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Nicole Brunhart

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in Germany

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Series Editors

Werner A. Müller

Martina Bihn

Author

Dr. Nicole Brunhart

Kesslerstrasse 12

8702 Zollikon

Switzerland

Nicole.Brunhart@alumni.unisg.ch

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.

The person who deserves my deepest gratitude for his unconditional support and commitment is my future husband, Dr. Beat Bachmann. Our extensive discussions have proven to be very fruitful to this dissertation and have substantially shaped and advanced it. Apart from sacrificing a lot of our joint time to this effort, Beat supported me with love and comprehension and also kept an eye on my discipline when the going got tough.

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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.

Table of contents

1 Introduction.....	1
1.1 Motivation and background of the study	1
1.2 Review of existing research.....	5
1.3 Knowledge aim and research questions.....	6
1.4 Research objectives and structure of the thesis	8
1.5 Demarcation and contribution	11
2 Frame of reference and conceptual approach for the analysis of individual retirement-specific financial planning behavior	13
2.1 The individual financial optimization problem	13
2.2 FP perspectives and FP actions: the components of individual FPB.....	25
2.3 Conceptual approach for the analysis of individual retirement-specific FPB	35
2.4 Summary of the frame of reference and the conceptual approach..	42
3 Fundamentals of the retirement system in Germany	43
3.1 Demographic developments in Germany	44
3.2 The German pension system.....	51
3.3 Summary of the fundamentals of the retirement system in Germany	73
4 Retirement-specific behavioral finance and derivation of benchmark behavior for FP actions	75
4.1 Relevance of behavioral finance to the study of individual retirement-specific FPB.....	76
4.2 The standard economic theory of decision-making and its adaptation to behavioral finance.....	78
4.3 Behavioral finance adaptations of additional FPB relevant theories	114
4.4 Postulated benchmark behavior for individual FP actions	117
4.5 Summary of retirement-specific behavioral finance and the derivation of benchmark behavior for FP actions	134

5 Investor retirement survey and outlook on empirical analyses about individual retirement-specific FPB	137
5.1 Operationalization of research-specific FP perspectives and FP actions.....	138
5.2 Investor retirement survey as chosen observation instrument	150
5.3 Identification of different investor groups with a particular capability for risk.....	161
5.4 Structure of the empirical analyses for the examination of the conceptual approach	175
5.5 Summary of introduction to investor retirement survey and empirical analyses	176
6 Empirical analyses of individual retirement-specific FPB.....	179
6.1 Pooling of investor groups and characterization of the newly defined homogenous investor types	179
6.2 Analysis of investor type specific FP perspectives.....	199
6.3 Analysis of investor type specific FP actions and comparison to benchmark behavior	250
6.4 Scenario analyses for adequate saving rates.....	277
6.5 Summary of the empirical analyses of individual retirement-specific FPB.....	302
7 Review of empirical research and identification of suggestions for policy-makers, financial planners and the individual.....	305
7.1 Review of identified FP perspectives	306
7.2 Review of gaps identified in individual retirement-specific FP actions.....	311
7.3 Summary of individual retirement-specific FPB profiles for the five investor types.....	313
7.4 Suggestions for policy-makers, financial planners and the individual.....	322
7.5 Summary of the review of empirical research and identification of suggestions for policy-makers, financial planners and the individual.....	354
8 Conclusion	357
8.1 Summary of results	358
8.2 Assessment and critique of this study.....	362
8.3 Further research questions	363

Detailed table of contents

Foreword	VII
Acknowledgements	IX
Abstract	XI
Table of contents	XIII
Detailed table of contents	XV
1 Introduction.....	1
1.1 Motivation and background of the study	1
1.2 Review of existing research.....	5
1.3 Knowledge aim and research questions.....	6
1.4 Research objectives and structure of the thesis	8
1.5 Demarcation and contribution	11
2 Frame of reference and conceptual approach for the analysis of individual retirement-specific financial planning behavior	13
2.1 The individual financial optimization problem	13
2.1.1 Life-cycle hypothesis as theoretical basis for the inter-temporal financial optimization problem	14
2.1.2 Financial flows and risks relevant to individual retirement-specific FPB	19
2.1.3 Model for the individual inter-temporal financial optimization problem	22
2.2 FP perspectives and FP actions: the components of individual FPB	25
2.2.1 General perspectives on financial planning.....	25
2.2.2 Individual retirement-specific FPB and its two components as research focus.....	27
2.2.3 FP perspectives: the first component of individual retirement-specific FPB.....	30

