Mental Accounting, Estate Bequests, and Retirement Satisfaction

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ABSTRACT
This study examines the association between earmarking bequeathable assets and retirement satisfaction. Utilizing longitudinal data from the Health and Retirement Study, the authors examine the retirement satisfaction of retirees who have intentionally earmarked their bequeathable assets compared to retirees who have not. The findings suggest that earmarking bequeathable assets is associated positively with higher levels of retirement satisfaction.

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Introduction

The monumental wealth transfer between the baby boomer generation and the X and millennial generations warrants retirement, estate planning, and behavioral research initiatives. Since the mid-1990s, the U.S. financial services industry has anticipated and prepared for the largest generation of retirees in history—the baby boomer generation. This wealth transfer is estimated to be as much as 48 trillion dollars.[1] Consequently, research has studied cross-generational communication,[2] tourism patterns,[3] specific marketing approaches,[4] and elements of retirement security[5] to understand the baby boomer retirement transition better. With the last of the baby boomer generation turning 65 by 2030, an exploration of this generation's bequest motives, asset decumulation decisions, and the impact of these outcomes on their heirs is warranted.

Traditional life-cycle consumption models posit that the act of saving is undertaken to smooth consumption throughout the life course, suggesting that assets are only saved to finance late-life consumption needs.[6] Life-cycle models suggest utility is maximized if all assets at the end of the life course are consumed; however, many individuals possess sizeable assets at the end of their life course, even when considering their bequest and charitable intentions.[7] In other words, retirees tend to either decumulate wealth at a slower rate than the predictions of the traditional life-cycle hypothesis or continue to accumulate assets during retirement.[8] Several explanations for this perplexing asset decumulation behavior by retirees have been offered, including one by Kotlikoff, which pointed to intergenerational transfers as a major driver.[9] The resulting prospect of ending the life course with nontrivial assets represents a high opportunity cost when considering the forgone ability to retire sooner or spend more throughout the life course.

Researchers have reframed the retirement consumption puzzle by examining the traditional life-cycle consumption model through a behavioral lens. As recent behavioral research has highlighted, individuals do not always act in an economically rational capacity. Behavioral life-cycle models seek to explain the retirement puzzle through observed judgment errors and the resulting biases in human behavior. Of particular interest within this behavioral context is mental accounting. Mental accounting is a behavioral bias where “individuals are hypothesized to form psychological accounts for the costs and benefits of outcomes” (p. 136).[10] This dynamic applies when evaluating one’s intention to leave a bequest to the next generation.

This study examines retirees who have mentally accounted or “earmarked” their bequest intentions and the resulting association with retirement satisfaction. The authors posit that retirees who intentionally account for their bequeathable assets will result in those retirees having a greater sense of entitlement to consume their remaining nonbequeathable assets. The liberation to spend nonbequeathable assets allows for consumption patterns to follow the predictions of traditional life-cycle models, resulting in increased retirement satisfaction.

Literature Review

Retirement Satisfaction

Previous studies on the predictors of retirement satisfaction are abundant. Researchers have found associations between retirement satisfaction and financial risk tolerance and risk ratios,[11] home equity,[12] marital status,[13] retiree location,[14] and health.[15] Van Solinge and Henkens find a relationship between retirement satisfaction and finances, health, and marriage.[16] Szinovacz and Davey’s conclusions are more nuanced.[17] The researchers used the Health and Retirement Study (HRS) results to show that retirement satisfaction is associated with marital influence structures.[18] These insights operationalize how individuals maximize their satisfaction in retirement and during their transition into retirement. This study further explores these findings by examining the role of mentally accounting for bequest motives and retirement satisfaction.

Mental Accounting

In his seminal paper, Thaler introduced the concept of mental accounting.[19] This concept comes from the field of behavioral economics and is closely related to the concept of framing. It builds on previous theories, namely, the theory of consumer choice and prospect theory, and allows “individuals and households to organize, evaluate, and keep track of financial activities” (p. 183).[20] Researchers have utilized this theory as a foundation to explain irrational behaviors across disciplines, such as management, accounting, and finance.[21]

