

TRANSFERRING CONTROL OF FINANCES: TIMING POSES A RISK

BY JOHN AMERIKS, ANDREW CAPLIN, MINJOON LEE, MATTHEW D. SHAPIRO, AND
CHRISTOPHER TONETTI*

Introduction

As older Americans approach the end of their lives, many have to make major financial decisions, including estate planning and long-term care arrangements. Unfortunately, with age comes the risk of cognitive decline, which may affect the quality of such decisions as well as making people easier targets for financial scams.

One way to help individuals protect their finances against mistakes is to involve a third party (an “agent”), commonly a family member, to take over financial decisions. But several conditions need to be met to make it work. First, the agent must be capable of making good decisions on behalf of the individual and be trustworthy. Second, the agent must be available when needed. Lastly, the transfer of control must be made at the right time, in particular before the aging individual makes irreversible mistakes.

This *brief*, which summarizes a recent study of the authors published by the American Economic Association, assesses the perceptions of individuals ages 55+ about the roles and limits of an agent in addressing cognitive decline, based on a sample of retail investors at the Vanguard Group.¹

The discussion proceeds as follows. The first section provides background on the prevalence of cognitive decline and related financial mistakes; and it describes the survey and the sample. The remaining sections summarize the results of the survey. The second section reports that most respondents are confident that they have a suitable agent in mind. The third section explains, though, that respondents anticipate a significant chance that they might transfer control too late, primarily due to a failure to quickly detect their own cognitive decline. The fourth section

* John Ameriks is Principal, Head of Quantitative Equity Group with The Vanguard Group Inc. Andrew Caplin is a Silver Professor of economics at New York University. Minjoon Lee is an associate professor of economics at Carleton University. Matthew Shapiro is Lawrence R. Klein Collegiate Professor of Economics at the University of Michigan. Christopher Tonetti is an associate professor of economics at the Stanford Graduate School of Business. The research summarized here uses data from the Vanguard Research Initiative (VRI) that was developed under the NIA program project P01-AG026571. The Vanguard Group Inc. supported the data collection of the VRI. Vanguard’s Client Insight Group and IPSOS SA were responsible for implementing the VRI survey and provided substantial input into its design. The design of the VRI benefited from the collaboration and assistance of Annette Bonner, Wandi Bruine de Bruin, Sophia Bunyaraksh, Alycia Chin, Brooke Helppie-McFall, Mi Luo, Anna Madamba, Derek Neidhardt, Wendy O’Connell, Ann Rodgers, Feiya Shao, and Fu Tan. For documentation of the VRI, including the survey instrument, see <http://ebp-projects.isr.umich.edu/VRI/>.

summarizes the consequences of delay – respondents think it could substantially damage their finances and well-being. The last section concludes that any measure that can help the timely detection of cognitive decline could protect against serious financial mistakes, thereby improving late-life financial security.

Background

Cognitive decline is a significant risk for older Americans. About 23 percent of all individuals 65+ have a mild cognitive impairment; and an additional 11 percent have dementia. These rates, of course, grow as individuals age.²

Increasing evidence suggests that cognitive decline is related to financial mistakes.³ When cognitive decline is unnoticed, the affected individual may continue making financial decisions, increasing the chance of suboptimal decisions and financial losses.⁴ Cognitive decline also makes older individuals more vulnerable to financial exploitation and fraud.⁵ Thus, people need a timely transfer of control over their finances to a trusted agent to mitigate the adverse impacts of cognitive decline.

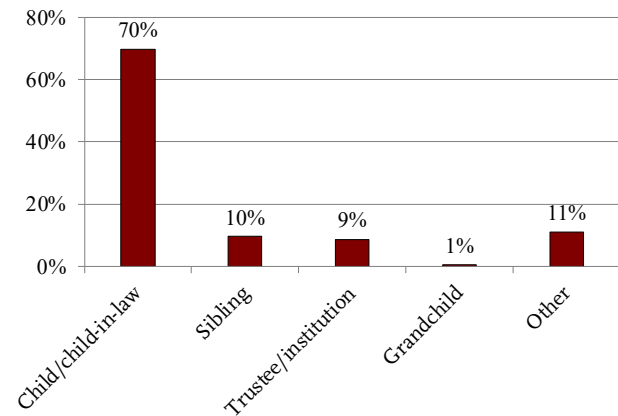
To determine whether people are well situated, we conducted a survey of participants in the Vanguard Research Initiative (VRI), a panel of account holders at the Vanguard Group, Inc. The sample comprises individuals ages 55+ with at least \$10,000 in their Vanguard accounts and internet access to complete online surveys. Comparisons with nationally representative samples of older individuals, such as the *Health and Retirement Study*, show that the VRI has good coverage of the above-median range of the U.S. net worth distribution. This survey on cognitive decline was conducted in July 2020 and included 2,489 respondents.