2.2.4 FP actions: the second component of individual retirement-specific FPB	34
2.3 Conceptual approach for the analysis of individual retirement-specific FPB	35
2.4 Summary of the frame of reference and the conceptual approach..	42
3 Fundamentals of the retirement system in Germany	43
3.1 Demographic developments in Germany	44
3.2 The German pension system.....	51
3.2.1 Overall set-up	52
3.2.1.1 The first pillar: Compulsory state pension, also called statutory state pension (SSP)	55
3.2.1.2 The second pillar: Occupational pension scheme (OPS)	59
3.2.1.3 The third pillar: Voluntary personal pensions (VPP) ..	61
3.2.2 Status of pension reforms	62
3.2.3 The German statutory state pension benefit formula.....	67
3.3 Summary of the fundamentals of the retirement system in Germany	73
4 Retirement-specific behavioral finance and derivation of benchmark behavior for FP actions.....	75
4.1 Relevance of behavioral finance to the study of individual retirement-specific FPB.....	76
4.2 The standard economic theory of decision-making and its adaptation to behavioral finance.....	78
4.2.1 Standard economic theory of decision-making	78
4.2.2 Step 1: “Normal” perception of reality	80
4.2.2.1 Faulty probability assessments based on prominent past information	81
4.2.2.2 Positive bias	84
4.2.3 Step 2: “Normal” decision making.....	87
4.2.3.1 Prospect theory	87
4.2.3.2 Limited cognitive abilities.....	92
4.2.3.3 Portfolio segregation	102
4.2.3.4 Complexity aversion	105
4.2.4 Step 3: “Normal” implementation of actions	107
4.2.4.1 Passivity	107
4.2.4.2 Lack of self-control.....	110
4.2.4.3 Home bias.....	112
4.2.4.4 Regret	113

4.3 Behavioral finance adaptations of additional FPB relevant theories	114
4.3.1 Behavioral finance adaptation of the life-cycle hypothesis	114
4.3.2 Behavioral finance adaptation of the modern portfolio theory.....	116
4.4 Postulated benchmark behavior for individual FP actions	117
4.4.1 Benchmark behavior: Start of financial planning activities	119
4.4.2 Benchmark behavior: Overall understanding of the individual financial situation in retirement	121
4.4.3 Benchmark behavior: Holding of classical pension savings products	124
4.4.4 Benchmark behavior: Diversification.....	127
4.4.5 Benchmark behavior: Risk-return profile of the personal asset portfolio	130
4.4.6 Benchmark behavior: Risk mitigation.....	132
4.5 Summary of retirement-specific behavioral finance and the derivation of benchmark behavior for FP actions	134

5 Investor retirement survey and outlook on empirical analyses about individual retirement-specific FPB	137
5.1 Operationalization of research-specific FP perspectives and FP actions.....	138
5.1.1 Operationalization and measurement specifications of socio-demographic and socio-economic attributes	138
5.1.2 Operationalization and measurement specifications of FP perspectives.....	141
5.1.3 Operationalization and measurement specifications of FP actions	147
5.2 Investor retirement survey as chosen observation instrument	150
5.2.1 Choice of the target group	151
5.2.2 Introduction of the observation instrument.....	155
5.2.3 Structure, content and formal characteristics of the questionnaire	157
5.2.4 Realization of the investor retirement survey.....	160
5.3 Identification of different investor groups with a particular capability for risk.....	161
5.3.1 Introduction of investor groups with a lower than average risk capability	164
5.3.2 Introduction of investor groups with a higher than average risk capability	169
5.3.3 Assignment of individual interviewees to different investor groups	172

