



Are the American Future Elderly Prepared?

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Based on joint work with Jeff Brown, Leandro Carvalho,
Erzo Luttmer, Olivia Mitchell, Lila Rabinovich, Htay Wah Saw

Research supported by several grants from the
National Institute on Aging and the Social Security Administration

Today's Plan



- Age and Cognition
- How do Americans Manage their Finances
- What do People know about Social Security?
- Who is able to Value Social Security Benefits?
- Do they know when to claim Social Security Benefits?
- Discussion

When we get older we gain experience and lose fluid intelligence



- Agarwal, Driscoll, Gabaix, and Laibson (2009) [home equity loans and lines of credit; auto loans; credit card interest rates; mortgages; small business credit cards; credit card late payment fees; credit card over limit fees; credit card cash advance fees; and use of credit card balance transfer offers] and Korniotis and Kumar (2011) [stock market investing] document that young and old have the worst performance.
- Sumit Agarwal, John C. Driscoll, Xavier Gabaix, and David Laibson (2009), “The Age of Reason: Financial Decisions over the Life-Cycle with Implications for Regulation”. *Brookings Papers on Economic Activity*
- George M. Korniotis and Alok Kumar (2011), “Do Older Investors make Better Investment Decisions?”, *Review of Economics and Statistics* 93(1): 244–265.



How do Americans Manage their Finances?

Leandro Carvalho, Arie Kapteyn & Htay-Wah Saw

*This project was funded by the Social Security Administration (SSA), Health and Human Services (HHS), and Society of Actuaries (SOA)



The Financial Management Survey

In 2012 the Federal Reserve Board conducted an online survey – the Older Adult Survey – to study the financial lives of older U.S. adults

The Older Adult Survey was originally fielded online using the RAND American Life Panel (ALP) with participants age 40 and older

Since December of 2012 the American economy has steadily recovered from the Great Recession

In April of 2015 we fielded the Financial Management Survey in the Understanding America Study to investigate how the financial lives of Americans have changed with the recovery

The Understanding America Study (UAS)

USC's Understanding America Study (UAS) is an Internet panel with 6000 respondents 18 and over living in the U.S.

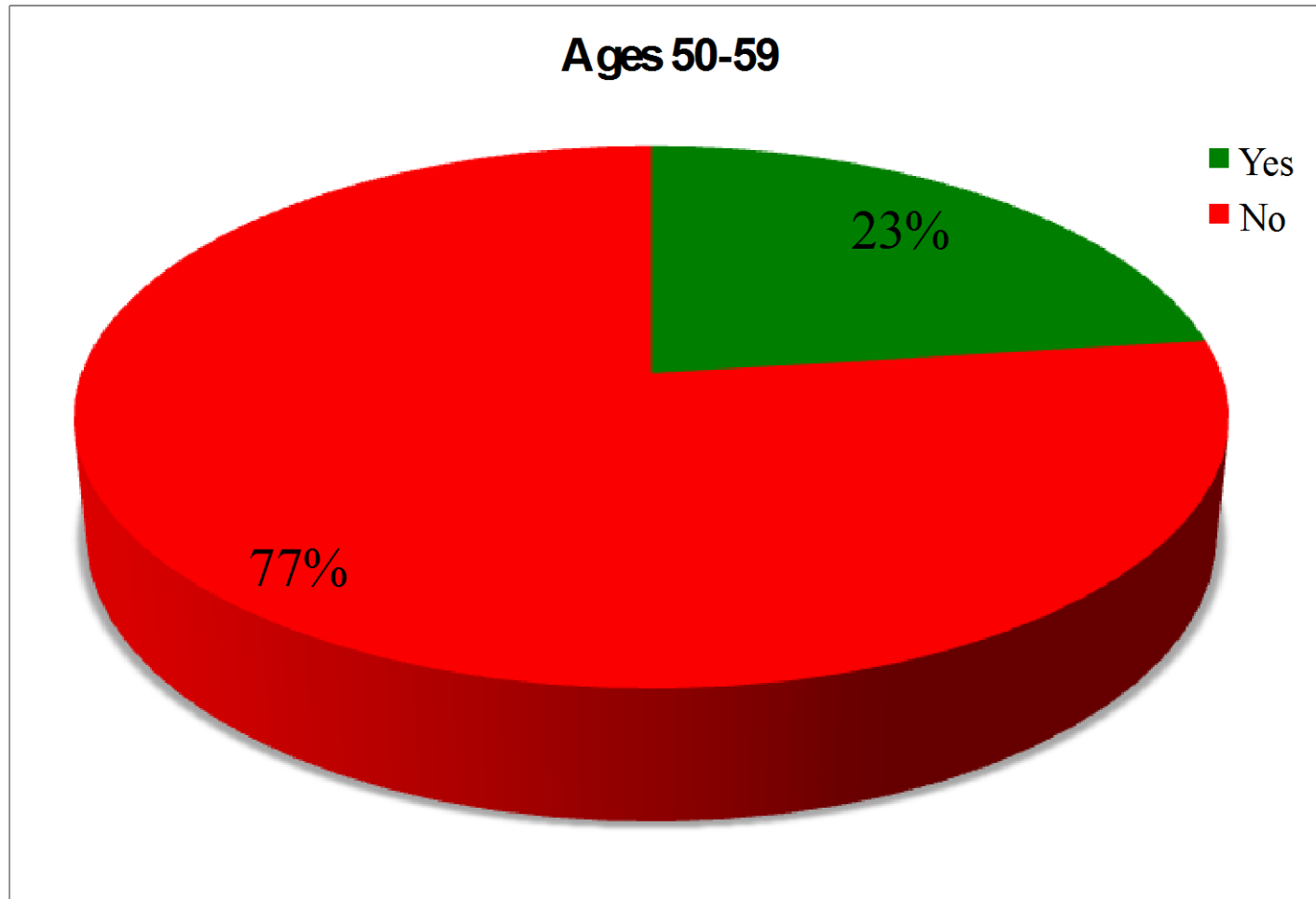
About twice a month respondents receive an email with a request to visit the UAS site and complete a questionnaire

Panel members are recruited through address-based sampling

Respondents without Internet access at the time of recruitment are provided tablets and Internet access

A wealth of information on panel members: numeracy, financial literacy, personality traits, core HRS instrument, risk aversion, etc.

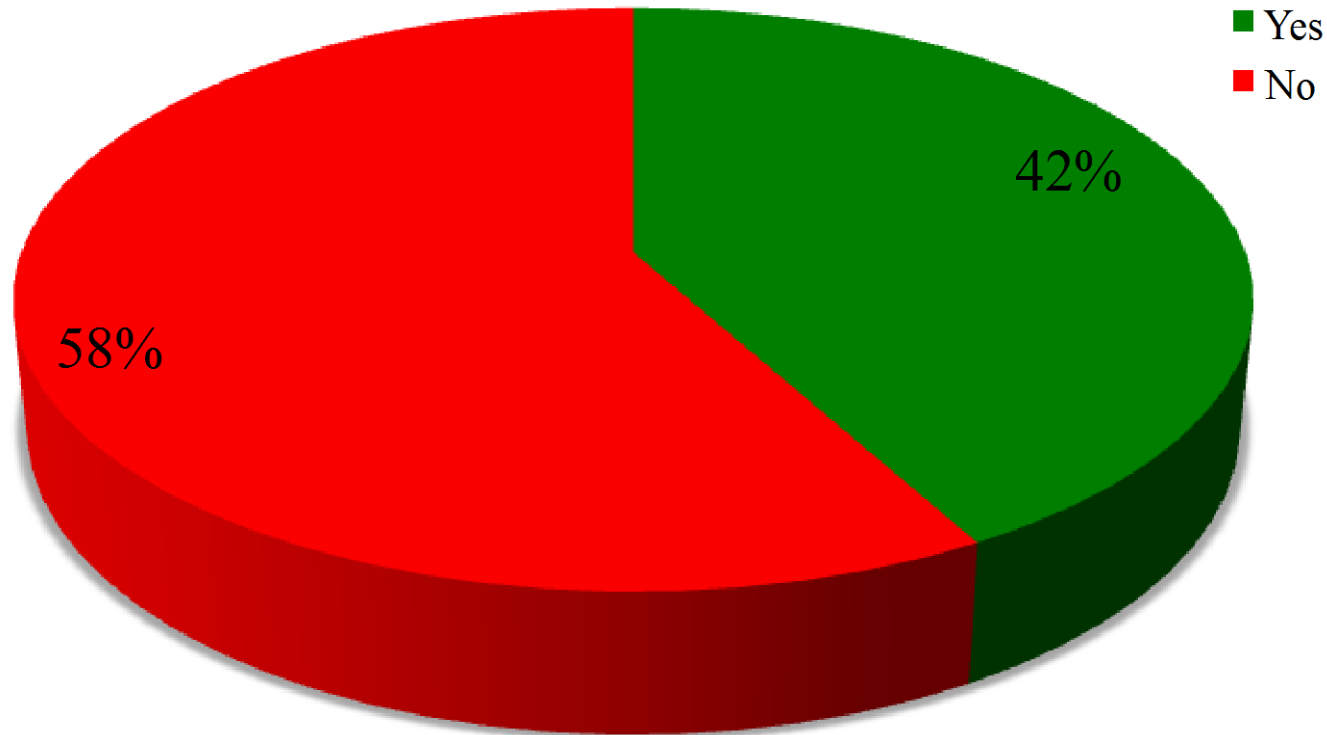
In the last 3 years, did you retire or did you do any planning for your retirement?