Do People Have a Capable Agent?

The survey begins by asking who will be the most likely person to make financial decisions on behalf of the respondent in case of severe cognitive decline (the “likely agent”). Respondents are asked to assume that they outlive a spouse or partner and, therefore, cannot have them as their agent. The vast majority of respondents (70 percent) report that the likely agent will

be one of their children, while 10 percent say a sibling and another 9 percent select a trustee or institution (see Figure 1).

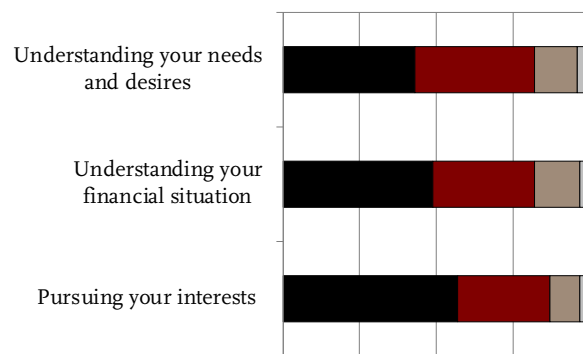
FIGURE 1. RESPONDENTS’ MOST LIKELY AGENT



Source: Authors’ calculations from the Vanguard Retirement Initiative (VRI) survey 7.

The respondents are overall very confident with the quality of their likely agent. The vast majority think the agent will be excellent or very good at understanding their needs and desires and their financial situation, and in pursuing the respondent’s interest (see Figure 2). The respondents are also very confident that the agent will be available to help when needed – they believe, on average, there is a 76-percent chance of this outcome.

FIGURE 2. RESPONDENTS’ VIEWS ON QUALITY OF THE LIKELY AGENT



Source: Authors’ calculations from the VRI survey 7.

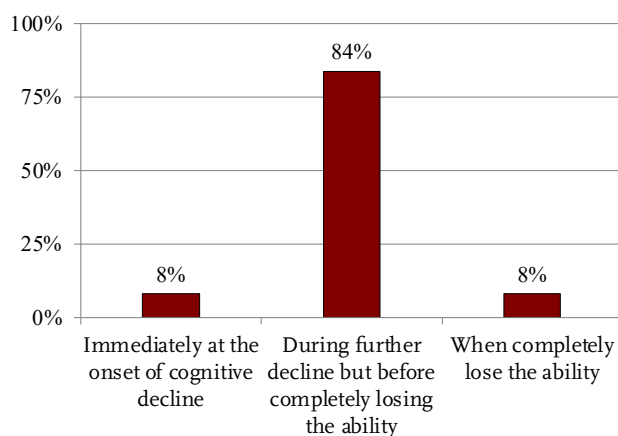
Will the Transfer Be Timely?

The results so far reveal that the respondents have an agent in mind who is capable and available. Still, for an agent to capably protect a person’s finances from the effects of cognitive decline, the transfer of financial control should occur before people make irreversible mistakes. Many factors make it challenging to transfer control at the right time, including the elusiveness of cognitive decline.

The survey specifies a hypothetical situation to investigate the transfer timing issue. In this situation, the respondents are entering the last five years of their life and have mild cognitive decline. The progression of decline over their remaining years is left uncertain. The respondents must continue to decide how to handle their money if they are still in control and when to transfer control to the likely agent.

The survey then asks the optimal timing of the transfer of control. The respondents are asked to choose one of three options (see Figure 3). Very few respondents want to transfer control immediately at the onset of cognitive decline, even though it would reduce the chance of making financial mistakes, which suggests that the respondents value being their own agents when they feel they are still capable. Similarly, few opt for the other extreme of waiting until they completely lose the ability to manage their money. Instead, the vast majority – 84 percent – prefer a middle ground, where they risk some further decline but hope to avoid the worst.

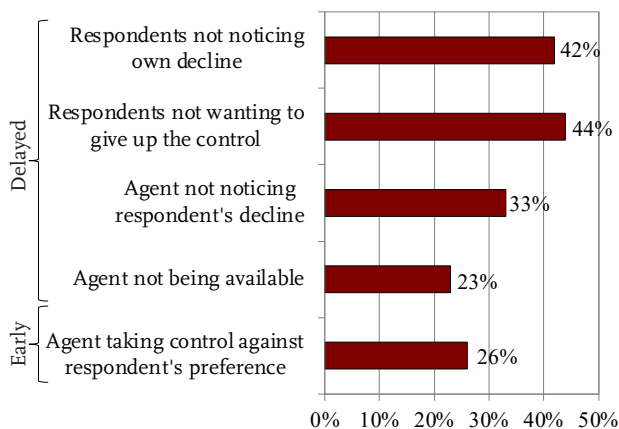
FIGURE 3. RESPONDENT’S VIEWS ON THE OPTIMAL TIMING FOR TRANSFERRING CONTROL OF FINANCES



Source: Authors’ calculations from the VRI survey 7.