Of particular interest are studies that review the role of mental accounting in financial decision making and consumption within household finance. Soman tracks the role of time investments and decision making, both with and without attached monetary values.[22] Rockenbach used the theory of mental accounting to explain options pricing and found that individuals separate assets into different mental accounts based on risk.[23] Prelec and Loewenstein use mental accounting as a lens to study savings and debt accounts as explained by hedonics and the pain of purchasing. They also explore the earmarking of accounts for certain financial objectives.[24] One application to personal financial planning is that individuals mentally account for their saved assets by earmarking resources for specific purposes, accounts, or goals.[25]

Although not widely used in journals related to personal financial planning, the mental accounting framework offers a theoretical structure for an inquiry into bequests and the intention to transfer assets to the future generation. For instance, mental accounting could affect bequest intentions through wealth framing. Individuals might separate their wealth into "current income," "savings," and "bequest," viewing these as distinct mental accounts. Consequently, they might be less willing to draw from the "bequest" account for current consumption because they view it as earmarked for future generations.[26] This framework helps people mentally manage intergenerational wealth transfers. Similarly, "prospect theory," which is closely related to mental accounting, suggests that individuals make decisions based on the potential value of losses and gains rather than the final outcome.[27] This could influence bequest decisions, as individuals may weigh the "loss" of wealth transfer against the "gain" they perceive their beneficiaries will receive.

Andreoni suggests another angle, that of "warm-glow giving," where people derive personal satisfaction from the act of giving.[28] If individuals mentally account their bequest as part of their altruistic or legacy "budget," the warm-glow effect might be a driving factor behind their bequest intentions which may also be a contributing factor to retirees' satisfaction post-retirement. To the authors' knowledge, the relationship between mentally accounting for a bequest and retirement satisfaction has yet to be explored.

Bequest Motives

Several researchers have explored the relationship between savings and bequest motives. Browning and Lusardi explored bequest motives as one of nine reasons for saving.[29] Spencer and Fan extended this research, finding a positive relationship between savings and the motivation for bequest.[30] From an international perspective, Cigdem and Whelan explored bequests through home ownership transfers in Australia, finding a positive relationship between homeownership and bequests.[31] Hamaaki, Hori, and Murata explored the equality of bequest giving in Japan versus the United States using bequest motives, finding that Japanese bequests are less equally distributed among decedents' children and that cultural differences influence bequest division decisions.[32] Although this study analyzes data reflecting attitudes found in the United States, this international perspective is helpful in framing the topic at hand.

This study examines the relationship between mentally accounting or earmarking bequests, as measured by bequest intention, and retirement satisfaction. The authors posit that retirees who are intentional in earmarking bequeathable assets will allow retirees to have a greater sense of entitlement to spend their remaining assets, resulting in higher levels of retirement satisfaction. This hypothesis is proposed for two reasons. First, when earmarking bequeathable assets, the burden of spending guilt is removed, allowing retirees increased freedom to enjoy their remaining financial assets. Second, retirees will have the salient experience of an inter vivos asset transfer and its resulting satisfaction, even when legal title is transferred postmortem. The findings provide a further understanding of the connection between bequest intention and the increased ability to enjoy retirement. The key implications orbit the need for retirees to be intentional in estate planning dialogues and that separating bequeathable and nonbequeathable assets can allow for increased retirement satisfaction.

Methodology

Data

To examine the association between earmarking bequest motives and retirement satisfaction, panel data from the HRS are examined.[33] The HRS is sponsored by the National Institute on Aging and is conducted by the University of Michigan biennially. Specifically, the data examined are biennial data from the 1992 to 2018 RAND HRS longitudinal file. Data and other information provided by the HRS are collected through survey questions and recorded responses. The purpose of the data collection effort is to provide data for research on health and aging in the United States. The HRS has a participation sample of approximately 20,000 and conducts data collection at both the respondent and household levels.

To focus solely on retirees, the subset of HRS respondents answer "retired" when asked, "Are you working now, temporarily laid off, unemployed and looking for work, disabled and unable to work, retired, a homemaker, or what?" Observations with responses other than retired and missing values are dropped. To ensure the sample is fully retired, retirees who report earned income are dropped from this sample. The resulting sample size is N = 67,349.

Variables

The dependent variable of interest is retirement satisfaction. The HRS retirement satisfaction question asks retirees to rank their level of retirement satisfaction between 1 and 3, with 3 representing "not at all satisfied," 2 representing "moderately satisfied," and 1 representing "very satisfied." For this study's analysis, the retirement satisfaction variable is recorded as a binary dependent variable, where 1 represents "very satisfied" and 0 represents "moderately satisfied" and "not at all satisfied."