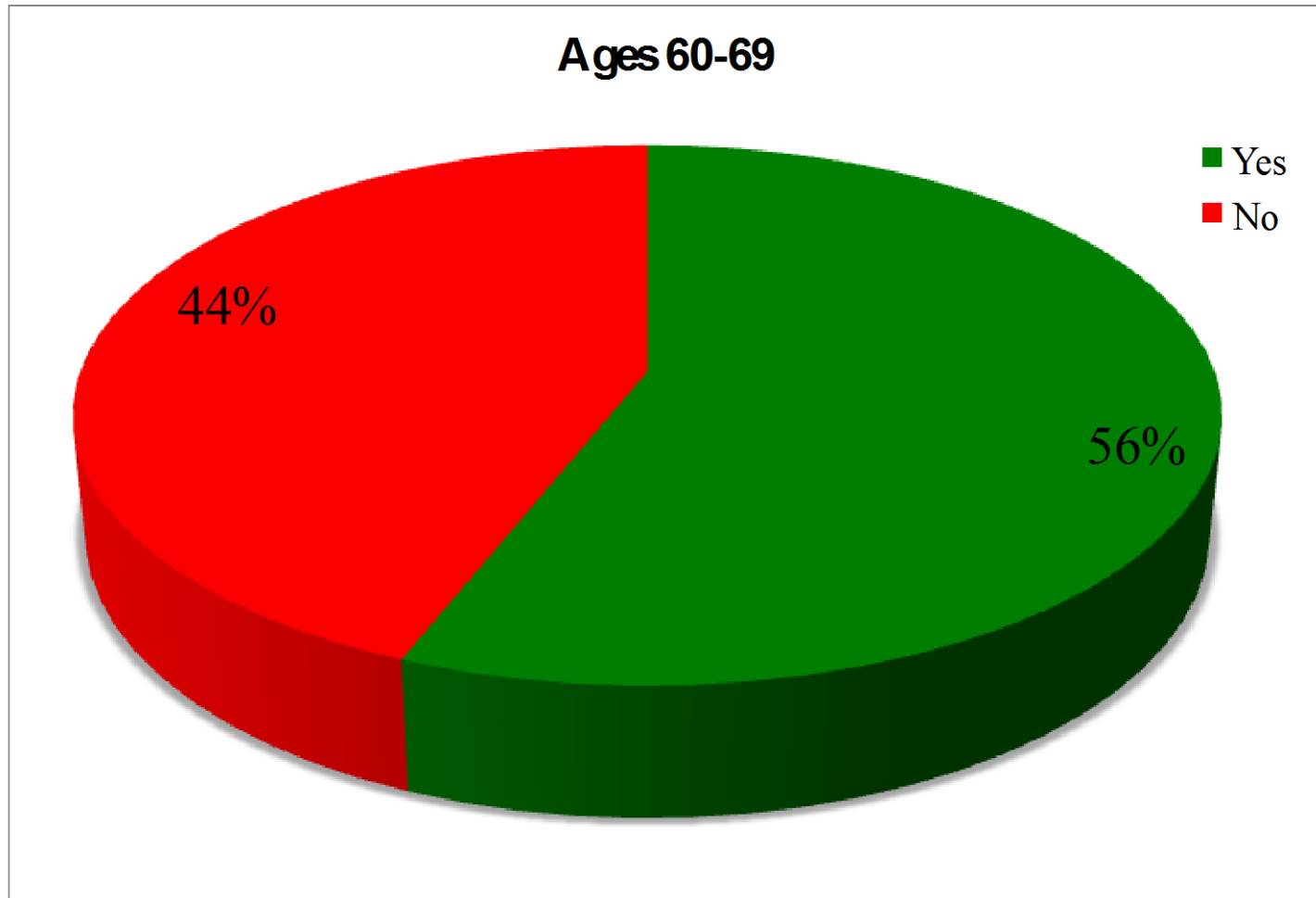
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Ages 60-69



