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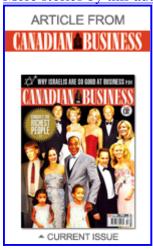
Financial planning

Investing: Are you getting too old to invest on your own?

A new study reveals that people's financial judgment starts to slide after the age of 53.

By Joe Castaldo **±**

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At nearly 104 years old, Irving Kahn is credited with being the oldest active investor on Wall Street. His firm, Kahn Bros. Group, returned an average of 10.9% per year between 1994 and 2008, according to *The Wall Street Journal*, outperforming the S&P 500. Clearly his age has not affected his financial judgment. But according to a new study, Kahn is the exception to an unnerving rule.

Economists from Harvard University, New York University, and the Federal Reserve Board have concluded that financial decision-making skills begin to decline in middle age. Or, to be more precise, at 53.3 years old — when we've developed a wealth of financial experience, and still have most of our faculties intact. It's what the economists dubbed the "age of reason" in a new study published for the academic journal *Brookings Papers on Economic Activity*. This presents a serious problem, given North America's rapidly aging population — enough of one, in fact, that the authors suggest a government licensing system be instituted to ensure older adults have a base level of financial understanding before they are permitted to invest.

"A lot of members of the older population are making these financial decisions on their own," and they're more likely to be bad ones, says Sumit Agarwal, senior financial economist with the Federal Reserve Bank of Chicago, and one of the authors of the study. Agarwal and three other economists looked at 10 financial decisions facing people ranging in age from 25 to 75, including transferring an account balance to a new credit card and borrowing through home-equity loans. In every case, those above middle-age made decisions that resulted in paying unnecessarily high fees. With home-equity lines of credit, for example, those older than 53 tended to incorrectly estimate the value of their residences and, as a result, took out loans with higher

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interest rates. In fact, the researchers found that 75-year-olds pay about US\$265 more each year on home-equity lines of credit than the middle-aged.

One way to ensure a better informed populace, Agarwal and his co-authors suggest, is to mandate a government-administered financial literacy test before, say, getting a mortgage or committing to a major investment. In the same way that some jurisdictions retest older drivers, people could be required to pass the test again after a certain age.

The researchers got the idea from economics professors Annamaria Lusardi of Dartmouth College and Alberto Alesina of Harvard. The pair first proposed financial licensing for everyone, not just the elderly, in a 2006 article in a Dartmouth alumni publication. They argue the concept is a logical extension of other government policies. We need a license to drive, for example. New immigrants are required to pass a test before they're granted citizenship. So why not a test to ensure we're equipped to deal with our finances?

But the professors' idea didn't fly. "We wrote an op-ed piece and sent it to *The New York Times*, but they didn't take it," Alesina recalls. The recent economic calamity, however, has highlighted the importance of financial education and, Agarwal believes, changed perceptions about the government's role in personal finance. "People will be more favourable toward paternalistic solutions," he says.

Financial licensing would not only help to prevent people from harming themselves, but also society at large. "Financial mistakes will potentially be dealt with by the taxpayer," Lusardi says. Consider the number of Americans who took out sub-prime mortgages, and the chaos triggered around the world when they could no longer make payments. "Nobody forced anybody to do anything," Alesina says, "but the investor needed to be more attentive," adding a licensing process could have at least equipped people with basic knowledge about mortgages.

Of course, many logistical questions need to be answered before licensing can be seriously proposed, such as how the test would be administered, at what cost, how effective it would be, and what happens to people who repeatedly fail. Agarwal also admits the idea of a licensing system targeting older adults could spark a political firestorm as well.

Nevertheless, Lusardi maintains financial licensing has promise for the young and old alike. It won't turn us all into investment sages like Kahn, but it could make us a little wiser. "Now that we've seen the tragedy of financial mistakes," she says, "this paternalism just looks like such a low cost to pay."

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