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A NUDGE TOO FAR?

OPPORTUNITIES AND CHALLENGES FOR ADVISING THE RELUCTANT RETIREE

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EXECUTIVE SUMMARY

Retirement plans commonly “nudge” individuals into plan participation and a default investment option (typically, a target date retirement fund) if they do not make an affirmative choice. Target date funds may offer an acceptable default during the wealth accumulation phase since they address diversification and asset allocation issues. But consider the retirement decision. Should there be a default policy regarding retirement and wealth disbursement? Data from a survey of university professors aged 60 and over suggests that retirement is a complex decision of a highly-individual nature. A large percentage of the survey respondents are reluctant to stop working at a “normal” retirement age, and reluctance is often based on a combination of financial, institutional, and social/emotional factors. The majority of the reluctant retirees have not received any financial planning advice or life coaching regarding the retirement decision. For universities, the opportunity is to move beyond “one-size-fits-all” retirement policies by offering access to independent financial advice along with tailored professional performance assessment. For faculty in the retirement “zone,” the challenge is to balance skepticism about financial advisory services and products with the legitimate need they have for assistance. For advisors, the opportunity is to serve this growing need; the challenge is being familiar enough with the faculty client and university context to understand all of the factors influencing the retirement decision, but also far enough from the employer to be viewed as independent.

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INTRODUCTION

In the United States, bad outcomes often trigger political scrutiny and calls for changes in public policy. Unfortunately, bad outcomes for defined contribution retirement plan participants have been frequent. Since the dawn of the defined contribution retirement age about three decades ago, the stock market has exhibited several periods of extreme downside volatility (e.g., 1987, 2000-2002, 2008-2009). Using individual account data from this investment environment, the behavioral finance literature has documented poor decision making by retirement plan participants. Failing to discriminate among investment options, overconfident, or just following the crowd, retirement plan participants often moved into or out of equities at the wrong times (see, e.g., Barber and Odean, 1999; Benartzi and Thaler, 2001). Moreover, retirement plans in the private sector sometimes pushed company stock as an investment, leaving participants decimated when the firm's fortunes went downhill.

Retirement plan sponsors have come under increasing pressure to minimize the likelihood that participants have bad retirement financial outcomes. Following the passage of the Pension Protection Act of 2006, a number of plans have adopted a retirement plan structure with default choices (nudges) built into the accumulation stage. For example, workers are automatically enrolled in a retirement plan rather than needing to proactively enroll themselves in order to participate. If they fail to choose an investment, or are auto-enrolled into the plan, their contributions are allocated into the plan's default investment, i.e., included in the plan design is a Qualified Default Investment Alternative (usually a target date retirement fund) as the (Tier 1) default. Nudging participants into the target date fund as a default for plan investment is part of wider design strategies to help individuals achieve better financial outcomes (Thaler and Sunstein, 2008). The target date funds offer both the diversification and equity exposure most advisors would recommend. So the hypothetical 30-year old investor, absent making a choice, would be defaulted into a target date fund of year 2050. Furthermore, the fund also adjusts its allocation over time, meaning that participants need not make any changes themselves.

Nudging participants into plan participation and a target date fund is arguably a reasonable strategy for plan design in the accumulation stage. But would nudges work with the decumulation stage? Furthermore, would nudges work with the retirement decision itself?

Some call for mandatory annuitization of a portion retirement plan proceeds, but there is no public policy on decumulation to date other than the requirement that retirees begin to take minimum distributions from retirement plans with pre-tax contributions in the year after reaching age 70 ½. This policy inaction might be for good reason. Unlike accumulation, which may be amenable to reasonable defaults, the retirement and decumulation decisions are likely to be much more complicated and individually nuanced in nature. Mandates may be a nudge too far.

The timing of retirement and disposition of plan accumulations involve analyzing an array of factors, not all of which are financial. While one could argue whether a "generic" 30-year old should have an 85% or 90% allocation to equities in a target date fund, most would concede that both are quite reasonable allocations. In contrast, the decision to nudge a "generic" 65-year old into retirement and to annuitize half her wealth would seem quite problematic. The retirement disbursement decision is much less "one size fits all." In addition, the older employee has reason to be concerned about plan sponsor (i.e., employer) motivations. Depending on the context, the older employee may feel that the sponsor/employer has incentives to either provide advice indicating that retirement is financially feasible (they want the employee to go) or not feasible (they want the employee to stay).