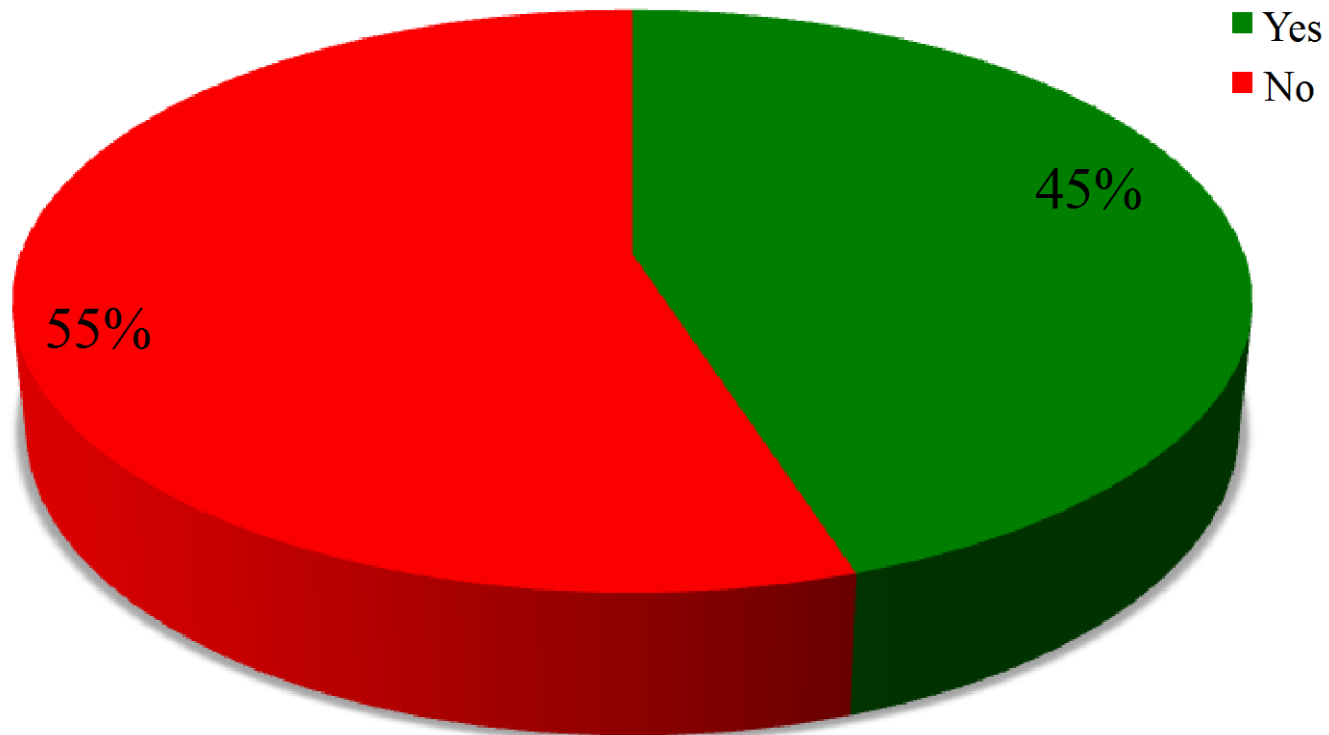
Mortgage debt



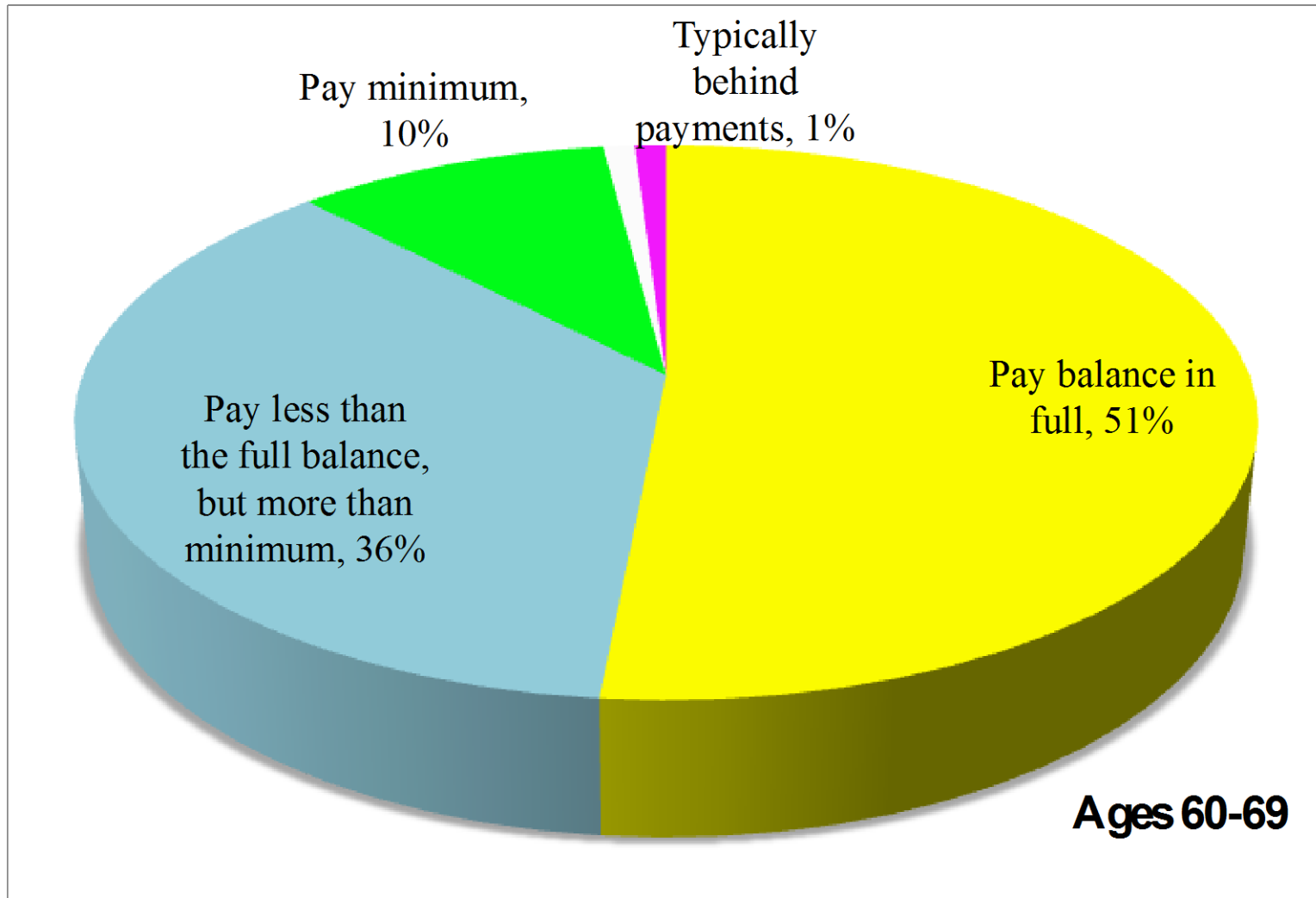
Mortgage debt



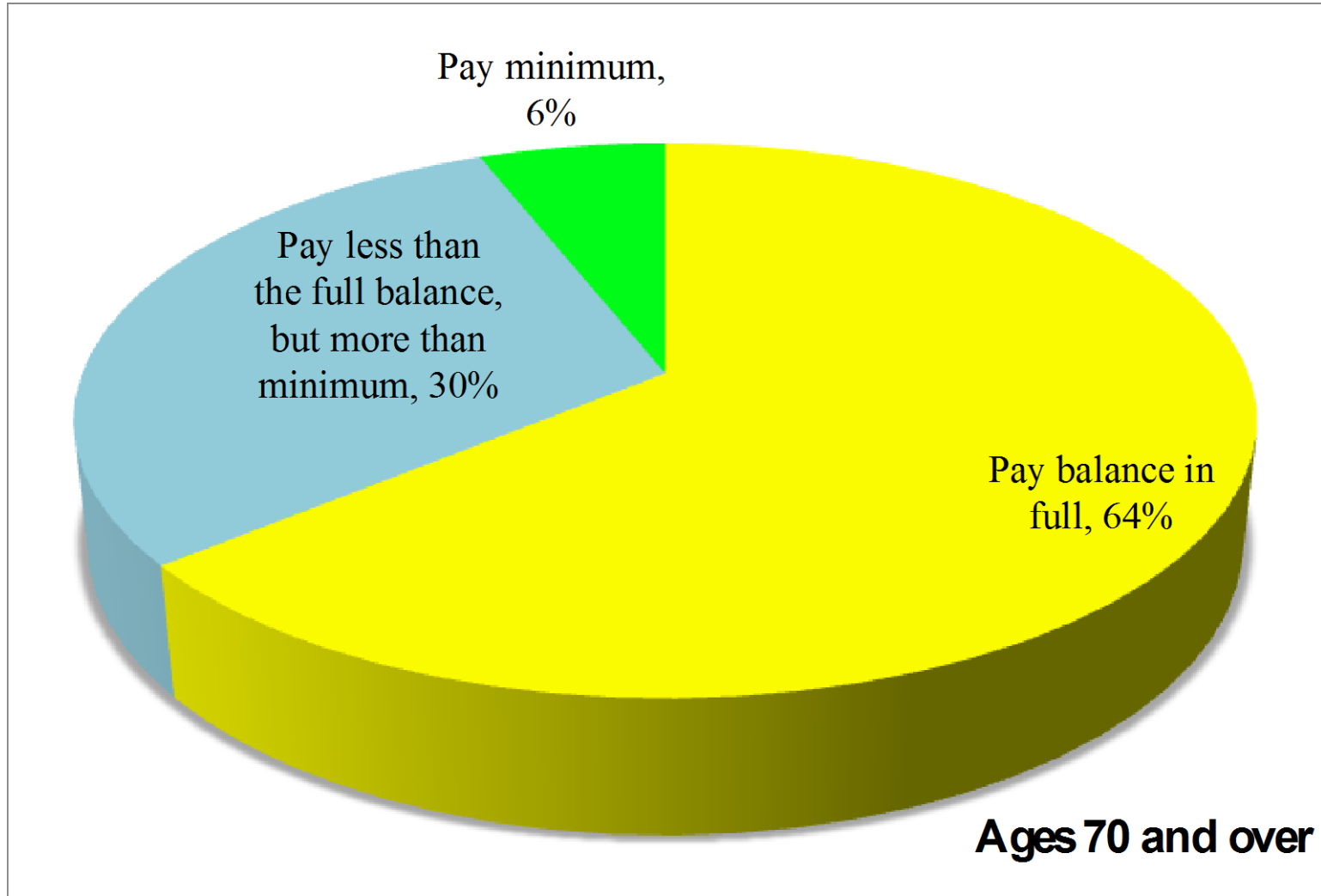
Ages 70 and over



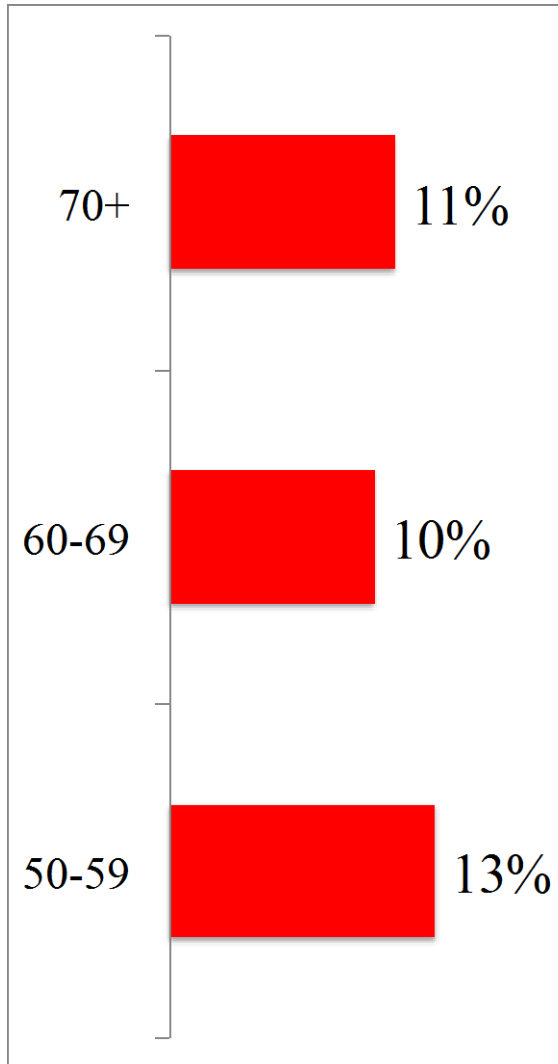
Credit card bills



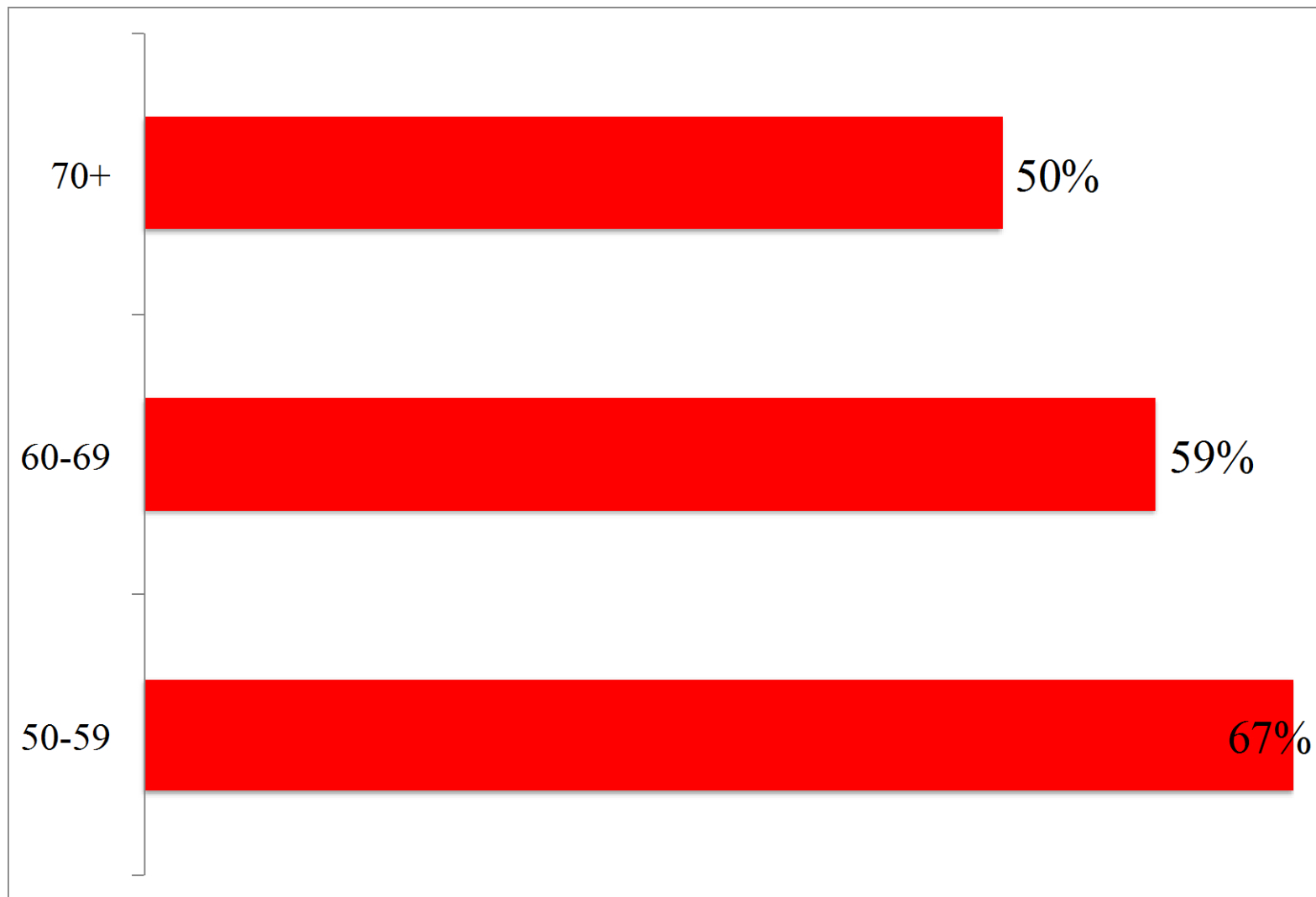
Credit card bills



Could NOT pay for an unexpected expense of \$1,000



Could NOT pay for an unexpected expense of \$10,000



Summary



Only a fifth of respondents in their 50s had planned for retirement

One in six of those planners did not factor in ability to pay expenses in the future, inflation, major illness, or long stay in nursing home

Among those 70 and over 4 in 10 owe mortgage debt and more than a third do not pay their credit card bills in full

Only half of them would be able to pay for an unexpected expense of \$10,000



What do People Know about Social Security?