The earmarking of bequest motives variable is estimated by analyzing respondents' self-reported probability of leaving a bequest. Respondents are asked to provide the probability that they will leave a bequest of $10,000 or more. If the probability is greater than zero, they are asked for the probability of leaving a bequest of $100,000 or more. If that probability is greater than zero, they are asked for the probability of leaving a bequest of $500,000 or more. Because the goal of this study is to examine the probability of leaving a bequest, rather than measuring the magnitude of a bequest intention, the "$10,000 or more" response is utilized in the econometric analyses.

The control variables in this study are health, married, income, wealth, age, and age^2. Retiree health is coded as (1) poor, (2) fair, (3) good, (4) very good, and (5) excellent. The variable married is coded as a "1" if the respondent is married. A "0" is coded otherwise. Age and age^2 are measured continuously. Net worth is measured in $10,000s, and the income variable is log-transformed.

Model Testing

A Hausman specification test is performed to analyze model fit.[34] The null hypothesis is that a random-effects logit model is appropriate, and the alternative hypothesis is that a fixed-effects model is appropriate.

H_0: *Random-Effects Logit Model Is Appropriate*

H_1: *Fixed-Effects Logit Model Is Appropriate*

The results of the Hausman specification test suggest that a random-effects model is not an appropriate model ($p < 0.001$). Based on the results, the null hypothesis is rejected in favor of the alternative hypothesis. Consequently, the fixed-effect logit model is utilized.

Analytic Model

The following fixed-effects probit model is estimated via maximum likelihood on the unbalanced panel:

$$SAT^{*}_{it} = \beta_{0i} + \beta_1\ Bequest_{it} + \beta_j CV_{it} + a_i + e_{it}$$

$$SAT_{it} = 0 \text{ if } SAT^{*}_{it} < \mu_1 \ \textit{(Not at all satisfied)}$$

$$SAT_{it} = 0 \text{ if } \mu_1 \leq SAT^{*}_{it} < \mu_2 \ \textit{(Moderately Satisfied)}$$

$$SAT_{it} = 1 \text{ if } \mu_2 \leq SAT^{*}_{it} \ \textit{(Very Satisfied)}$$

where SAT^{*}_{it} is a latent measure of retiree *i*'s satisfaction in wave *t*, and the unknown thresholds, μ_1 and μ_2, are to be estimated.

The variable $Bequest_{it}$ is a dichotomous variable measuring whether retirees have reported a 100 percent probability of leaving at least a $10,000 bequest. The matrix CV_{it} contains the control variables that are utilized in this model, which include health, married, net worth, ln(income), age, and age^2. Health enters the model as a categorical variable. The poor health category is the reference category by which fair, good, very good, and excellent health categories are compared. Married enters the matrix as a dichotomous variable, where the variable is coded as a "1" if the retiree is married. A "0" is coded otherwise. Net worth, ln(income), age, and age^2 enter the model as continuous measures.

Fixed-effects regression models require within-subject variation. Therefore, the variables White, male, and education are not included in the model, as these variables are assumed to be time-invariant. Although educational attainment has been associated with long-term satisfaction levels,[35] it is assumed that retirees have no rational incentive to invest in their human capital for purposes of labor income. Therefore, retiree educational attainment is treated as time-invariant and not included in the model.

The y-intercept of the model is represented by β_0; β_1 is the coefficient associated with $Bequest_{it}$; β_j is a vector of coefficients associated with the control variable matrix, CV_{it}; and a_i is the unknown intercept for each i^{th} retiree. Estimated marginal effects provide the magnitudes for each of the effects on the observed retirement satisfaction variable. The error term is assumed to follow a standard normal distribution.

Results

Table 1 provides the profile of retirees who have indicated that they will leave a bequest. The findings indicate that respondents who desire to leave at least $500,000, on average, include retirees who are primarily married; have a net worth of over $600,000; have a retirement income of $60,000 or greater; are over age 73; and have at least a high school degree. While those characteristics held true for the largest bequest amount, in the lowest amount of bequest intention ($10,000), an average education of less than high school is observed. Additionally, a retiree stating a desire to leave a bequest appears to influence the retiree's retirement satisfaction. This holds true for all measured bequest amounts, but with diminishing levels of increased satisfaction as the amount of the bequest increases. For instance, of those who report a $10,000 bequest intention, 52.20 percent report being "very satisfied."