If nudges and defaults are problematic in the retirement decision and decumulation contexts, an opportunity arises for individualized advice. To that end, this article continues with a description of the information gathered from a survey of university faculty members regarding expectations for the timing of their retirement and factors influencing that timing. After discussing the key results, the opportunities and challenges for universities, faculty employees, and advisors are discussed.

SURVEY DATA

The telephone survey of faculty members aged 60 and over took place between September 23 and October 6, 2011. Conducted by Matthew Greenwald & Associates on behalf of the TIAA-CREF Institute, the survey results are discussed in Yakoboski (2011). This article builds on Ciccotello, Pollock and Yakoboski (2011) by focusing on the advice issues associated with the portion of the respondents who identify themselves as "reluctant" to retire. In the survey, "reluctant" was defined as expecting to retire after the "normal" retirement age (as defined by eligibility for full Social Security benefits, i.e. age 65 or 66 in this case). As Yakoboski (2011) shows, about 75% of the 700 survey respondents identify themselves as reluctant to retire.

The financial makeup of senior faculty is typical of a mass-affluent profile. About 60% of those surveyed indicate that their household income was between $100,000 and $200,000 in 2010. About 12% have over $200,000 in annual household income. Regarding savings and investments, about 35% of those responding indicate amounts between $100,000 and $500,000, 20% between $500,000 and $1 million, and 18% over $1 million.

Interestingly, at the sample level the survey respondents indicating that they plan to retire by a normal retirement age (traditional retirees) do not appear to have a stronger financial profile than those who expect to work longer. Neither income nor investable wealth differs significantly between the two groups. Pension income also does not appear to be a decision driver. In both subsamples, about one-tenth of the respondents indicated they are solely in a defined benefit plan.

Despite the similarities in income and investments, financial matters outside of those surveyed may matter. For example, reluctance to retire might be due to having a mortgage left on a home, or because of family–related expenses (e.g., children at home or parent-care). Without that data, inferences about the "cost" side of retirement are not possible. From the data gathered, however, it does not appear that finances are the sole driver of retirement reluctance. In fact the majority of those reluctant to retire indicate that this is their preference.

A natural progression is to examine whether the traditional retirees have evaluated the issue more carefully or received more financial advice than the reluctant retirees. When asked if they have done a careful evaluation of their financial situation and when they can afford to retire, 86% of the traditional retirees said "yes" compared to 77% of the reluctant retirees. Of those indicating that they had done a careful evaluation, 59% of the traditional retirees responded that they had used a professional financial advisor compared to 56% for the reluctant retirees. Reluctant retirees are thus getting less professional financial advice and guidance than traditional retirees, but the percentages do not differ greatly. About one-half (59% of 86%) of the traditional retirees have received professional financial advice and guidance about whether and when they can retire compared to 43% (56% of 77%) of the reluctant retirees.

RELUCTANT RETIREES

Why are reluctant retirees reluctant? Building on Yakoboski (2011), Table 1 offers summary of the responses to the reasons offered. Several patterns emerge. First, money and benefits matter. Seventy-seven percent of reluctant retirees list personal finances as a reason for delayed retirement, but only 43% list it as a major reason. Health benefits also matter, as two-thirds of the respondents list it as a reason for being reluctant. This is somewhat curious given the availability of Medicare, but it may be driven by the need to cover a spouse who is not Medicare eligible, as well as expenses not covered by Medicare. Reinforcing the notion that money is important, the 43% of the reluctant retirees who listed money a major reason were asked a follow-on question: "Suppose finances were not an issue and you were financially able to retire whenever you wanted. Would you retire sooner than you currently expect?" Two-thirds of them indicated "yes."

TABLE 1
WHY DO YOU EXPECT TO WORK PAST A NORMAL RETIREMENT AGE?