Joanne Yoong
Lila Rabinovich
Saw Htay Wah

Update, September 1, 2016

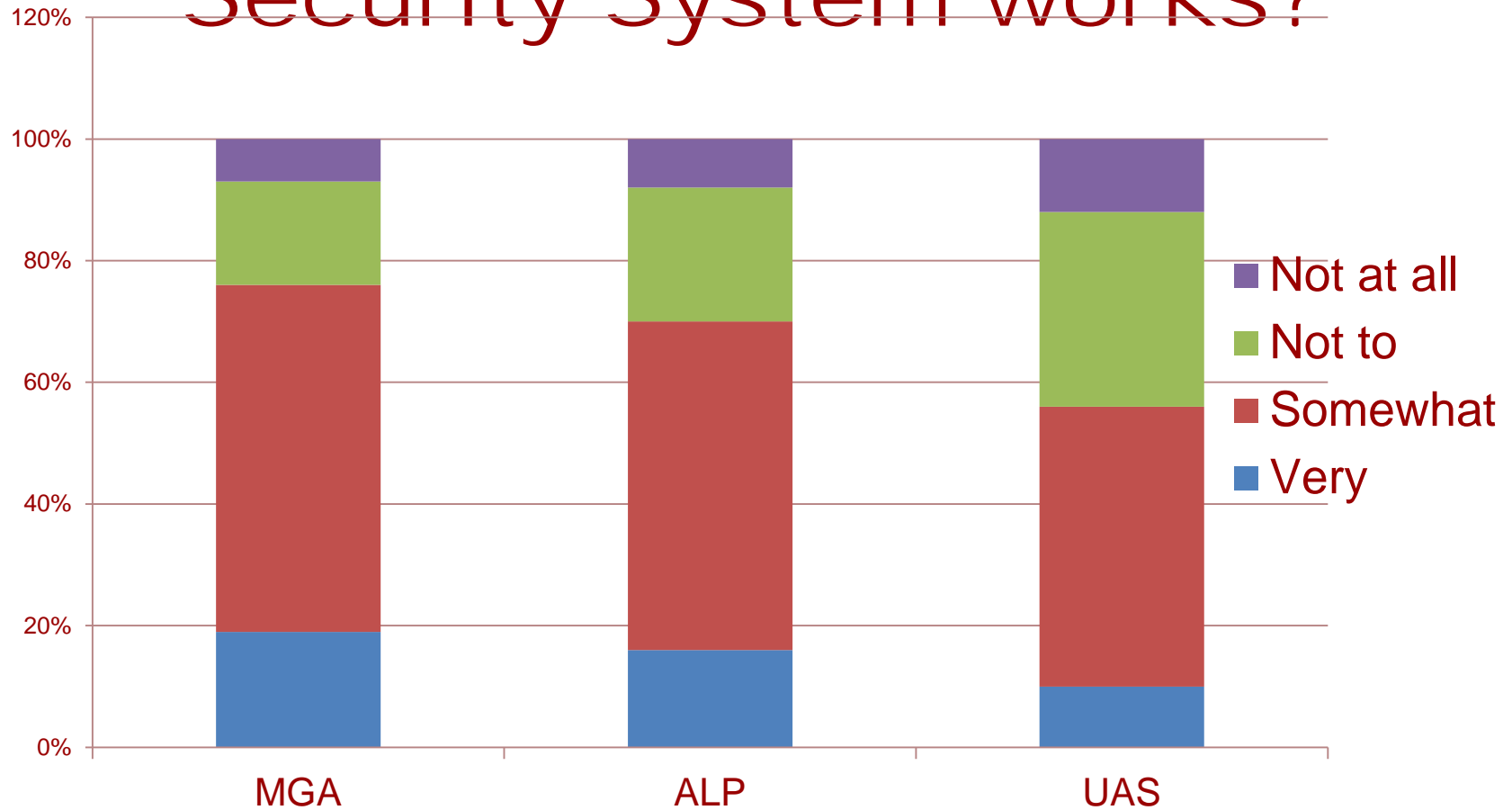
Arie Kapteyn

This Study is an Update of Earlier Studies

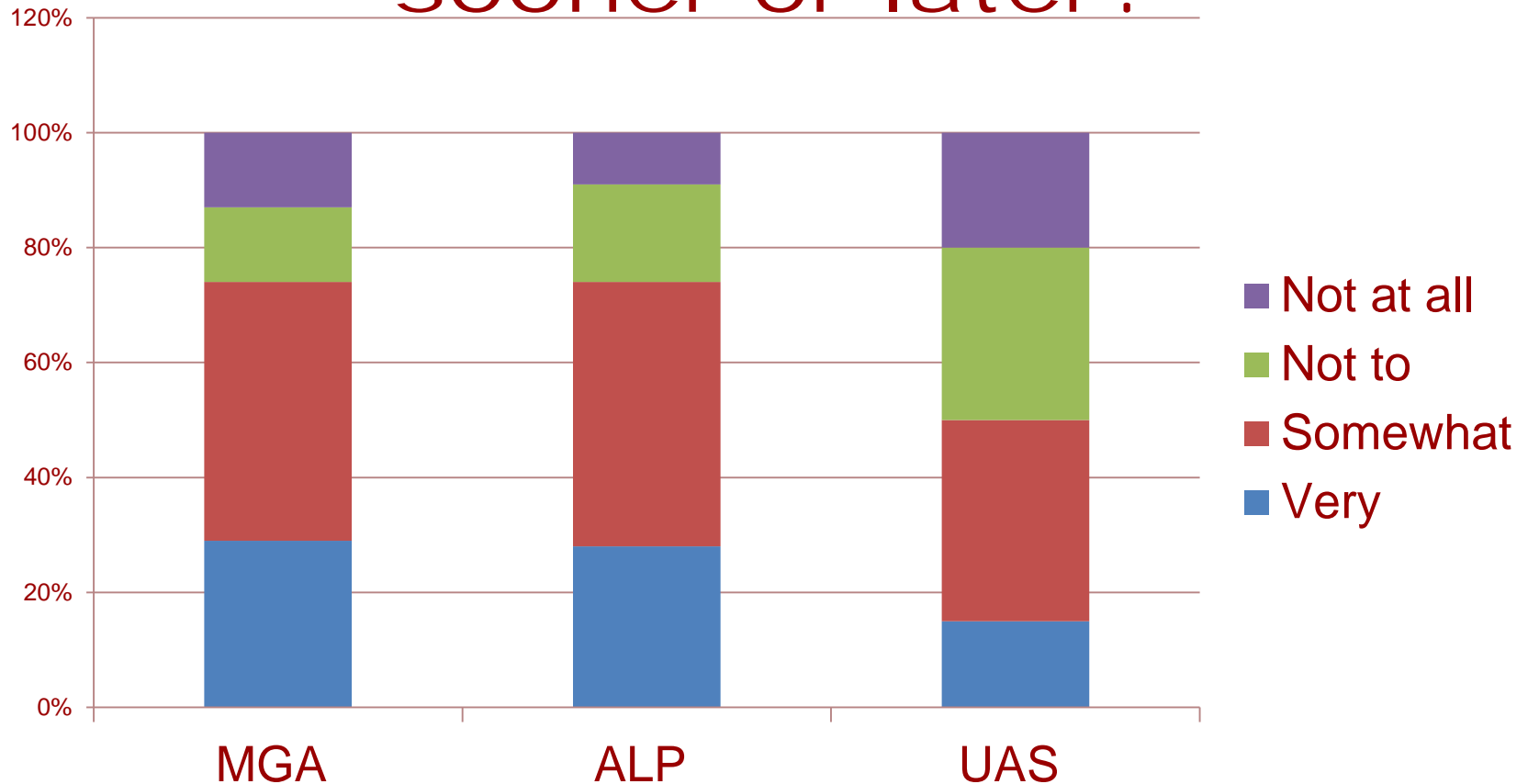


- 2010:
 - Matthew Greenwald and Associates (MGA)
 - Telephone
 - American Life Panel (ALP)
 - Internet
- 2016: UAS

Please tell me how knowledgeable you feel about how the Social Security System works?



How your benefits change if you claim Social Security benefits sooner or later?



Social Security Knowledge Quiz (True or False)



- Someone who has never worked for pay may still be able to claim benefits if one's spouse qualifies for Social Security
- Social Security benefits are not affected by the age at which someone starts claiming
- Social Security benefits are adjusted for inflation
- Social Security benefits have to be claimed as soon as someone retires
- Retired people who continue to earn income from working or investments may have to pay tax on their Social Security benefits
- Social Security is paid for by a tax placed on both workers and employers

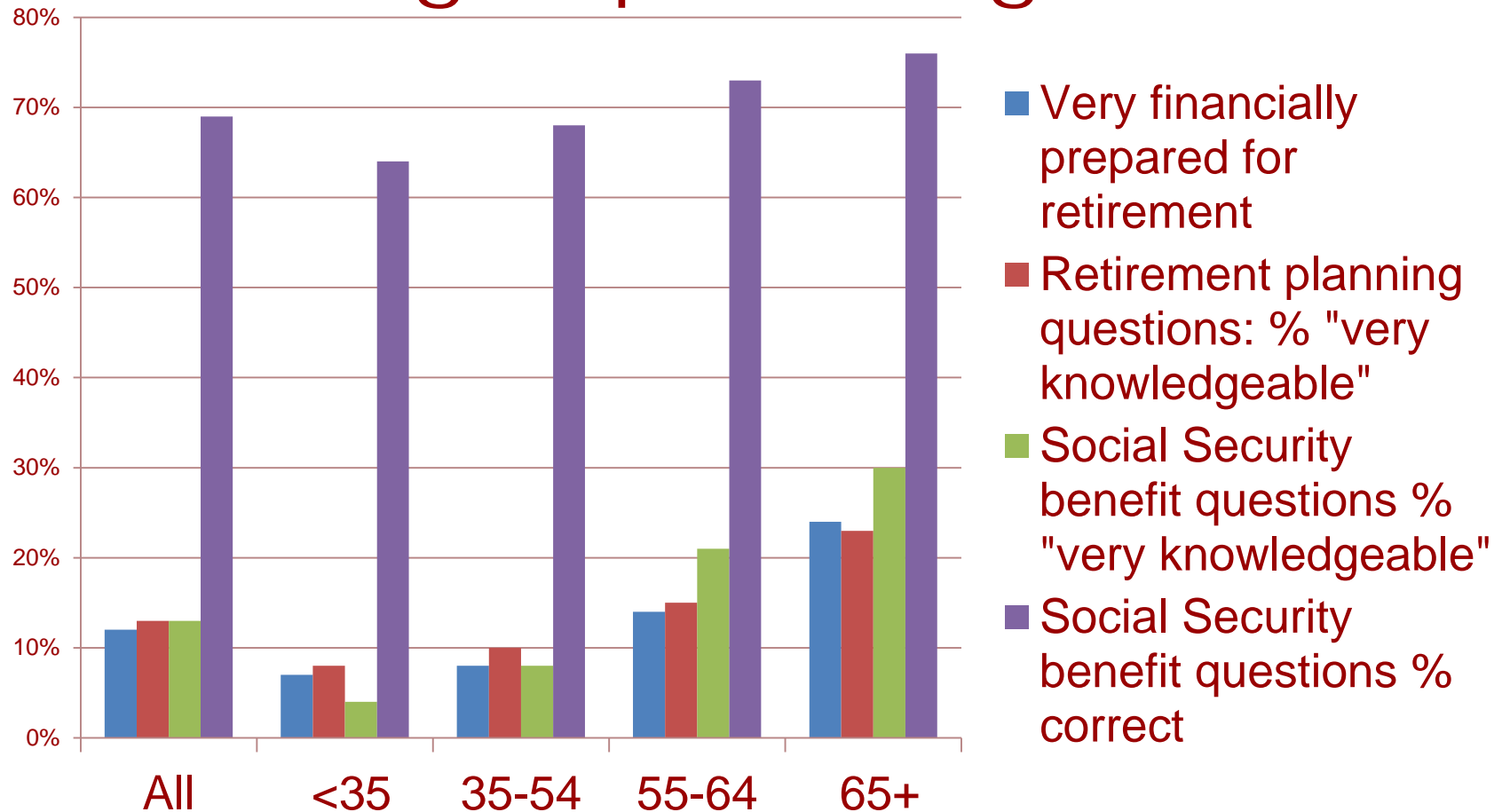
Social Security Knowledge Quiz

(Continued; select one)