TABLE 1
Profile of Retirees Leaving a Bequest

	$10k Bequest	$100k Bequest	$500k+ Bequest
Retirement Satisfaction			
Not Satisfied	9.09%	18.38%	8.93%
Moderately Satisfied	38.71%	48.92%	40.83%
Very Satisfied	52.20%	32.70%	50.25%
Married	40.89%	48.91%	61.35%
Net worth	$141,202	$329,133	$641,825
Income	$38,043	$39,861	$59,274
Age	67.46	72.51	73.75
Education (years)	11.46	12.09	13.02

Data from the 1992-2018 Health and Retirement Study.
N = 67,349.

Table 2 provides the demographic statistics of the sample. The average respondent reports being "very satisfied with retirement" (μ=0.5219), with approximately 40 percent intending for a $10,000 bequest. The majority of the respondents indicated their health was "good" or better (66.259 percent), with the remainder indicating "fair" or "poor." The majority of the respondents were married (55 percent), White (80 percent), female (58 percent), and had 12.51 years of total education. The average net worth of the respondents was roughly $500,000, with an average age of 72.

Table 3 reports the average marginal effects resulting from the fixed-effects regression. The results of interest show that having a bequest motive of at least $10,000 or greater resulted in a 3.84 percent increase in the likelihood of being satisfied during retirement ($p < 0.001$). Being married showed a similar increase of 3.1 percent ($p < 0.001$). Most impactful on retirement satisfaction was the respondents' health. As compared to those who responded that they had "poor" health, those who stated "excellent," "very good," "good," and "fair" showed 22 percent, 21 percent, 14 percent, and 7 percent increases in retirement satisfaction, respectively ($p < 0.001$).

Discussion

The results reveal that retirees who earmark bequeathable assets are more likely to experience greater levels of retirement satisfaction compared to retirees who do not, even when controlling for net worth and income. The identification of bequeathable assets may allow retirees to experience greater financial organization and an increased sense of freedom to enjoy their nonbequeathable assets. Earmarking assets can allow retirees to experience a salient identification of which assets are bequeathable and nonbequeathable, which can help manage the "spending guilt" retirees may sustain when considering their assets, heirs, and bequest intentions. Consequently, earmarking bequeathable assets can be a helpful tool for retirees who are considering leaving a bequest, as it helps in the clarification of estate goals and provides specific identification of bequest intention.

Moreover, in their explanation of the behavioral life-cycle hypothesis, Shefrin and Thaler discuss the importance of countering behavioral errors.[36] For example, they note that a lack of willpower can be managed by earmarking funds to a restricted account.[37] Earmarking bequeathable assets can help to ensure that the assets are used for their intended estate planning purpose. When assets are earmarked for a specific purpose, a behavioral spending roadblock is established. The establishment of a behavioral spending roadblock can help ensure that the assets transfer to the retiree's intended heirs.

TABLE 2
Descriptive Statistics of Retirees

	Mean	Std. Dev.
Very Satisfied with Retirement	0.5219	0.4995
Bequest of $10k	0.3986	0.4898
Health		
Poor	0.0987	0.2982
Fair	0.2388	0.4264
Good	0.3304	0.4703
Very Good	0.2623	0.4399
Excellent	0.06989	0.2549
Married	0.5467	0.4978
Net Worth (10k)	$47.5225	121.6152
Log (Income)	$10.3386	.9409
Age	72.6967	9.0838
White	0.7961	0.4029
Male	0.4205	0.4936
Education (years)	12.5188	3.0126

Data from the 1992-2018 Health and Retirement Study.
N = 67,349.
Married, White, Male are coded as "1" if respondent is married, White, and male; and a "0" otherwise.
Net worth mean and standard error reported in $10,000s.

Earmarking assets intended for bequest may allow retirees to also experience increased retirement satisfaction resulting from the fulfillment received from the identification process, as in the case of an inter vivos bequest intention or plan to bequeath assets. Even in the case of legal title transferring postmortem, retirees can still experience the satisfaction of leaving a bequest by earmarking their bequeathable assets while living. In other words, retirees may experience increased retirement satisfaction from acknowledging the assets that will transfer to their heirs. Moreover, inter vivos transfers may reduce estate tax liability for retirees' future heirs.