	MAJOR REASON	MINOR REASON	NOT A REASON	NO RESPONSE
Personal Finances Necessitate	43%	34%	23%	0%
Need Employer Health Insurance Benefits	38%	29%	33%	0%
Enjoyment and Fulfillment of Work	83%	13%	4%	0%
No Attractive Alternatives for Time	17%	28%	54%	1%
Would Miss Colleagues and Campus Associations	27%	48%	25%	1%
Remain Effective in Faculty Responsibilities	68%	20%	11%	1%
No Reason to Retire	41%	26%	30%	3%
Have Not Considered Possibility of Retirement	14%	24%	57%	5%

Table 1 also highlights a large number of "meaning-related" issues that confound a simple story that money alone drives the retirement decision. A stunningly high 96% of the reluctant retirees enjoy their work and feel fulfilled by it. Over two-thirds believe that their effectiveness as faculty is a major reason to stay. Three-quarters would miss their colleagues and campus activities. It is possible that the results are occupation-specific (speaking to the high quality of a faculty lifestyle and the reluctance to change a familiar routine) and the responses to these questions would be lower in other industries. The findings by Lahey, Kim, and Newman (2006) suggest otherwise. Using cross-industry data, the authors find that "dissatisfaction with retirement" is the strongest factor explaining why those that retire later return to work. Thus, the indications of social and emotional attachments to work found in this survey are likely to matter in other contexts and should not be ignored (*see* Yakoboski, 2011).

The Table 1 results raise the issue of whether reluctant retirees have given any thought to their "time budget" upon retirement, or relied upon professional life coaches to assist them with such a task. When asked whether they had done a careful evaluation of how they could spend their time in retirement, 52% of the reluctant retirees said that they had. Of these, only 15% had employed the services of a life coach for such an evaluation. Thus, only about 8% of the sample of reluctant retirees had used a life planning advisor or coach. Of the 48% of the sample that had not done a careful evaluation of how they could spend their time after retirement, nearly half indicated that they would find it very or somewhat useful to have the assistance of a life planner or coach to do so.

SOURCES OF ADVICE

Table 2 summarizes the responses to a question asking how interested the faculty member would be to receive guidance about retirement from the sources listed. The overall impression from Table 2 is that the respondents are not very excited about any of the choices. Outside advisors hired by the university fare best, as 57% of the reluctant retirees would be either very or somewhat interested in receiving advice from that source. At the other end of the spectrum, the "chain of command" attracts the lowest level of interest. Only 2% of the reluctant retirees would be very interested in guidance from their boss (the department chairperson) or their boss' boss (the dean of the college).

TABLE 2
HOW INTERESTED ARE YOU IN RECEIVING ADVICE ABOUT RETIREMENT FROM THESE SOURCES? (AMONG RELUCTANT RETIREES)

	VERY INTERESTED	SOMEWHAT INTERESTED	NOT TOO INTERESTED	NOT AT ALL INTERESTED
Human Resource Office at University	10%	32%	19%	38%
Outside Advisor Hired by University	19%	38%	17%	25%
Boss (Department Chairman) or Boss' Boss (Dean)	2%	11%	18%	68%
Retired Faculty from Your University	8%	31%	24%	36%

The results speak to the issue of incentives and advice about the retirement decision. Similar to trends in a number of industries, higher education is interested in improving efficiency and trimming staff. Ciccotello, Pollock, and Yakoboski (2011) provide a discussion of this issue and an example of a retirement program implemented at a large state university. In this type of environment, senior employees are likely to be wary of advisory sources they view as under the control of the employer (i.e., the retirement plan sponsor). If an employee is told that "you have plenty of money for retirement," they may hear "we want you out of here." As such, the boss is clearly not viewed as a desirable financial advisory resource. Even the university Human Resources Office is not viewed favorably with nearly 40% responding that they are "not interested at all." Human Resources may be viewed less suspiciously than the individual's superior, but may suffer from the perception that they must treat everyone the same in order to avoid administrative and possibly legal problems. Stated differently, those considering the retirement decision may not believe that Human Resources can tailor advice to their situation.

Previous retirees are viewed somewhat less negatively than employer-based sources, but also garner little positive reaction. Reluctant retirees may have concerns about previous retirees' competence to give advice rather than about a conflict of interest. So the use of previous retirees as advisors could entail a somewhat analagous concern as with using Human Resources. The previous retiree might know her own situation quite well, but not have the expertise to adapt it. Human Resources would have a standard solution, and not have the flexibility to adapt it.

