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What the Health and Retirement Study Tells Us About Cognitive Ability, Financial Literacy, and the Demand for Financial Advice at Older Ages

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Executive summary

Prior research has not revealed to date whether cognitive ability is positively or negatively associated with seeking financial advice at older ages. That is, if older investors recognized that their ability to manage financial assets was diminished, they would rationally delegate managing their finances to others. But if they mistakenly believed that their acumen remains intact at older ages, they would continue managing their assets, rather than seeking help from financial advisors.

Our research examines a purpose-built module we fielded in the nationally representative survey known as the Health and Retirement Study (HRS) on respondents over the age of 50. We show that cognitive ability and financial literacy as measured in the HRS often are associated with financial behaviors when other controls are not held constant, but the statistical associations are often attenuated when age, education, race/ethnicity, and other factors are controlled. Focusing only on significant factors, we show that people scoring higher on the cognitive questions by one standard deviation are 52% more likely to avoid advice due to self-confidence, but also 50% less likely to know whom to ask for help, with other factors controlled. Financial literacy generally is significantly associated with a broad set of behaviors related to investment and seeking financial advice: someone who is a standard deviation more financially literate is 13% more likely to spend time managing his finances; 10% more likely to get help with money

This is based on our longer study by Kim/Mitchell/Maurer entitled Cognitive Ability and the Demand for Financial Advice at Older Ages: Findings from the Health and Retirement Survey." Kim: The Darla Moore School of Business, University of South Carolina: 1014 Greene St., Columbia, SC 29208, USA; hugh.kim@moore.sc.edu. Maurer: The Goethe University Frankfurt. Theodor-W.-Adorno-Platz 3, 60323 Frankfurt am Main, Germany; maurer@finance.uni-frankfurt.de. Mitchell: The Wharton School, University of Pennsylvania. 3620 Locust Walk, Philadelphia, PA 19104; mitchelo@wharton.upenn.edu. The authors thank Yong Yu for excellent programming and research assistance. This project was sponsored by the TIAA Institute and the Pension Research Council/Boettner Center at the Wharton School of the University of Pennsylvania. Opinions and conclusions expressed herein are solely those of the authors and do not represent the opinions or policy of the funders or any other institutions with which the authors are affiliated.

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BUILT TO PERFORM.
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management; 29% less likely to avoid asking for help due to self-confidence; and 21% less likely not to know whom to ask for help. We also show that neither Cognitive nor FinLit scores are significantly associated with money management behaviors, including the number of self-management activities people undertook, or with reasons for why they did not self-manage their money.

Finally, the financially savvier and more cognitively able individuals are not more likely to access financial advice regarding a variety of financial tasks, obtain free help, or follow the advice when given. The reader is cautioned, however, that sample sizes are sufficiently small that these conclusions are as yet tentative, and our future research will extend the analysis to larger samples as the data become available.

Introduction

Little research offers insight as to how cognitive ability and financial literacy influence older persons' money management behavior. In fact, the effects could be theoretically ambiguous: if older investors recognized that their ability to manage financial assets was diminished, they could rationally delegate managing their finances to others. But if they mistakenly believed that their acumen remained intact at older ages, they would continue managing their assets, rather than seek help from financial advisors.

Our research study examines a purpose-built module we fielded in the nationally representative survey known as the Health and Retirement Study (HRS) on respondents over the age of 50. To date we have data on about 1,180 age-eligible people who participated in the module. To this information we linked data on each respondent taken from the core HRS; these variables included financial literacy, education, wealth, age, race/ethnicity, and marital status. The core HRS also provides a measure of cognitive ability that is widely used in the literature, defined as the sum of the respondent's total word recall and mental status indices, evaluated in 2016.

Descriptive findings

As a first finding, we show that the average Cognition score in this older population is 23.93 with a standard deviation of 4.23. Financial literacy (FinLit) is measured as the sum of correct answers on four financial literacy questions based on those developed by Lusardi and Mitchell (2014). In this population, the average score is 2.1 (with a standard deviation of 0.91). The Cognition and FinLit score are positively related.