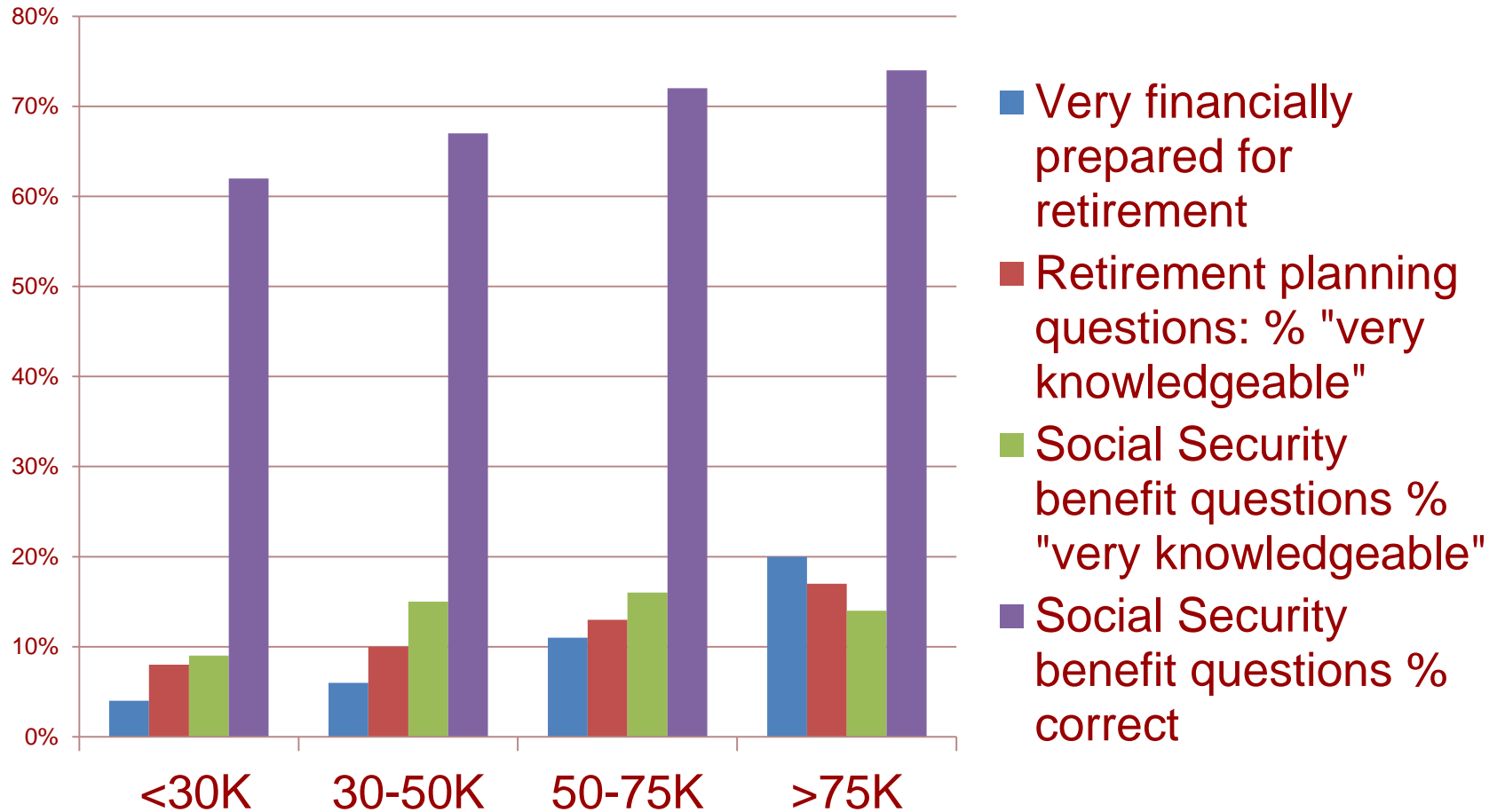
- Which of the following best describes how a worker's Social Security benefits are calculated?
- They are based on how long you work as well as your pay during the last five years that you are employed
- They are based on the average of the highest 35 years of your earnings
- They are based on how much Social Security taxes you paid
- They are based on your income tax bracket when you claim benefits



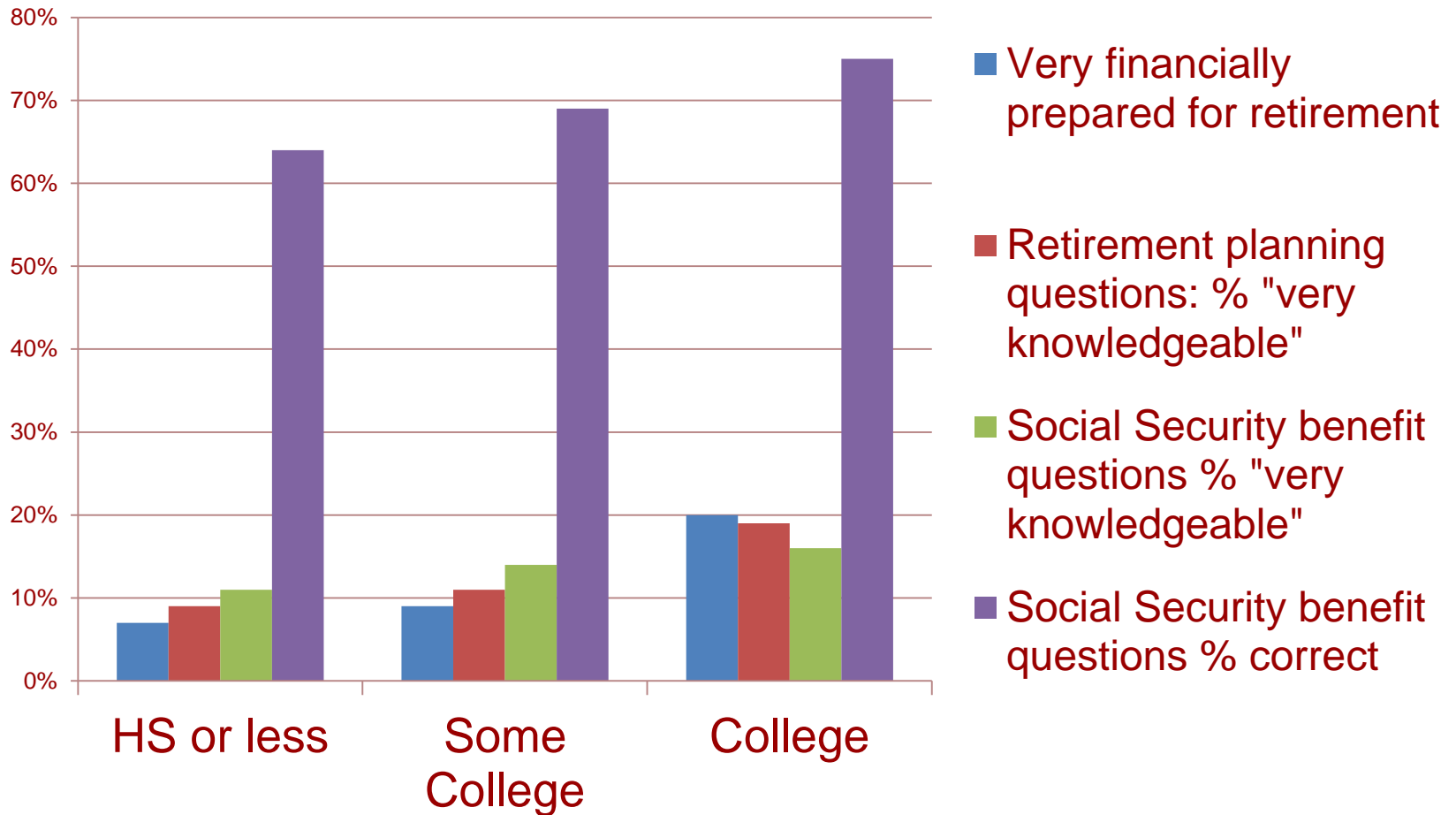
Knowledge and Preparedness go up with age