OPPORTUNITIES FOR ADVISORS

The survey results clearly suggest an opportunity for financial advisors and life planners. Retirement is a complex decision of a highly-individual nature. Serving as the investment consultant for a state-level defined contribution retirement plan, I observed data from one of the investment vendors showing that only 27% of participants aged 55-65 had asset allocations whose equity component was within plus or minus 10% of the equity percentage in the associated target date fund. Thus, nearly three-quarters of the participants were well off of the default "glide path." About one-third of these individuals are at the extremes, having either a 0% or 100% equity allocation.

The large range of asset allocations could mean that individuals are customizing their portfolios to their circumstances. A 60-year old entirely in equities, could, for example, be quite well informed—she could have a spouse who is vested in a defined-benefit plan and the household could have low debt payments. Or the couple could have other investments they intend to liquidate and consume over the short to medium horizon. Nudges toward a particular allocation thus face the challenge of conforming toward a wide array of circumstances in the lives of those close to retirement.

Deviations from the target date fund glide path can be rational given the participant's individual situation and goals, but what if they are not? For example, the wide spread off the glide path observed in the vendor data could also mean that participants have not adjusted their allocation over many decades, falling prey to the well-documented phenomena of inertia that impacts a number of financial decisions or to overconfidence.

The opportunities for advisors are apparent in the investment vendor data. The spread in asset allocation identified in the data suggests that circumstances of near-retirees vary greatly and that customized advice is needed. The majority of near-retirees in the survey have not had any financial advice; far fewer than that any life planning or coaching assistance. Futhermore, from the phone survey wealth demographics, it appears that a clear majority could afford to pay for such assistance.

CHALLENGES FOR ADVISORS

Table 2 illustrates that trust is key in an advisory relationship with faculty members aged 60 and over. Trust issues show up clearly in the low level of desire to receive advice from supervisors. Sources associated with the employer could be viewed as having a conflict of interest, or as agents rewarded for getting a faculty member to leave. The low levels of interest in speaking to Human Resources might also be trust related, but could also reflect concerns about one-size-fits-all advice dictated by university policy. Compared to employer sources, reluctant retirees are more interested in outside advisors, even if they are picked by the university. The data give some hope that these types of advisors with the necessary expertise could be trusted.

The proximity between the university (plan sponsor) and the advisory source presents a challenging tradeoff. Too much proximity suggests that the goals of the employer may be the goals of the advisor. Too little proximity suggests that the advisor may not have the institutional knowledge needed for the engagement. In the college faculty context, this would include knowledge of early-retirement programs, benefit continuations, ability to retain an office, emeritus status, different college norms and policies within the broader university, etc. While these are all “faculty” context issues, a similar number of institutional and social issues would likely surround advising most potential retirees outside the higher education sector as well.

What types of advisors are close enough, but not too close? Consider retirement plan vendor representatives. In the state-level plan where I serve, a dramatic consolidation in the number of vendors occurred when the sponsor responded to regulations placing more emphasis on sponsor fiduciary duties. As part of this effort, some sponsors have also attempted to curtail advisory relationships outside of those with the remaining vendors. More proximity thus exists between vendors and the plan sponsor than before. But do participants perceive greater proximity as a positive or negative?

An advantage that some vendor advisors have is a long track record independent of the plan sponsor or they may have advisory operations that function independently of the vendor personnel who interact with sponsors directly. Human Resource office coordination of meetings between vendor advisors and participants appears to be one viable alternative in addressing the advisory need. Table 2 shows that participants have some interest in relying on outside advisors that the university “hires.” This category could also mean advisors hired by the university who are not associated with an investment vendor. Indeed, the case study described by Ciccotello, Pollock, and Yakoboski (2011) involved the use of a life planning coach as part of a faculty retirement program.

The challenge for outside advisors who are not “hired” by the employer is to gain the familiarity needed regarding the social, institutional and emotional factors associated with the retirement decision. Competent advisors should be able to manage the financial and technical aspects of the decision in order to provide a customized plan, but Table 1 shows that the technical aspects are only part of the challenge. The results of the survey reinforce the importance of focus in advisory clientele. A history of working with retired faculty could give “outside” advisors the exposure to the factors that matter. Also, previous experience interfacing with a large bureaucratic entity (such as a university) is valuable. Not all faculty members are the same, for certain. But the scale economies achieved working with a group of faculty may help outside advisors bridge the information gap.

