The Causes and Consequences of Financial Fraud Among Older Americans

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Prepared for the 16th Annual Joint Meeting of the Retirement Research Consortium
August 7-8, 2014
Washington, DC

The research reported herein was pursuant to a grant from the U.S. Social Security Administration (SSA), funded as part of the Retirement Research Consortium (RRC). The findings and conclusions expressed are solely those of the authors and do not represent the views of SSA, any agency of the federal government, DePaul University, Rush University Medical Center, or the Center for Retirement Research at Boston College. The data set used in this study was collected with the financial support of the National Institute on Aging (grant R01-AG33678).

Little is known about why many older Americans are susceptible to financial fraud and what factors contribute to this vulnerability. There is a lack of available data that include the required information about fraud victimization along with personal characteristics of victims and those not victimized. This research study uses the rich data set collected by the Rush University Alzheimer's Disease Center's Memory and Aging Project, which provides a notable exception. This data set includes yearly self-reports of fraud victimization along with demographic characteristics and measures of cognition, financial literacy, and decision making. Our analysis includes 787 participants without dementia, and 93 (12 percent) of these seniors report being recently victimized by fraud. We use this data set to test two hypotheses concerning the causes of fraud victimization and one concerning the consequences.

We hypothesize that decreased cognition predicts increased vulnerability to fraud. We use two measures of vulnerability. The first, which we call the susceptibility-to-scam score, employs a set of six survey questions designed to capture actions and beliefs that are consistent with providing an opportunity for scammers. For example, participants are asked if they have difficulty ending a phone call and if they believe persons over the age of 65 are often targeted by con-artists. Indeed, we find that a decrease in cognitive slope predicts a higher susceptibility-to-scam score. Our second measure of fraud vulnerability is self-reported fraud victimization. We find that a one-standard-deviation decrease in cognitive slope is estimated to increase odds of fraud victimization by 33 percent.

Our second hypothesis is that overconfidence in one's financial knowledge is a significant predictor of the odds of becoming a victim of financial fraud. Our measure of overconfidence combines participants' answers to a set of standard financial literacy questions with their confidence in each answer. Overconfidence is defined as getting the literacy questions wrong while thinking that they are right. We find that overconfidence is a significant risk factor for becoming a victim of financial fraud. A one-standard-deviation increase in overconfidence increases the odds of falling victim to fraud by 26 percent. Financial knowledge, not just general knowledge, protects against fraud: years of education is not a significant predictor of the likelihood of being victimized by fraud.

Our third hypothesis concerns the impact of financial fraud on victims' willingness to take on financial risk. Thaler and Johnson (1990) demonstrate that, after taking losses, many decision makers show an increased willingness to take on risk in an effort to break even. Indeed, we find that financial fraud victims show an increased willingness to take risk relative to those not victimized. We employ two measures of willingness to take financial risk. First, fraud victims report an increased assessment of their lifetime willingness to take on financial risk relative to the decline in non-victims' assessment of their lifetime willingness. Second, fraud victims become increasingly willing to accept a gamble with an equally likely chance of doubling one's annual income as cutting it by 10 percent. Both of these results are robust to propensity-matched comparisons of fraud victims to non-victims.

This paper identifies two of the causes of financial fraud among older Americans and one of the consequences for victims' future decision making. We find that decreasing cognition is predictive of higher susceptibility to scam and future fraud incidence. Cognitive changes may be evident to those spending time with and caring for affected seniors, and our results show these changes provide a warning sign for fraud vulnerability. In addition, we find that overconfidence in one's financial knowledge is a significant risk factor for seniors becoming a victim of financial fraud. This result makes an important contribution to existing research connecting overconfidence with poor investment decision making. Increasing the financial knowledge of older Americans is likely to help protect them from becoming victims of financial fraud. In cases where increasing financial knowledge is not possible, increasing awareness of one's limitations may help protect against the harmful effects of overconfidence. Finally, this study identifies increased willingness to take financial risk as a consequence of fraud victimization. This increase in risk acceptance may make victims vulnerable to subsequent exploitation, though our results also show that victims may not be more willing to take on particularly large risks following victimization.

How to protect one's finances from abuse should be an important part of the late life planning of seniors; however, money is often kept out of the conversation with caregivers. Additional research is needed to inform these conversations and planning. Financial victimization of seniors is a large and growing problem, yet the availability of data to study this problem is very limited. New data sources would allow for additional research needed to better understand the factors that predict fraud victimization and the consequences of it. Additional research is an important first step in order to design effective solutions to limit the impact of fraud.

References

Thaler, Richard H. and Eric J. Johnson. 1990. "Gambling with the House Money and Trying to Break Even: The Effects of Prior Outcomes on Risky Choice." *Management Science* 36(6): 643-660.