The results also highlight that health remains a major contributor to satisfaction in retirement, more than earmarking assets intended for bequest. This finding is not particularly surprising, considering the significance of health and health care planning at the end of life. The interpretation of the importance of health in retirement is underscored by the results of related studies examining the so-called "health-wealth" connection.[38] Carr et al. build a case for the connection between health and retirement, but more research is needed to understand this interaction.[39]

TABLE 3
Fixed-Effects Regression Marginal Effects and Standard Errors

	Marginal Effect	Standard Error
Bequest of $10k	0.0384***	0.0041
Health (poor as base outcome)		
Fair	0.0719***	0.0124
Good	0.1411***	0.0140
Very Good	0.2127***	0.0160
Excellent	0.2232***	0.0189
Married	0.0310***	0.0098
Net Worth (10k)	0.0079	0.0057
Log (Income)	0.0009*	0.0004
Age	0.0046	0.0031
Age^2	-0.0001***	0.0000

Data from the 1992-2018 Health and Retirement Study.
N = 67,349.
Net worth reported in $10,000s.
Significance is defined as follows: * significant at $p < 0.05$; ** significant at $p < 0.01$; *** significant at $p < 0.001$.

The results show that marriage also remains an important part of satisfaction during retirement. This result is not particularly surprising, given previous research insights. See Easterlin[40] and Waite[41] for detailed explanations regarding marriage and its positive association with happiness and well-being. Thus, one would expect marriage to be a retirement satisfaction indicator. Research could further explore the connection of marital quality and other life-giving relationships that contribute to retirement satisfaction.

Finally, this study highlighted one facet of the multidimensional construct known as retirement satisfaction. The HRS includes a plethora of variables, and future research could investigate an increasingly diverse set to deepen the field's understanding of retirement satisfaction. The psychosocial variables found in the survey, in particular, could give rise to new insights into what influences retirement satisfaction beyond health, marriage, earmarking bequeathable assets, and other factors mentioned previously in the literature review. Researchers might be particularly interested in integrating the work of Seligman, whose PERMA model identifies multiple factors that influence overall well-being.[42]

Implications

This study finds that having a bequest intention increases retirement satisfaction. Consequently, to improve retirement satisfaction, retirees should intentionally engage in estate planning dialogues among their families, heirs, and financial and legal service professionals. Engagement in estate planning dialogues can allow retirees to communicate their bequest intentions, which may reduce confusion and conflict among heirs postmortem. Moreover, communication of bequest intentions provides heirs with inheritance expectations, which may aid when planning for their financial future. Thus, transparent communication among interested parties can help in establishing a framework for the implementation of retirees' estate plans.

For financial planning practitioners, acknowledging the bequest intentions of their retired clients may serve as a catalyst to prompt clients to engage in estate planning. Furthermore, a financial planning practitioner can aid in the coordination of retirees' estate plans with their other financial plans, such as retirement plans and investment plans. This comprehensive process can help ensure that life course financial goals are met. Further, the financial planning practitioner could go beyond simply acknowledging the bequest motive and attempt to actualize the bequest intention. For instance, the financial planning practitioner could encourage the client to manifest the existing mental accounting by creating a bequest account to house the bequeathable assets. Based on the results of this study, the bifurcation of assets into a bequest account and a nonbequest account should increase retirement satisfaction. Future research can investigate this concept empirically.

Conclusions

As the number of retirees grows, an increased focus on satisfaction during retirement is warranted. Traditional life-cycle consumption models theorize that consumption ebbs and flows over a lifetime; however, behavioral life-cycle models—including Thaler's model of mental accounting—can help explain financial behaviors such as bequest motives and their connection to retirement satisfaction. Although the theories offer, at times, conflicting explanations for various financial behaviors, they both offer helpful lenses to study the topic of intergenerational transfers.

Undoubtedly, financial practitioners need to have a thorough understanding of what leads to a successful retirement. This article identifies one more perspective on that valuable topic. A significant responsibility of financial professionals is to act as a knowledgeable guide and support clients through this complex transition. Practitioners can help clients focus on controllable factors such as maintaining a healthy lifestyle and cultivating the joys of a marital relationship. Fortunately, an extensive body of research outlines these and many other conditions that enhance retirement satisfaction. ■

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