SUMMARY THOUGHTS

For the University

Despite the sample participants' disdain for advice from those in the university chain of command, these individuals are the ones who often know the faculty or staff member's day-to-day professional life the best. The university program described in Ciccotello, Pollock and Yakoboski (2011) is a good example. There, the early retirement program was not one-size-fits-all policy, but carefully targeted based on performance. The challenge will be to couple detailed job performance assessment with independent financial advice. So the "early" retirement decision must also involve an analysis of the retirement funding decision. In the case above, the university's addition of an independent advisory source as to both the life and financial planning aspects was a sound strategic choice.

For the Faculty Participant Considering Retirement

The survey results have a bright side and a dark side. A number of faculty over age 60 love what they do, and remain good at it. But, a large number of these faculty members also have poor insight into their financial situation. This is sad, given the analytical nature and high level of intelligence of faculty generally. The problem may be more behavioral than technical. Advice is a two-way street. Faculty are often skeptical and do not trust easily. Extreme skepticism serves academic pursuits quite well. However, failing to seek independent advice because skepticism leads one to believe that it cannot be found is a cop-out that will eventually disserve.

For the Investment Vendor in the University Retirement Plan:

Vendors have the strategic advantage of being close to the participant, but the downside of being affiliated with the sponsor university. Having an independent advisory unit partner with the investment product unit provides an opportunity to take advantage of higher levels of institutional (and participant) information while mitigating perceived conflicts of interest. The conflicts may relate to motives of the sponsor university (they want me out of here) as well as to the investment product personnel (they want to sell me what makes them more money).

Despite the challenges, retirement plan investment vendors are in an increasingly strong position. As discussed above, the consolidation in the number of investment vendors in university retirement plans can be dramatic. The remaining vendors act as "gatekeepers" to the funds of other families, as sponsors discuss whether and where to include these funds within the open architecture of the plan. Thus, power is shifting to the remaining vendors in a fashion similar to the evolution in mutual fund "supermarkets" (see Ciccotello, Greene, and Walsh, 2007 for a more complete discussion).

Despite the advantage the investment vendors possess, the key will be to recognize that financial (or life) planning and investment management are two different endeavors. The vendor must devise an efficient way to capitalize on the information advantages across the planning and investing boundaries.

For the Outside Advisor:

The outsider has the advantage of clear independence from the university regarding the retirement decision and funding thereof. Their disadvantage is information based, namely the distance from the array of institutional details that surround the decision. The disadvantage is not insurmountable. Some advisors focus on retirees from specific companies (an example in Atlanta is Coke) and know the details surrounding employee retirement and benefit plans in extreme detail. Advisors who serve a clientele of faculty and staff retirees from a local university are similarly positioned. Referrals from prior retirees are a powerful tool for building business.

CONCLUSION

Nudging workers into plan enrollment and target date investment funds is reasonable during the accumulation stage, but a “one-size-fits-all” answer for near-retirees regarding retirement and decumulation may be a nudge too far. Data from a survey of 700 faculty members age 60 and over reveals that a large portion of the respondents are reluctant to retire, meaning that they foresee working beyond the normal retirement age of 65 or 66. Reluctance is a combination of financial, institutional, social and behavioral factors. Not having enough money to retiree (or believing that to be the case) is important, but so are other factors related to personal fulfillment. Over half the reluctant retirees have not received any professional financial planning advice regarding when they can afford to retire, and only a very small percentage has received any life planning (or coaching) services. Reluctant retirees are wary of advice sources linked too closely to their employer, but advisors too distant may also have problems.

Universities face a growingly competitive landscape, with the rise of for-profit entities and the emergence of low-cost delivery models. A number of universities have a large overhang of senior faculty, kept in place by fear following the 2008-2009 crash in the financial markets, as well as by the dearth of hiring in its aftermath. As financial markets recover, some in this senior faculty cohort may reconsider whether to continue working. However, there is a shortage of advice on both the technical and behavioral aspects of the transition.

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