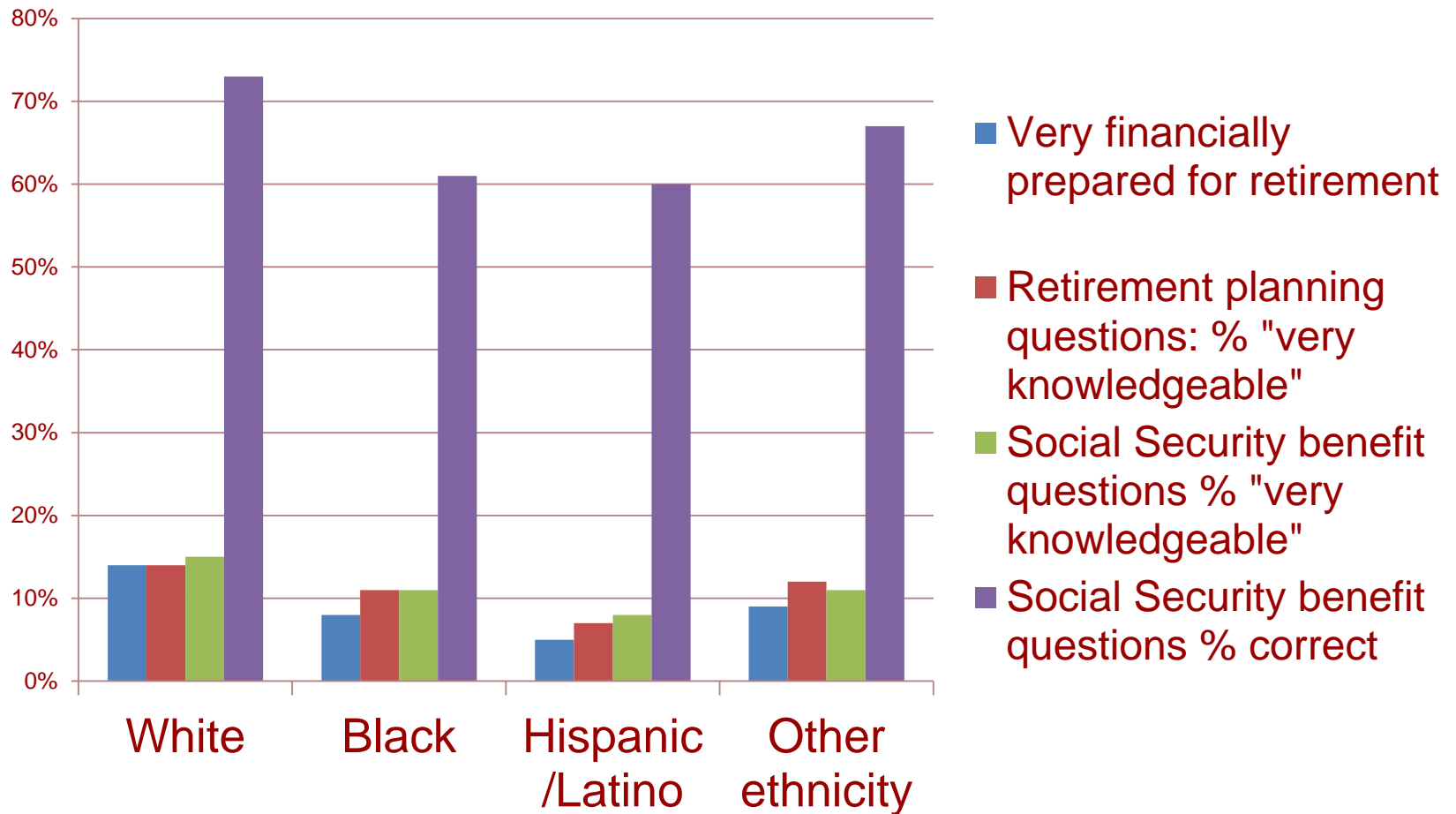
And with Income



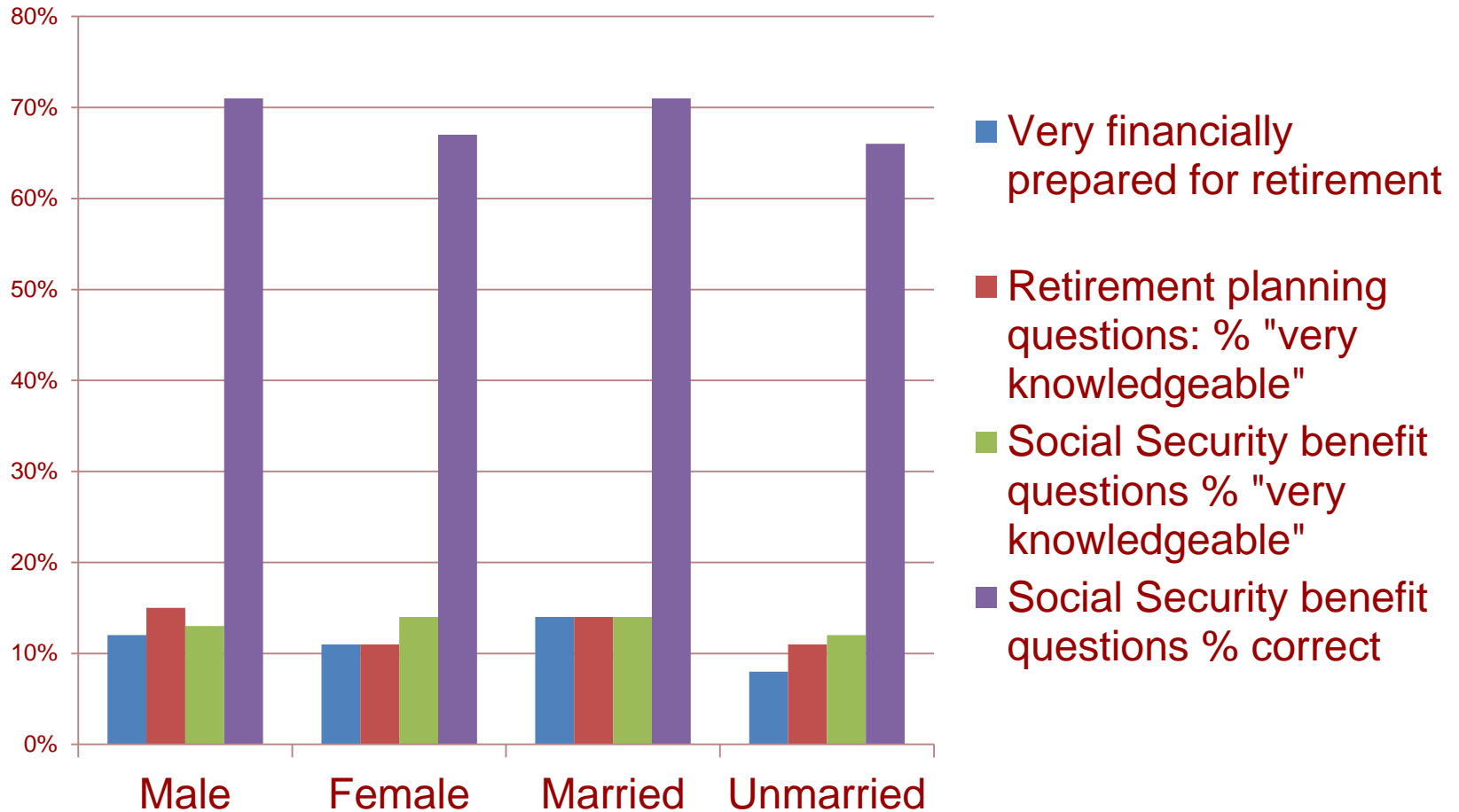
And with Education



And varies by Race/Ethnicity



Demographics



Discussion



- Knowledge of how Social Security works does not seem to have improved over the last six years
- As in 2010 the vast majority of respondents does not feel they are financially prepared for retirement.
- Knowledge and preparedness for retirement is lowest among the groups that need it most
- Social Security terminology is less than intuitive and could probably be simplified.

Can we simplify?



- For instance; Full Retirement Age plays only a minor role these days
- Can we concentrate on a small number of key concepts?
 - Claiming window
 - Later claiming implies higher monthly benefits
 - Benefits are inflation protected
 - How benefits are related to earnings history
 - How benefits are related to spousal earnings



Cognitive Constraints on Valuing Annuities

Jeffrey R. Brown

Arie Kapteyn

Erzo F.P. Luttmer

Olivia S. Mitchell

Under a wide range of assumptions people should annuitize to guard against length-of-life uncertainty



- What are supply side barriers?
 - Adverse selection
 - Incomplete annuity markets (aggregate risk)
- What are demand-side limitations?
 - Bequest motives
 - Formal or informal substitutes (e.g. family)
 - Pretty much any explanation creates new puzzles:
 - E.g. if family provides risk sharing, annuity demand should go up after a spouse dies

Behavioral aspects



- Decisions are complicated and there is little opportunity for learning
- If one does not understand an annuity product, then reluctant to buy it
- Endowment effect (valued higher when one owns it than when one can buy it)
- Probably sensitive to how the product is framed
- Sensitivity will be related to sophistication

Our Experiment



- Use two waves of the American Life Panel and ask questions like the following:
- *“In this question, we are going to ask you to make a choice between two money amounts.*
- *Please click on the option that you would prefer*
- *Suppose Social Security gave you a choice between:*
- *(1) Receiving your expected [current] Social Security benefit of \$SSB per month.*
- *or*
- *(2) Receiving a Social Security benefit of $\$(SSB-X)$ per month and receiving a one-time payment of \$LS at age Z [one year from now].”*

Screen shot: Selling Annuity



In this question, we are going to ask you to make a choice between two money amounts.

Please click on the option that you would prefer.

Suppose Social Security gave you a choice between:

- Receiving a Social Security benefit of \$1,500 per month and **receiving** a one-time payment of \$20,000 one year from now.
- Receiving your Social Security benefit of \$1,600 per month.

<<Back

Next>>



Screen Shot: Buying Annuity



In this question, we are going to ask you to make a choice between two money amounts.

Please click on the option that you would prefer.

Suppose Social Security gave you a choice between:

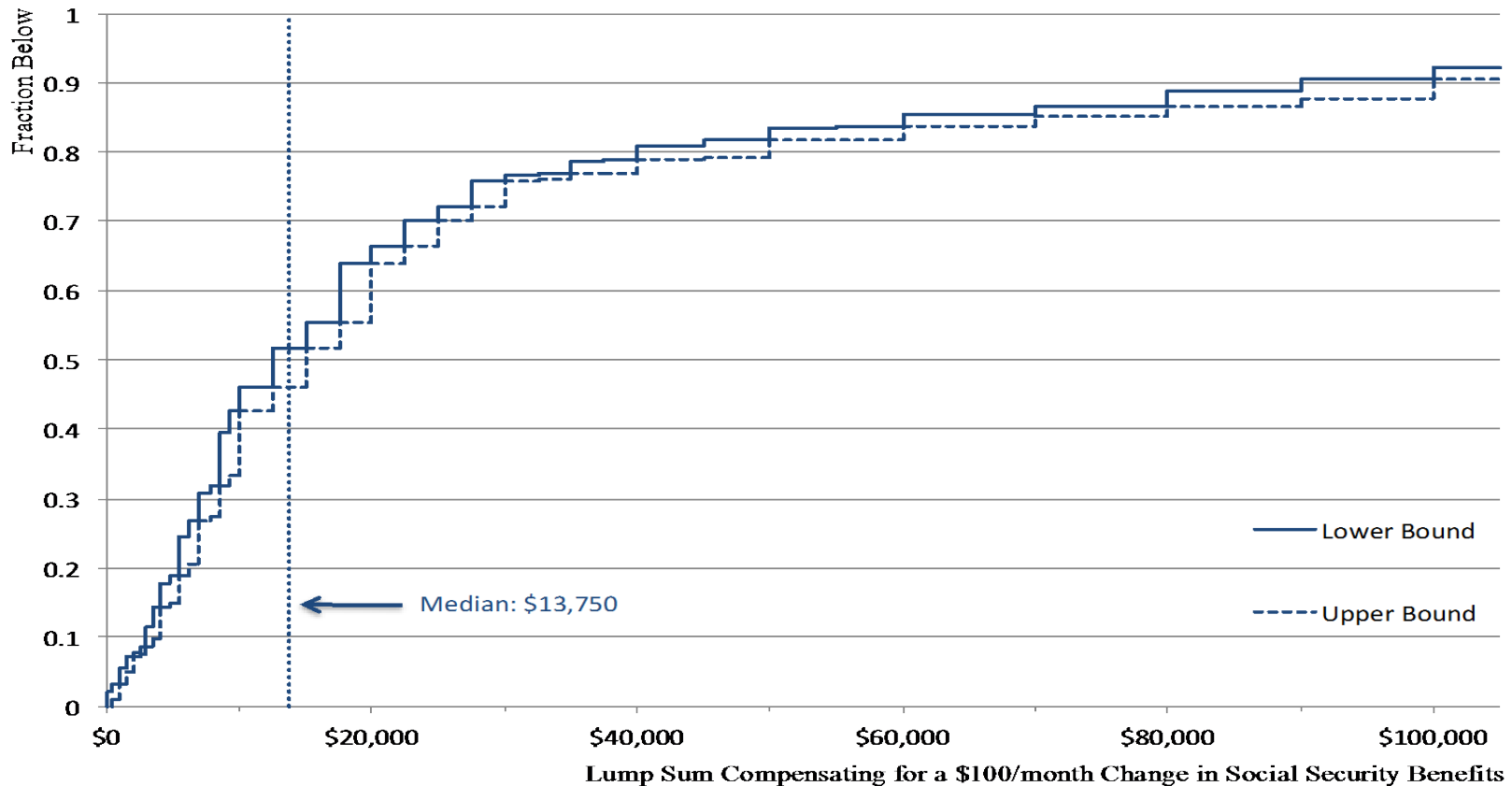
- Receiving your Social Security benefit of \$1,600 per month and **making** a one-time payment of \$20,000 one year from now to Social Security.
- Receiving a Social security benefit of \$1,500 per month.