The HRS module on older people's financial behaviors asked questions which we gather into three groupings. The first set of questions asked people whether they **received any type of financial advice**, and if not, why not. The second set asked whether people **self-manage their money**. That is, respondents were asked whether they engaged in financial activities in the last year, if they engaged in sophisticated investment decisions (e.g., investments and withdrawals), and if they did not engage in any self-management, why they did not. The third set of questions asked respondents to identify **the types of financial advice they received** when managing their money, and whether they paid for professional help.

Naturally, sample sizes for each question can differ depending on whether respondents met the right conditions given precursor questions. For instance, in the full sample of respondents, we find that half indicated that they did devote time to managing their finances in the last year, and one third (34%) sought advice on money management. Of those who did get financial advice, half received advice on investments, and on average people received this help within the past year. Focusing on the respondents who did not receive financial advice, 4% believed they were confident enough to manage the money on their own; 3% indicated they did not trust advisors, and 3% indicated they did not know whom to ask.

We also show that, on average, older people undertook about 1.45 activities in doing their own money management, and 41% engaged in activities more sophisticated than simply managing their checking

accounts. Only 7% of those who did not self-manage their own finances indicated that inertia was a reason for not asking for advice.

When we turn to those who did receive financial advice and what types of help they received, we find that a large majority (71%) of those who received financial advice got it from a professional advisor. Over three-quarters (76%) received help from a professional or other nonfamily member. A sizeable fraction, 14%, received free professional advice with potential conflicts of interests. Of those receiving advice, the average number of advisors was one, who provided help with an average number of 1.58 different types of financial tasks. Interestingly, of those who received this advice, people reported that they mostly did act on the advice given.

Multivariate results

We then show that cognitive ability and financial literacy as measured in the HRS are often associated with financial behaviors when other controls are not held constant, but the statistical associations attenuate when age, education, race/ethnicity, and other factors are controlled. Focusing only on significant factors, we show that people scoring higher on the cognitive questions by one standard deviation are 52% more likely to avoid advice due to self-confidence, but also 50% less likely to know whom to ask for help, with other factors controlled. Financial literacy generally is significantly associated with a broad set of behaviors related to investment and seeking financial advice: someone who is a standard deviation more financially literate is 13% more likely to spend time managing his finances; 10% more likely to get help with money management; 29% less likely to avoid asking for help due to self-confidence; and 21% less likely not to know whom to ask for help. We also show that neither Cognitive nor FinLit scores are significantly associated with money management behaviors, including the number of self-management activities people undertook, or with reasons for why they did not self-manage their money. Finally, the financially savvier and more cognitively able individuals are no better able to access financial advice, advice regarding a variety of financial tasks, free help, or follow the advice when given. The reader is cautioned, however, that sample sizes are sufficiently small that these conclusions are as yet tentative.

Conclusions

In sum, we have found that cognitive ability as well as financial literacy can help shape older persons' money management behaviors, though financial literacy appears to be related to a broader set of observed financial behaviors in our dataset. We also conclude that more cognitively able older persons are more likely to seek financial advice from professionals outside of family members; nevertheless, they are also more likely to be overconfident regarding their investments. The more financially literate tend to ask for help with money management and they are less likely to be overconfident.

In future research, we will revisit these themes with a larger sample of respondents to the HRS experimental module, and we will also investigate the possibility that Cognition and FinLit scores might be endogenously determined. We believe it extremely valuable to provide insight into who seeks financial advice when, as well as much-needed information on financial management practices among older households.

About the authors

Hugh H. Kim is an assistant professor of finance at the Darla Moore School of Business, the University of South Carolina. He received his Ph.D. from the Wharton School, the University of Pennsylvania in 2013. Kim's research interests include investment, asset pricing, investor behavior and financial institutions. His research has been published in leading finance and economics journals such as the *American Economic Review* and the *Journal of Financial Economics*. Before joining the University of South Carolina, he was an assistant professor of finance at the Sungkyunkwan University in Seoul, Korea and a visiting scholar to the Sloan School of Management at M.I.T.

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