift decision-making responsibility to others, it is not always a good choice because the people to whom responsibility is delegated may present risk of financial exploitation and problems such as poor investment and financial management skills.
- The typical financial planning process and tools are focused heavily on investments and saving in the pre-retirement period. Retirees have many decisions to make, and today's tools often do not address these issues.
- The changing context, particularly the decline of DB plans coupled with rising healthcare costs, makes paying attention to issues such as the potential for fraud and the need for managing a lump sum during the payout years even more important.

Below, I discuss several chapters that I found most helpful and with the greatest application for advisors.

COGNITIVE DECLINE, POOR DECISIONS, AND FRAUD

Many retirement professionals understand their clients may experience cognitive decline, but most lack the education necessary to handle it. Chapters 2–4 present research about cognitive change and age. There are three types of cognitive skills: fluid, cognitive deliberation, and crystalized ability. On average, cognitive deliberation declines with age while other skills tend to be flat or increase with experience. The research also focuses on how to detect and measure cognitive skill, or the lack thereof. Chapter 4 examines whether retirement leads to cognitive decline. Cognitive skills, just like physical skills, have some element of "use it or lose it."

Chapters 9 and 10 focus on poor decisions and fraud, to which retirees are more vulnerable when their cognitive skills decline. Retirees face many types of fraud, such as investment fraud, financial exploitation, and misappropriation of assets by family members and caretakers. These chapters include practical information about fraud and efforts to prevent and deal with it.

Chapter 9 focuses on both financial exploitation, where an older person is taken advantage of by those they trust, including family, friends, and advisors, as well as elder fraud, where an older person pays money in exchange for an expected future benefit. Crimes such as identity and credit card theft are not addressed in this chapter. Chapter 9 includes interviews with numerous financial service firms and regulatory agencies as well as strategies to help deal with these issues. The authors found that both banks and financial advisory firms use strategies to reduce exploitation of elders. Different strategies are used for models where the financial firm representatives know the customer personally and for firms such as large banks where they would not. Primary interventions are focused on stopping losses before they occur by training personnel to recognize red flags, blocking suspicious transactions, and educating customers about scams. Secondary interventions are after-the-fact, and include recovery of funds and criminal prosecution. Other strategies include more training programs, community outreach, early financial planning, guidelines on management of other people's money, financial products that allow limited debit cards for caregivers when paying for specific types of expenses, and data-driven strategies to detect exploitation.

The chapter also reviews regulation including reporting to Adult Protective Services and suspicious activity reports filed with the U.S. Department of the Treasury's Financial Crimes Enforcement Network. Reporting requirements vary by state, and the chapter offers a table of state requirements and an overview of the many regulatory agencies involved. One difficulty in this area is the conflict between protecting privacy and protecting the customer from financial exploitation. The authors discuss this, as well as ideas for future improvements in regulation and practice.[1]

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Chapter 9 then discusses concerns of wealth advisory firms and points out that universal standards and safe harbors would allow them to better protect clients without fear of liability. The "in case of emergency" form designates a person to contact to discuss concerns about exploitation, but it does not authorize the designated person to transact business on behalf of the client. The authors indicate that while this likely will become a standard practice in the future, it has yet to be implemented widely.

Chapter 10 provides a different view of financial risks that retirees face. It reviews and analyzes data on financial fraud and victimization. The authors found that one in ten investors will experience investment fraud. Investment fraud occurs when someone knowingly misleads an investor using false information and includes scams such as penny stock fraud, oil and gas scams, Ponzi schemes, and others. The chapter also discusses actions that consumer protection agencies are taking to protect investors.

Investment and financial fraud are costly. The authors suggest that they will become more costly as fraud becomes more prevalent when boomers retire and withdraw funds from their 401(k) plans. In addition to direct financial losses, nearly two-thirds of financial fraud victims experience stress, anxiety, and depression. Victims also incur indirect costs including legal fees, late fees, and bounced checks. Chapter 10 provides some analysis of the demographics of fraud victims and finds that they have higher incomes and educational levels than victims of other frauds.

Chapter 10 then provides information about combatting investment fraud. A variety of organizations such as AARP, the U.S. Securities and Exchange Commission, the U.S. Commodity Futures Trading Commission, and the Financial Industry Regulatory Authority (FINRA) Investment Education Foundation are involved in helping retirees understand and combat fraud. However, the chapter also discusses the difficulty of measuring the effectiveness of fraud prevention activities. Advisors can expect larger firms to develop programs that enable them to use these resources and deal with these issues, but advisors in every kind of firm should develop plans to address them.

DECISION-MAKING THROUGHOUT THE LIFE CYCLE

Chapter 7 focuses on a move from investment advice to a more holistic lifetime financial plan. The chapter identifies areas that are important in people's lives including family, housing, work, and health as well as financial management. Merrill Lynch worked with Ken Dychtwald's company Age Wave to secure a series of research reports on these domains, and they now employ a financial gerontologist to help integrate thinking about these areas when developing and setting financial goals. Merrill Lynch is training advisors to work with clients on a much more holistic basis and using partner services to help clients when specific advice is needed.

In Chapter 7, the authors conclude that today's retirees are not simply retiring, but they are exploring new options, pursuing dreams, and working to live life to the fullest. They are taking advantage of longer life spans to pursue passions and ambitions they could not fit in while working full time. The authors' conclusions are:

- 81 percent of retirees said that health is the most important ingredient for a happy retirement.
- Health challenges threaten financial security due to costs and push some people into early retirement.
- Most retirees have not factored health costs into their retirement planning.

