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# ACTUARIES NEED TO PAY ATTENTION TO BEHAVIORAL RESEARCH AND FINANCE

By Anna M. Rappaport and Jeremy Burke

**E**arly in 2012, the Society of Actuaries Committee on Post-Retirement Needs and Risks learned about the Rand Behavioral Finance Forum (BeFi). BeFi hosts an annual conference in Washington bringing together academics, policy makers, think tanks, the business community and others to discuss how behavioral finance helps us learn how people make decisions and improve the design of financial products and arrangements, and the communication linked to them. Anna is very proud to have moderated a panel on retirement issues in both the 2012 and the 2013 BeFi conferences. Don Fuerst, Senior Pension Fellow from the American Academy of Actuaries was the discussant in the retirement session at the 2013 conference. Both BeFi

and the actuaries who have been involved are hoping for further collaboration.

As an actuary, Anna says that she really likes attending these conferences because the presentations are almost all of interest to her, and many of them include information that is new to her (and probably many actuaries), and that attendees would not hear in most of the settings retirement experts and actuaries participate in. We have come to feel that all actuaries who are involved with arrangements for the security of individuals should take an interest in behavioral finance because it provides insights that they should consider in their work. However, for those who missed the conference, the good news is that it was videotaped, and the videos will be available on the [BeFi website](#). Prior conferences are available as well.

**Some perspective on BeFi:** The RAND Behavioral Finance (BeFi) Forum is a collective of academic, financial and government leaders fostering cutting edge behavioral research for practical application. Behavioral research deals with the science and study of how people make decisions, and with understanding how changing the way decisions are presented can impact choices. The [BeFi website](#) is one of a number of sources that offer a wealth of resources on this topic.

**Some perspective on the actuarial knowledge base:** Actuaries have drawn their knowledge and training from a variety of disciplines including specialized mathematics and risk analysis, law, investments, accounting, finance, business practice, etc. They have traditionally focused more on the business enterprises that produced financial products and offered employee benefits than on the individuals who were users of these programs. Individual decision making and behavioral finance are not part of the traditional knowledge base of actuaries.

We would like to share with you some comments about the 2013 conference.

Panels included a session on retirement, a session on communicating financial concepts, examples of how industry is putting behavioral finance to work, examples of how government is putting behavioral finance to work, a session on investments, and a session on short-term issues including debt and short-term savings.

Several of the papers were based on experiments. These experiments usually involve using a panel (often through the online survey system, the American Life Panel), and asking them a series of questions to see how they respond to alternative framing of a financial decision or product.

It was reinforced several times during the session that asking consumers to do complex financial calculations will not work for many of them. Many consumers do not have the math literacy or the will to do the calculations. So, you need to find a way to reach them that works. One example by Anya Samak from the University of Wisconsin was

to present decisions using short video clips that told a story based on people making a decision. She showed an approach to explaining investment diversification. In their research they tested a variety of ways of presenting the same ideas. Two more examples were presented by Doug Lebda of Lending Tree. He showed how Lending Tree makes it easy for people to shop for and manage mortgages online. We know that people have been very accustomed to shopping for airline tickets and hotels online. It seems to us that if you make it easy and available, there is a good chance to improve outcomes and potentially save a lot of money. He also talked about Tykoon, a system using social media techniques to help children manage their own money and in so doing, learn to manage money in a way that would help them for all of their lives. Tykoon is a financial services platform for families that empowers children to develop strong financial practices and values, and it is focused on children age 8 to 12. Children (and even adults) who are comfortable with Facebook would probably quickly adapt to Tykoon.

The ideas presented at the conference were a mix of ideas that are focused on the population at large, but particularly the middle class, and ideas that are more focused on those without much in the way of financial resources. It is particularly gratifying to see work focused on the middle class and on those without much financial resources. So often, when financial issues are discussed, the focus is on engaging those with more money.

Several of the presenters focused on helping people solve problems and on responding at the point in time when help is needed. Lee Lundy from Experian focused on a program they offer which helps people with poor credit scores improve them. He presented research suggesting that the program may work for those who participate in it. The Lending Tree program helps people get a

better result when they shop for mortgages. Jonathan Zinman focused on household debt, the size of the problem and the potential to help people. In Anna's experience, actuaries are very focused on risk management, but not very often on the problems of managing debt. Yet, debt is a huge problem for resource constrained households, and for many, managing that debt is the first step to being able to secure a good future.

Jonathan Zinman of Dartmouth provided an example of a typical household that might be able to save \$2,700 a year by managing its debt more effectively. He indicated that there is \$13 trillion in debt on household balance sheets. He provided examples of a number of opportunities to improve debt management including better shopping, using other vehicles, and wiser refinancing. He is involved in research on how to help people use debt more wisely. The advantage of such an approach, particularly if automated, would be that potentially millions of people could benefit from it. We encourage actuaries to watch the tape of his talk. Anna suggests that this is an area that is often neglected in our thinking. (One of the reasons that this seemed so important to Anna is that in prior focus groups on the middle market, financial advisors pointed out that an important place to start is cash flow and debt management. The report on these focus groups: [Approaching the Underserved Middle Market: Insights from Planners](#) will increase the reader's interest in debt management.)

A comment was made during the conference that products look different to buyers and sellers. This makes a lot of sense to us, and our response is that sellers need to do more to understand buyers. In the government panel, there was a discussion about using behavioral finance to help individuals who are in prison and owe child support. Many such individuals fail to get their support orders modified and leave prison owing substantial back payments, creating more prob-



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lems for them. The discussion focused on using a different approach to these prisoners to encourage them to get support orders modified with the hope that they would be better positioned to make a good start when they leave prison. While this discussion was very far away from anything most actuaries do, it brought home to Anna the idea that the potential applications of behavioral finance are everywhere, and that we should be aware of what it offers as we analyze problems so as not to forget about these opportunities.

PS: There will be another Behavioral Finance Forum in 2014, and you might want to watch to see when it is scheduled. It is an interesting day for all who participate. ■

#### About the authors:

*Jeremy Burke is an Associate Economist at RAND, Director of RAND's Behavioral Finance Forum, Associate Director of RAND's Center for Financial and Economic Decision Making, and a professor in the Pardee RAND Graduate School. His main fields of research are information and behavioral economics, with a particular focus on how people gather and use information to make economic and financial decisions. His recent research has examined the impact of financial literacy and social acceptance on the decision to strategically default on one's mortgage; whether financial literacy and financial decision-making can be improved by providing information sequentially rather than all at once; and how reliance on financial advice (particularly biased advice) is influenced by financial literacy. Currently, he is examining how individuals make investment decisions in defined contribution plans, developing and evaluating novel programs designed to improve financial capability amongst the economically vulnerable, and designing soft-commitment savings products to try to promote healthy savings behavior.*

*Anna Rappaport, FSA, MAAA is an actuary, consultant, author, and speaker, and is a nationally and internationally recognized expert on the impact of change on retirement systems and workforce issues. She is passionate about women's retirement security and about improving employment opportunities for older Americans. Anna is a past-President of the Society of Actuaries and chairs its Committee on Post-Retirement Needs and Risks. Anna served on the ERISA Advisory Council, and currently serves on the GAO Retirement Security Advisory Panel, the Women's Institute for a Secure Retirement Board, and the Advisory Board of the Pension Research Council. Anna will be a 50 year FSA in 2013, and has an MBA from the University of Chicago. Anna is an abstract painter and a member of the original seven artists participating in "[Artuaries](#)."*