<<Back

Next>>



The sales value of a monthly \$100 annuity (median is approximately act. fair)

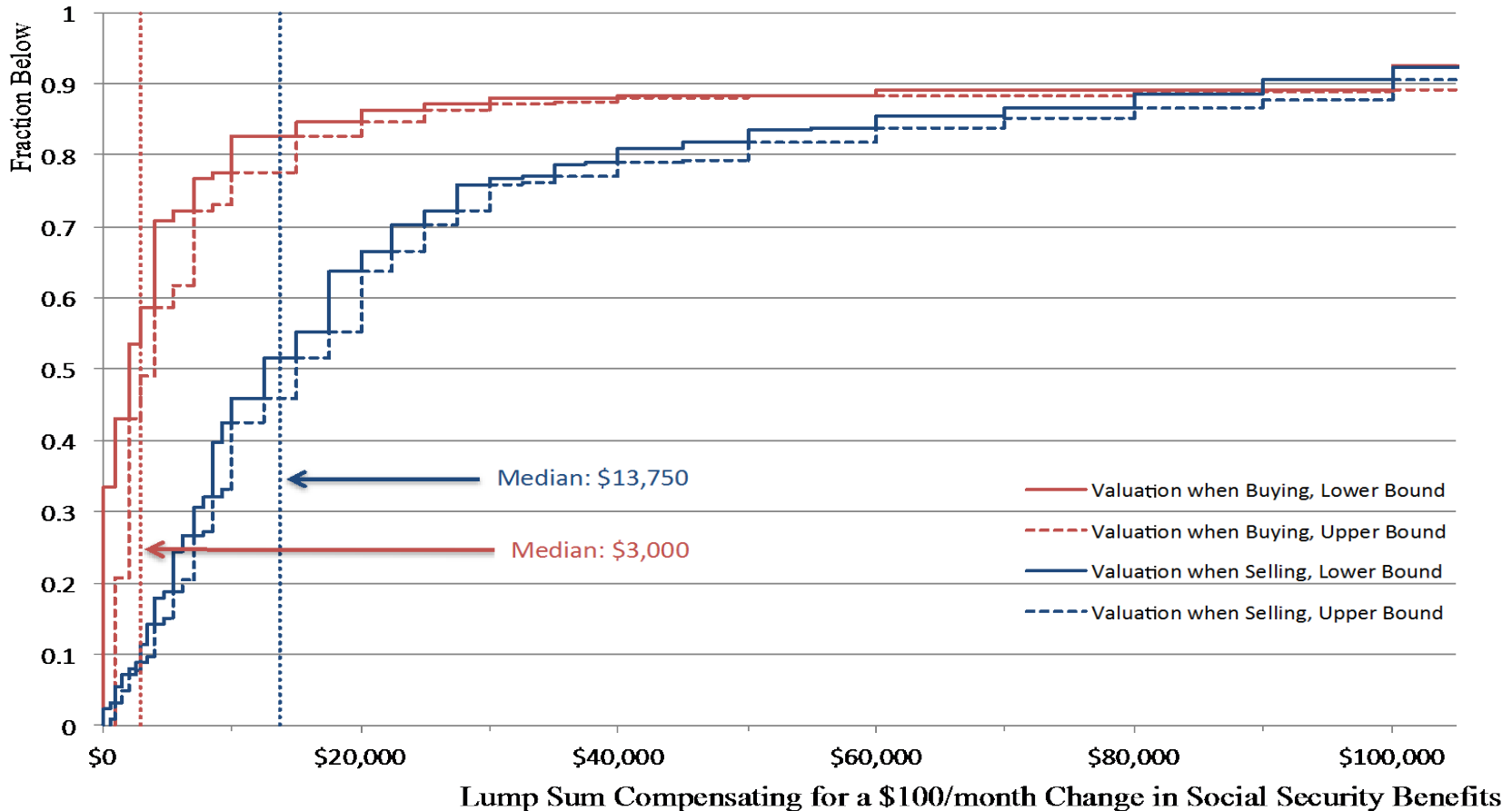


Selling a \$100 per month annuity (continued)



- 6% reports a valuation of \$1500 or lower
- 12% wants \$200,000 or more

The value of buying and selling a monthly \$100 annuity



Discussion



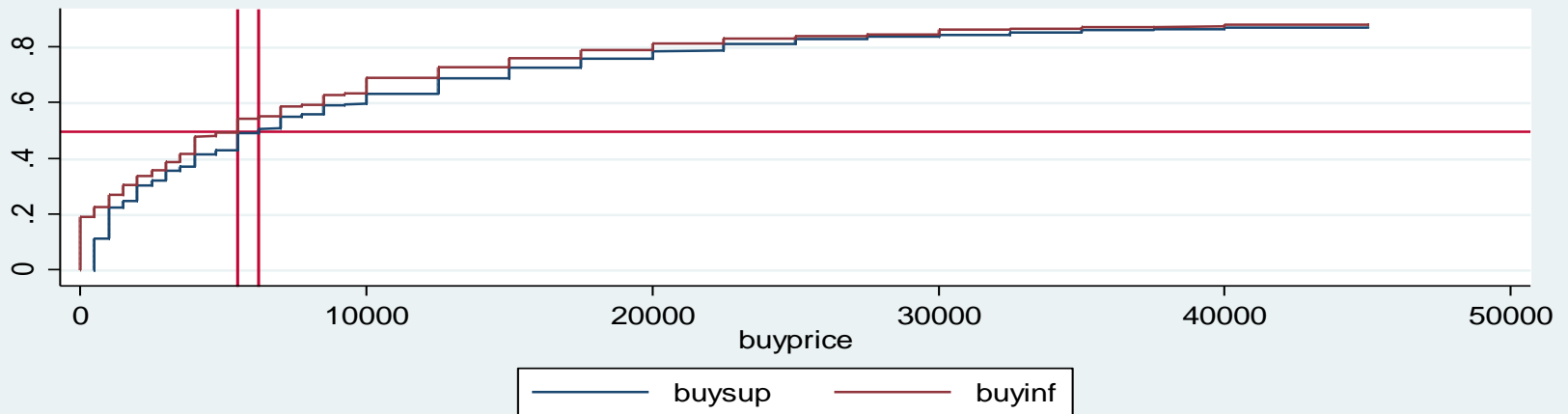
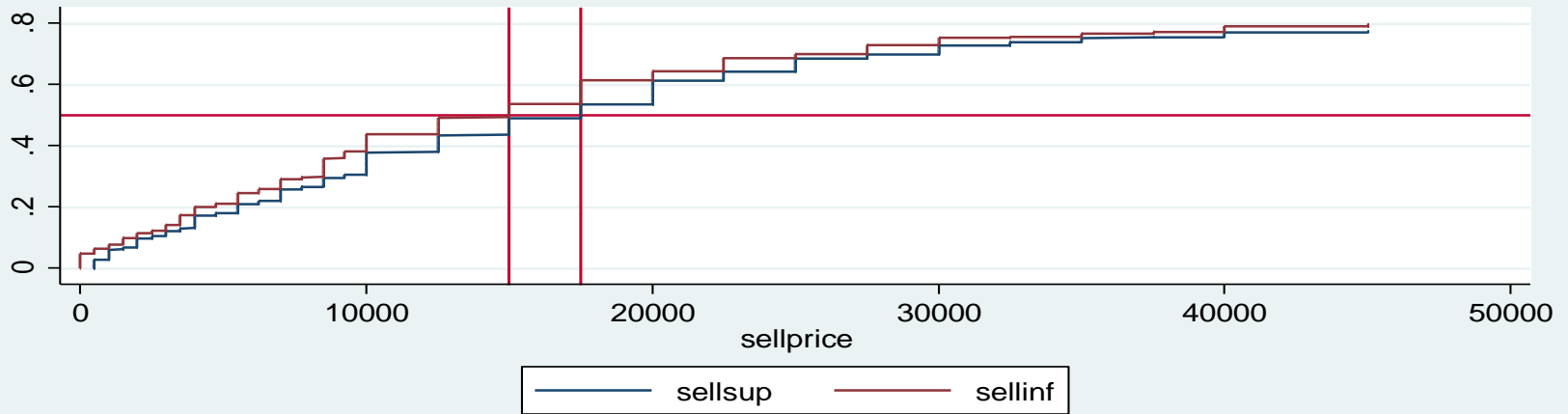
- People place a much higher value on SS when asked to give up some of it than when asked their willingness to pay for some more
- This could be status quo bias/ endowment effect
- Liquidity constraints are an unlikely explanation (e.g. about 82 percent of respondents indicate that they could come up with the lowest lump-sum amount that they declined to pay. Of the 18 percent that indicated that they could not come up with this amount, half said that even if they had had the money, they would have declined to pay the lump sum)

To address some of these issues,
we repeated the experiment by
showing vignettes in the UAS



- Respondents were shown vignettes describing hypothetical persons who had to decide to buy or sell annuities
- They were then asked to say how much the “vignette person” should offer (or ask) for a monthly \$100 annuity

The results are pretty much the same



There is more



- It turns out that buy and sell prices are negatively correlated:
 - Those who ask most for the monthly \$100 annuity are willing to pay the least
- Inconsistencies are lowest for respondents who are more financially literate, have higher education, score higher on numeracy tests

Extreme values are more likely for

- Older respondents
- Lower educated
- Minorities
- Women
- Non-home owners
- Respondents with lower incomes
- Respondents with lower wealth
- Lower financial literacy

Conclusion



- Even respondents with high cognitive skills appear finding it difficult to value annuities.
- Yet, the financially less literate are most likely to be “inconsistent” and more subject to framing.