5.4 Structure of the empirical analyses for the examination of the conceptual approach	175
5.5 Summary of introduction to investor retirement survey and empirical analyses	176
6 Empirical analyses of individual retirement-specific FPB.....	179
6.1 Pooling of investor groups and characterization of the newly defined homogenous investor types	179
6.1.1 Suggested pooling of investor groups with a lower than average risk capability.....	181
6.1.2 Suggested pooling of investor groups with a higher than average risk capability.....	187
6.1.3 Characterization of the resulting five investor types	191
6.2 Analysis of investor type specific FP perspectives.....	199
6.2.1 Analysis of the planned life in retirement	200
6.2.1.1 Planned timing of retirement.....	200
6.2.1.2 Individual life plans.....	202
6.2.1.3 Individual coping strategies	205
6.2.1.4 Financial objectives in retirement	207
6.2.2 Analysis of the financial view on life in retirement	209
6.2.2.1 Analysis of the expense side (income needs) in retirement.....	210
6.2.2.2 Analysis of the income side in retirement	215
6.2.2.3 Analysis of the retirement gap based on individually estimated income and expense streams.....	221
6.2.2.4 Comparison of retirement gap with feeling of financial preparedness for retirement.....	224
6.2.3 Analysis of the transaction preferences	228
6.2.3.1 Preferences for information gathering and decision making	228
6.2.3.2 Decision preferences in the family context	230
6.2.4 Analysis of the risk profile	231
6.2.4.1 Analysis of self-assessed risk appetite	231
6.2.4.2 Analysis of risk sophistication	236
6.3 Analysis of investor type specific FP actions and comparison to benchmark behavior	250
6.3.1 Comparative analysis: Start of financial planning activities	250
6.3.2 Comparative analysis: Overall understanding of the individual financial situation in retirement	253
6.3.3 Comparative analysis: Holding of classical pension savings products	262

6.3.4 Comparative analysis: Diversification.....	264
6.3.5 Comparative analysis: Risk-return profile of the personal asset portfolio.....	267
6.3.6 Comparative analysis: Risk mitigation.....	273
6.4 Scenario analyses for adequate saving rates.....	277
6.4.1 Different conceptions of the retirement gap	280
6.4.2 Analytical derivation of the saving rates required to cover the wealth-adjusted statutory state retirement income gap..	284
6.4.3 Scenario analyses for implications of different assumptions on the required saving rate.....	290
6.4.4 Scenario analysis combining impact of different levers on the financial situation of the Limited-wealth Risk-groups ..	293
6.4.5 The longevity risk or the investigation of the duration of a secured retirement financing	295
6.4.6 Comparative analysis with stated saving rates	298
6.5 Summary of the empirical analyses of individual retirement- specific FPB	302

7 Review of empirical research and identification of suggestions

for policy-makers, financial planners and the individual.....305

7.1 Review of identified FP perspectives	306
7.1.1 Planned life in retirement	306
7.1.2 Financial view on life in retirement.....	308
7.1.3 Transaction preferences.....	309
7.1.4 Risk profile.....	309
7.2 Review of gaps identified in individual retirement-specific FP actions.....	311
7.3 Summary of individual retirement-specific FPB profiles for the five investor types.....	313
7.3.1 Key findings about the Retirees.....	313
7.3.2 Key findings about the Limited-wealth Risk-groups.....	315
7.3.3 Key findings about the Limited-wealth Self-employed.....	317
7.3.4 Key findings about the High-potential	318
7.3.5 Key findings about the Wealthy	319
7.3.6 Comparative positioning of all five investor types.....	320
7.4 Suggestions for policy-makers, financial planners and the individual.....	322
7.4.1 Key limitations in individual retirement-specific FPB.....	323
7.4.1.1 Limitation #1: Over-optimistic perception of one's own financial reality	323
7.4.1.2 Limitation #2: Unsophisticated planning of retirement cash-flows.....	324

7.4.1.3 Limitation #3: Late start of financial planning for retirement	326
7.4.1.4 Limitation #4: Low risk mitigation despite high risk awareness	326
7.4.1.5 Limitation #5: Sub-optimal portfolio choices	327
7.4.2 Guiding principles to enhance individual retirement- specific FPB	329
7.4.3 Suggestions for policy-makers seeking to improve individual FPB	334
7.4.4 Suggestions for financial planners seeking to improve individual FPB	343
7.4.5 Suggestions for the individual seeking to improve individual FPB	348
7.5 Summary of the review of empirical research and identification of suggestions for policy-makers, financial planners and the individual	354
8 Conclusion	357
8.1 Summary of results	358
8.1.1 Investor-type specific findings	358
8.1.2 Most substantial limitations	360
8.1.3 Improvement levers for policy-makers, financial planners and the individual	361
8.2 Assessment and critique of this study	362
8.3 Further research questions	363
Appendix.....	367
List of symbols.....	411
Abbreviations	413
Bibliography.....	415
Index	439