- Boomers are much more likely than their parents to try to take charge of their health care.
- Fewer than one in four individuals older than age fifty are prepared financially if forced to retire early due to a health problem.
- Retirees often are free to choose where they want to live and no longer are limited by job constraints.
- Based on the Merrill Lynch sponsored study, retirees often relocate during retirement to be closer to family and to reduce expenses.
- Many retirees offer financial help to other family members, and 60 percent believe that there is a member of their family who serves as the family bank.
- Retirement planning includes four phases: pre-retirement, career intermission, re-engagement, and leisure.

ACTION STEPS FOR ADVISORS

After reading this book, I suggest the following action steps:

- Understand how decision-making may change with cognitive decline and learn how to recognize it.
- Develop a strategy with your clients for responding to cognitive decline. Some firms already have information about this and a recommended strategy. Find out if your firm has requirements regarding these issues.
- Consider reviewing how well your clients are managing their finances. Are they balancing their checkbooks? Are they making payments on time? How are they handling their credit card bills? Such an audit also would reveal if there are strange payments that should be reviewed.
- Take steps to protect clients in the event of cognitive decline. Implement an "in case of emergency" process in your practice.
- Be aware of fraud, financial exploitation, and the related laws that apply based on your licensing and jurisdictions.
- Implement procedures to follow legal requirements and to protect your clients. Make appropriate reports to legal authorities, including Adult Protective Services.
- Identify a mentor or resource to consult with to get help when you think there may be a problem and are unsure how to handle it. Do a reality check when you are unclear about what is going on. The issues related to these matters may be difficult, awkward to address, and ambiguous.
- Consider the possibility of an annuity or other systematic payout that does not require regular decisions or management on behalf of your client. This can be particularly important for people who will be on their own as they age.
- Work with clients to identify a plan for managing financial and other decisions if they start struggling. Explore the idea of a transition so that the client can work with the person who will help over a period of time, and that person can come to understand the client's preferences. Make sure legal documentation is in place.
- Try to bring the family member who will be responsible to help your client pay bills and manage regular finances as the

RESOURCES AND MORE RESEARCH

As advisors focus on decision-making, resources and tools are important. The book provides a lot of information, but there are more. For example:

- The Society of Actuaries offers a set of decision briefs to help individuals nearing retirement make better decisions. https://www.soa.org/research-reports/2012/research-managing-retirement-decisions/.
- The American Academy of Actuaries and Society of Actuaries are jointly sponsoring a longevity calculator. http://www.longevityillustrator.org.
- The Financial Fraud Research Center at Stanford Center on Longevity is a research group that did several reports on fraud and financial exploitation, including the response of the financial services industry to fraud. http://longevity.stanford.edu/financial-fraud-research-center/.
- FINRA offers educational material and publishes rules about financial exploitation. http://www.finra.org/newsroom/2018/new-finra-rules-take-effect-protect-seniors-financial-exploitation.
- Through a series of focus groups and in-depth interviews, the Society of Actuaries offers insights about retiree thinking. The 2013 focus groups interviewed individuals retired ten or fewer years and offered insights about the decision to retire and managing in retirement; the 2015 focus groups interviewed individuals retired fifteen or more years. These focus groups emphasized unexpected expenses and shocks. They also tested how well the strategies used by the more recent retirees were working for longer-term retirees. To complete the series, the Society of Actuaries conducted in-depth interviews with individuals ages eighty-five and older. https://www.soa.org/research/topics/research-post-retirement-needs-and-risks/#decisions.
- More Society of Actuaries research documents personal experiences in financial management for individuals ages eighty-five and older (Rappaport and Hass 2017).
- Merrill Lynch research conducted by Age Wave: "New Challenges, New Solutions." https://www.ml.com/articles/age-wave-survey.html.

client ages into the relationship. If there is no family member to help, explore the possibility of other help.

- Build awareness in a broader arena and learn about additional decisions that are important. Most advisors often are knowledgeable about important decisions only in the area in which they usually practice.
- Decide if you wish to broaden your practice, and if so, take steps to expand your knowledge, firm resources, and licenses, if needed. If not, consider finding partners and resources to help with areas out of your scope of practice.

Larger firms may deal with these issues on a firm-wide basis, and these action steps may be helpful to those developing the firm response. Professional organizations may wish to provide guidance and/or education on these matters.

CONCLUSION

As time moves on, many people become less capable of making decisions and some experience major cognitive decline. This can be a gradual process and individuals may be good at hiding decline. People experiencing decline also become more vulnerable to financial exploitation and fraud. The move to defined contribution plans makes these decisions more complex. Here are some ways to deal with these issues:

- Watch for cognitive slow down and start to involve others in order to reduce the chance for mistakes.
- Monitor how well clients are managing day-to-day affairs to understand how they really are doing.
- Delegate decision-making to a family member or someone else. In extreme cases, it could be a court-appointed guardian.
- Educate people to help reduce the risk of fraud and financial exploitation.
- Bring in authorities as needed.
- Structure individuals' retirement resources so that more is paid as lifetime income, reducing the vulnerability to fraud.

After thinking about the issues raised in this book, I have the following questions:

- How can we optimize decision-making and plan for a good retirement?
- How do we understand and deal with cognitive decline?
- When do family members (and other helpers) need to be involved with planning and management?
- What processes do advisors need to integrate these issues into their practices?
- What legal requirements are there, and how can advisors make sure they are protecting clients and complying with the applicable law?
- What benefit structures would work better for longer lives?

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ENDNOTES

1. FINRA has adopted new rules effective in 2018 to help protect seniors from financial exploitation, see http://www.finra.org/newsroom/2018/new-finra-rules-take-effect-protect-seniors-financial-exploitation. These rules attempt to address some issues discussed in the book.

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