In the U.S. an important decision is when to claim Social Security Benefits



Framing and Claiming: How Information-Framing Affects Social Security Claiming Behavior

Jeffrey Brown (Illinois)
Arie Kapteyn (USC)
Olivia Mitchell (Wharton)

The Journal of Risk and Insurance, 2014



Framing

- At least since Tversky & Kahneman (1981), we have known that “framing” matters
 - Presenting the same information in a different format can influence behavior and lead to inconsistent choices
- To the extent framing matters, it calls into question the extent to which individuals are acting as fully rational, optimizing agents
 - Optimizing agents who care about outcomes – e.g., the utility of consumption – should be unaffected by how information is phrased

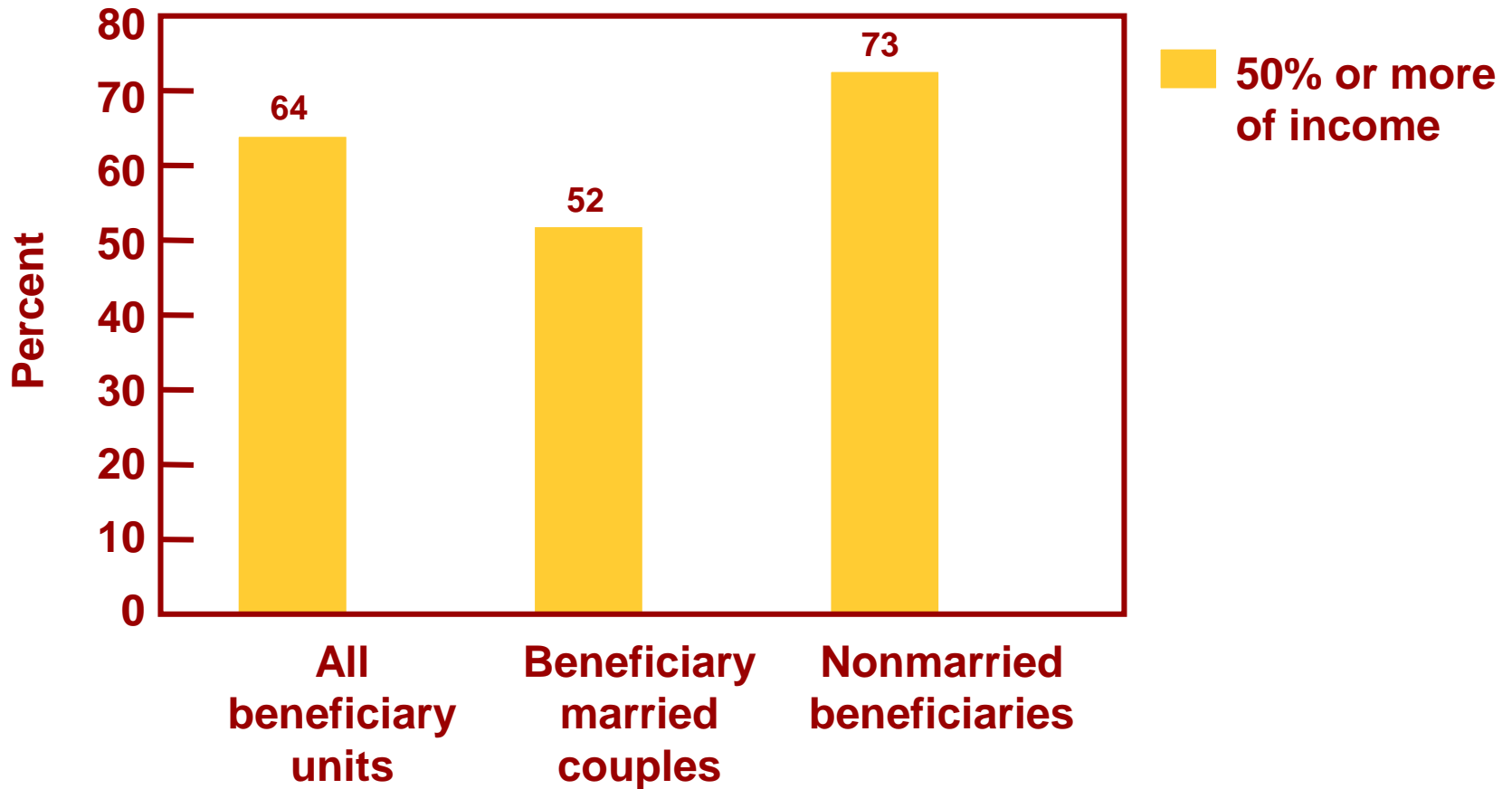
We Examined How Framing Affects Social Security Claiming



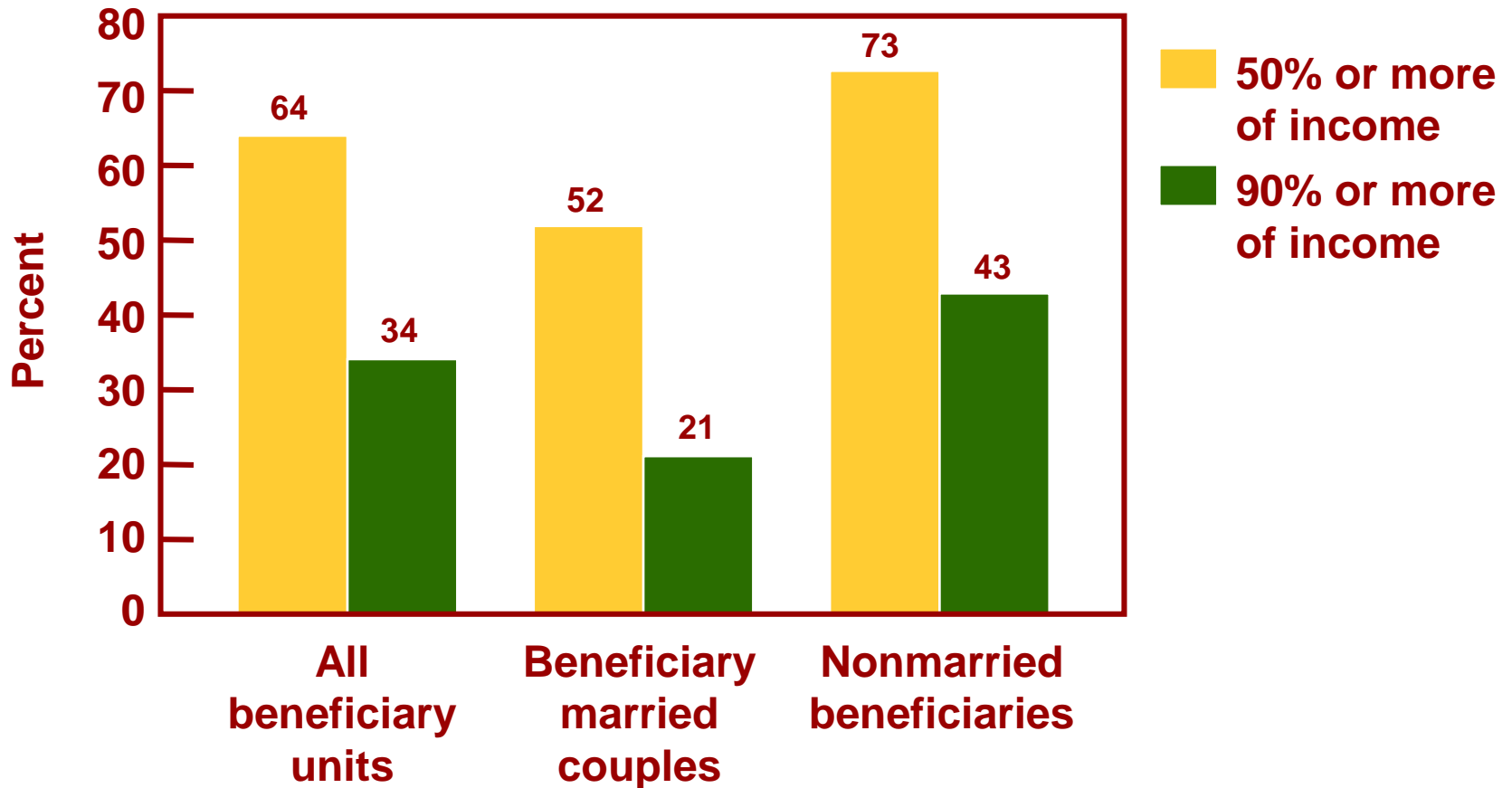
- People can claim benefits anytime from 62 to 70
 - Eligible for full benefits at normal retirement age
- The decision can have enormous consequences
 - Someone who stops working at 62 but waits to claim until 70 earns 76% more (real) dollars per month for life
 - Compared to claiming at age 62



Social Security Is the Main Source of Income for Most Older Americans



And It Is Essentially the Only Income for a Third of Older Americans



Claiming and Framing



- The decision about when to claim Social Security benefits is nearly universal (93% of workers)
- Welfare consequences are potentially important
- Social Security is an inflation-indexed, joint-and-survivor annuity priced based on average mortality
- Delaying claiming is akin to purchasing a larger annuity, with the “purchase price” equal to foregone income during delay period
- Important to know if people are optimizing the decision and/or how influenced by the framing that is implicit in SSA communications

Our Experiment



- We conducted an Internet survey to test the influence of different frames on date of claiming
 - Used the American Life Panel
- Each participant randomly shown 6 frames (out of 10)
 - 3 survey sessions
 - 2 weeks apart

Our Approach



- We are *not* calculating optimal claiming ages, as this is affected by a large number of factors
- Health and longevity expectations
- Liquidity constraints and the link to labor supply / retirement
- Preference parameters (e.g., risk aversion, discount rates)
- Policy parameters (e.g., earnings test, effect on widow benefits, etc)
- If people are truly optimizing, then changes in how information is framed should be unimportant

What We Hoped to Learn



- How much different frames influenced decisions
- Who was most vulnerable to framing
- What affect specific frames had on choice
- How framing could be improved to avoid poor decisions

Several Narratives Are Important for Social Security Claiming



- Breakeven analysis: SSA's approach before 2008
 - Still the prevalent approach of many private advisors
- Baseline: As neutral as possible—SSA's approach since 2008
- Consumption vs. investment language
- Gains vs. losses
- Anchoring age

We Created Ten Frames Using These Dimensions

Frame	Framing	Anchoring age
1	Breakeven	62
2	Baseline (neutral)	66
3	Consumption gain	62
4	Consumption gain	66
5	Consumption loss	66
6	Consumption loss	70
7	Investment gain	62
8	Investment gain	66
9	Investment loss	66
10	Investment loss	70

What we find



- Choices people made were strongly influenced by the way alternatives were presented
 - Certain frames led to earlier claiming; others to later
 - Intended claiming dates could move up to two years
 - Groups with lower levels of financial understanding were most susceptible
- Americans most vulnerable to financial hardship are also most likely to make poor decisions
 - Reducing their income in old age

So what is the picture?



- Financial decisions are difficult for many people, particularly for those with lower financial or cognitive capability.
- Bad decisions can have momentous effects if institutions don't protect individuals.
- There is relatively little scope for learning, and when we grow older we have more trouble learning.

Do People Seek Help?



- Many respondents in the Financial Management Survey make decisions about refinancing, investments and retirement without seeking assistance from a financial professional; those who do seek assistance rely on friends or family as the primary source of help.
- The majority of the survey respondents, including many of the oldest, have no plans in place in the event they cannot make financial decisions.

What to do?



- Education?
- Regulation of financial products?
- Soft Paternalism (e.g. defaults)
- Paternalism (limit choice)?
 - Who wants choice?
- Simplify where possible

What to do?



- Education?
- Regulation of financial products?
- Soft Paternalism (e.g. defaults)
- Paternalism (limit choice)?
 - Who wants choice?
- Simplify where possible
- All of the above!

Bottom Line



- There is vast inequality in people's financial preparedness for old age
 - Both in terms of where they are now
 - And in their capacity to deal with increasingly complex and life changing decisions

Bottom Line



- There is vast inequality in people's financial preparedness for old age
 - Both in terms of where they are now
 - And in their capacity to deal with increasingly complex and life changing decisions
- They need help!



Thank you!