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Nicole Brunhart

Individual Financial Planning for Retirement

Empirical Insights
from the Affluent Segment
in Germany

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This book is based on the dissertation 'Individual retirement-specific financial planning behavior – with special consideration of the affluent segment in Germany'. It was submitted to the University of St. Gallen, Graduate School of Business Administration, Economics, Law and Social Sciences (HSG) as dissertation no. 3328 and approved in September 2007 on the application of Prof. Dr. Andreas Grünbichler and Prof. Dr. Beat Bernet.

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To my beloved parents
Liz and Oskar Brunhart

Foreword

Individual long-term financial planning to ensure a secure financial situation in the old-age has gained substantial attention in the retirement discussion in industrialized countries. In the context of the shift of responsibility to the individual, the importance of personal retirement provision is not disputed. However, the questions often arise of whether the actual decisions and actions of individuals correspond to a theoretically ideal behavior and whether their attitudes and views mirror this new responsibility. To answer these questions, research needs to take a broader look at the topic of retirement provision and examine the perspectives and expectations individuals have for their pension-age financial situation as well as the actions they take in this respect.

This is the path taken by the author of this work. Its results are not only of high relevance for the individual but also for the whole society, which ultimately is responsible for old-age provision and will have to bear its political and sociological implications. Based on a better understanding of the individual perspectives and the congruence or divergence between actual and ideal behavior, this work highlights the key considerations policy-makers, financial planners and the individuals themselves should include in enabling, furthering and conducting retirement-specific financial planning.

The significant contribution of this research is that it deals with both theoretical and empirical aspects of individual retirement provision. In the theoretical dimension, it presents an innovative framework for grouping insights from behavioral finance, allowing the consequent evaluation of their relevance to the issue of individual retirement-specific financial planning. Emerging from a convincing combination of insights into modern capital market theory, behavioral psychology and behavioral finance, the derived normative principles set a benchmark for individual retirement-specific behavior. With over 500 personal interviews – conducted among the German affluent segment – the author complements and tests this theoretical basis with empirical research.

This novel approach empirically confirms and – to a large extent – even quantifies for the first time the generally presumed facts and typically human, irrational behaviors around individual retirement-specific financial

planning. Therefore, this work provides very valuable insights for a future discussion on increasing individual responsibilities for retirement provision, the problems associated with longevity, and the reforms of state pension systems.

This book is a must read for the financial planning community, policy makers and last but not least for all of us who sooner or later have to deal with this important issue.

St. Gallen, September 2007

Prof. Dr. Andreas Grünbichler

Prof. Dr. Beat Bernet

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I would like to thank my employer, McKinsey & Company, for giving me the opportunity to participate in the European “Retirement Initiative”. This work let me apply my academic retirement-specific behavioral finance knowledge in practice and allowed me to collect the raw data that served as the basis of this thesis. Also, I would like to thank McKinsey for supporting me in my educational leave while offering me the opportunity to work part-time.

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towards Renato Fasciati, Dr. Viola Markert and Prof. Dr. Thomas Berndt, who encouraged me along the way. I would also like to offer a big thank you to all my other friends who shared with me the “ups and downs” of my dissertation and on whom I could always count.

Finally, I am deeply indebted to the Truss and Gerrit Van Riemdijk trust in Liechtenstein for the financial contribution to publish this dissertation.

Zurich, September 2007

Nicole Brunhart

Abstract

Demographic shifts and behavioral changes are putting increasing pressure on today's public pension systems. A new reality is emerging, characterized by a high level of uncertainty and a shift of responsibility to the individual. In this context the question arises whether people are assuming this responsibility and adopting adequate financial planning behavior (FPB) to secure their financial situation in retirement.

The objective of this study is to investigate individual retirement-specific financial planning behavior of the German affluent segment. Specifically, this research aims for an improved understanding of individuals' expectations regarding their life and their financial situation in retirement (FP perspectives). Furthermore, it explores how people actually carry out financial planning for retirement (FP actions) and whether their behavior corresponds to recommended principles. The study investigates whether individuals show adequate retirement-specific financial planning behavior and in which areas their behavior demonstrates limitations. Based on these findings, suggestions to improve individual retirement-specific financial planning behavior are derived for policy-makers, financial planners and the individual.

This study centers on questions of personal finance, taking into consideration elements from behavioral finance, modern portfolio theory and other research. The empirical validation is based on standardized interviews with over 500 German affluent individuals, aged 45 to 70 years. The interviewees were grouped into different investor types, based on similar fundamental characteristics implying comparable financial situations and challenges in retirement.

The results of the study indicate that the German affluent segment is meeting only some of today's retirement challenges (e.g., they are prepared for compromises on the expense side, understand diversification benefits, and show high risk awareness). However, there are serious limitations that need to be addressed, such as a blurred perception of reality, unrealistic financial planning, belated start of financial planning, a lack of risk mitigation and sub-optimal portfolio choices. Differences occur between investor types: While wealthy and self-employed individuals show an active and more appropriate FPB, investor types with specific risks

(e.g., poor health, limited education) need content-related and motivational support. To improve individual FPB, policy-makers need to provide the appropriate background (e.g., a financial planning standard, mandatory retirement seminars) and the right incentives (e.g., financial planning support decreasing over time, confrontation with pension eligibility). Financial planners need to make limitations visible and illustrate possible solutions by incorporating typical human behaviors in the advisory process and supporting individuals in risk and asset management. However, it is the individual who needs to assume his responsibility and change his behavior by improving his knowledge, conducting conscious financial planning and adapting his vision of retirement flexibly to the respective needs.

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