# The Risk of Growing Old

## Protection against losses is more important during retirement

**ALLIANZ** recently published "Behavioral Finance and the Post-Retirement Crisis," a series of articles on retirement issues based on interviews with behavioral finance professors. It was submitted to the Departments of Treasury and Labor as a response to the Request for Information Regarding Lifetime Income Options and was developed by Shlomo Benartzi, a Professor at UCLA and a well-known behavioral finance expert. Among that series was an article featuring David Laibson, a Professor at Harvard University, entitled "Cognitive Impairment: Precipitous Declines in Cognition Can Set the Stage for Poor Decisions about Retirement Finances." Before the title causes you to stop reading, let me give you a quote that is powerful and compelling:

"After age 60, the prevalence of dementia roughly doubles every five years. By the time people reach their 80s, more than half will suffer from either dementia or other significant cognitive deficits."

Obviously, that is a problem, but why is it a concern for 401(k) plan sponsors? Before answering that question, I should point out that there is not a legal requirement for plan sponsors to protect former participants. However, for plan sponsors who want favorable outcomes for their employees, it is a real concern.

The issue is that retirees with "significant cognitive deficits" will have problems making sound financial decisions. They may make investment mistakes that cause losses in their rollover IRAs and that will reduce their retirement incomes and standards of living. Or, even worse, unscrupulous advisers might take advantage of those retirees by selling them investments that have undisclosed and excessive commissions. That is more easily done when decisionmaking abilities and the grasp of financial concepts are diminished.

Laibson's research also showed marked declines in "numeracy," which he defines as "the mathematical skills needed to cope with everyday life and to understand information in graphs, charts, or tables."

What can plan sponsors do about this? First and foremost, they can work with their advisers and providers to educate their older participants. Second, they can add investments and guaranteed features to their distribution lineups. For example, if a retired participant selected an annuity or other guaranteed feature and became comfortable with the automatic monthly income, he may be less likely to make imprudent investment changes or to be taken advantage of. While that is not assured, it may improve the odds of a better outcome.

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Historically, the 401(k) community has focused on the upside of stock market gains. However, based on my reading about withdrawals in retirement, it appears that protection against losses is more important during retirement than it is during accumulation. As a result, more should be done to distinguish between the accumulation stage and the withdrawal, or decumulation, stage, and to educate participants about those differences. Certain investments and products are appropriate for one stage, but may not be appropriate (or may not be appropriate in the same proportions) for the other. We need to have more analysis and understanding of the distribution period, including the impact of human frailties.

The benefit of having those choices inside a retirement plan is that the participants will receive institutional pricing and unbiased information, while the disadvantage of purchasing those products outside of a retirement plan is that they will pay retail costs—or even worse.

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