Strikingly, respondents think the chances of missing the optimal timing are significant. When asked about the subjective probability of having the transfer at the wrong time, the average respondent thinks there is a 35-percent chance of the transfer occurring too late and a 24-percent chance of it occurring too early. What could be the reasons for the transfer at the wrong time? Figure 4 shows that, regarding a delayed transfer, the respondents are concerned that they will not be able to notice their own decline – more than a 40-percent chance on average. They are also worried that, even though they currently believe that they should transfer control as cognitive decline progresses, they might change their mind and refuse to give up control (with the average subjective probability of 44 percent). On the flip side, as a cause for a premature transfer, the average respondent thinks some chance exists (26 percent) that the agent would take control too early against the respondents’ preferences.

FIGURE 4. RESPONDENTS’ ESTIMATES OF THE CAUSES OF TRANSFERRING CONTROL AT THE WRONG TIME



Source: Authors’ calculations from the VRI survey 7.

How Harmful is Bad Timing?

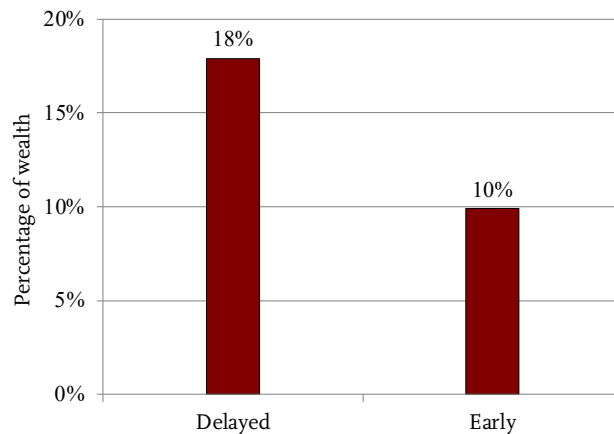
To measure the expected welfare cost of making a transfer at the wrong time, the survey asks the respondents to consider two scenarios:

- Scenario 1: The transfer happens at the optimal timing.
- Scenario 2: The transfer happens at the wrong time (either too late or too early, depending on which one the respondent is more concerned about).

The respondents are obviously better off in Scenario 1. Then the survey asks what level of additional wealth under Scenario 2 would make them feel just as well off as in Scenario 1. If the respondents believe that transferring control at the wrong time would have more negative impacts, they would demand more wealth under Scenario 2 to compensate.

The respondents believe that a transfer at the wrong time is likely to be very costly. For a delayed transfer, the average respondent believes the damage would equal 18 percent of their wealth (see Figure 5). The average cost of a transfer that is too early is smaller, but still significant at 10 percent.

FIGURE 5. RESPONDENTS' ESTIMATES OF THE AVERAGE COSTS OF TRANSFERRING CONTROL AT THE WRONG TIME



Source: Authors' calculations from the Vanguard Retirement Initiative (VRI) survey 7.

Conclusion

Older individuals with some retirement assets think they have a dependable agent they can rely on when they experience cognitive decline. Still, they perceive a significant chance of missing the optimal timing to transfer control over finances to the agent. Having a significantly delayed transfer compared to the optimal timing is particularly concerning. The survey respondents' desire to keep control while still capable exposes them to the risk of a delayed transfer. A delayed transfer may happen for many reasons, including the elusiveness of cognitive decline. If a delay were to occur, the survey respondents expect it to cause significant damage to their financial well-being. These results suggest that any measures that can help secure the optimal timing of the transfer of control – e.g., regular monitoring of cognitive abilities – can go a long way to protecting older Americans' financial well-being.

Endnotes

- 1 Ameriks et al. (2023).
- 2 Manly et al. (2022).
- 3 For example, see Laibson et al. (2009) and Korniotis and Kumar (2011).
- 4 Mazzonna and Peracchi (2020).
- 5 For example, see Choi, Kulick, and Mayer (2008), Gamble et al. (2014), and DeLiema et al. (2020).

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Contact Information

Center for Retirement Research
Boston College
Haley House
140 Commonwealth Avenue
Chestnut Hill, MA 02467-3808
Phone: (617) 552-1762
Fax: (617) 552-0191
E-mail: crr@bc.edu
Website: <https://crr.bc.edu/>

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