RETIREMENT INCOME INSTITUTE
Alliance for Lifetime Income

Who Should Read This Insight:
Consumers, financial professionals

Institute Research Agenda Topic:
Understanding differences in consumer behavior and decision-making

Definitions of **bold key terms** are at the end of this article.

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Authors, Titles and Publication Dates of the Articles Addressed in the Insight
Martin, Terrance, Michael Finke, and Philip Gibson. 2014. "Race, Trust, and Retirement Decisions." Journal of Personal Finance *13 (2): 62–71.*

Terrance K. Martin Jr., PhD, is Assistant Professor of Financial Planning at Utah Valley University. At the time the article was published, he was Assistant Professor, Department of Economics and Finance, University of Texas-Pan American. Michael Finke, PhD, is the Chief Academic Officer at The American College of Financial Services. He was Professor and Director of Retirement Planning and Living, Department of Personal Financial Planning, Texas Tech University, when the article was published. Philip Gibson, PhD, is Associate Professor, Department of Accounting Finance and Economics, Winthrop University.

Insight: HOW RACIAL DIFFERENCES IN TRUST CAN AFFECT DECISIONS ABOUT FINANCIAL PLANNING

IDEAS IN THE INSIGHT YOU CAN PUT INTO ACTION

Consumers can learn about the benefits of working with a **financial professional;** doing so can improve **consumer** well-being in retirement. Financial professionals can become more aware of possible mistrust of their profession among African American and Latino households, and can adjust their approach to those potential clients accordingly. They can also recommend to African American and Latino clients that they invest in protected lifetime retirement instruments to help address the persistent disparity in retirement savings.

PRINCIPAL INSIGHTS

Previous studies show that, on average, African American and Latino households plan less for retirement and have less accumulated savings. This disparity may bring about a decline in retirement well-being among African Americans and Latinos. Conversely, households that work with a financial professional are more likely to engage in positive financial behaviors such as saving adequately for retirement. This article explores whether racial differences in generalized trust (defined in detail below) can (a) affect a person's decision to hire a financial professional, and (b) explain variations in retirement savings. It uses data from a survey of respondents born between 1957 and 1965 who answered retirement-related questions.

Numerous research studies indicate that many people make inferior financial-related decisions. And although only about 25% of households use a financial professional, households that consult with one do a better job of setting goals, estimating their retirement needs, and diversifying their retirement investments.

Terrance Martin, Michael Finke, and Philip Gibson's article confirms strong evidence of racial differences in accumulated retirement savings. Overall, African Americans report lower levels of savings among all households as well as among respondents who use a financial professional. The researchers also discovered that, independent of race, survey respondents reporting lower trust levels have accumulated less savings. Importantly, the article shows the strongest predictors of retirement savings are education, **risk tolerance,** home ownership, and marital status. Differences in these household attributes may explain more of the disparity in retirement savings than race and trust across these racial groups.

Furthermore, most economic transactions involve some degree of trust, which also applies to hiring a financial professional. There are two types of trust: generalized and personalized. Generalized trust is a belief about a random individual who belongs to a certain group in society. Personalized trust is a conviction about a particular person that stems from interactions with that person. Several factors influence a person's propensity to trust, including life experiences, community, values, and cultural background. Other researchers suggest that African Americans are less likely to report generalized trust than are Whites. And a person with lower levels of generalized trust is less likely to seek out professional financial advice.

This study shows that race is a strong predictor of an individual's willingness to report generalized trust of other people. This finding is consistent with previous studies. The researchers found that African Americans and Latinos are 50% less likely to report a high generalized trust level than a low generalized trust level as compared with their non–African American, non-Latino counterparts. Moreover, the effect of generalized low trust appears to be more relevant among African Americans than among any other racial group. That is, nearly half of African American respondents report having a low trust level while only 21% consider themselves to be high trusting. In this study, education, income, net worth, and risk preference are all positively related to a household being in the high trust group rather than in the lower trust group.

Previous studies also show that using a financial professional can improve decisions about saving for retirement. African Americans and Latinos are more likely to seek guidance from a friend or family member than from any other resource, including financial professionals. They may be reluctant to hire financial professionals for multiple reasons. First, African Americans might have a negative perception of financial professionals because they have faced discriminatory practices from financial institutions. Second, racial discrimination in financial and consumer markets could have lasting effects, including the reluctance to hire a financial professional. Third, there is evidence that financial professionals are more likely to act in self-serving behavior when working with African American and Latino clients.

Additionally, the researchers suggest that African Americans would have a slightly higher likelihood of consulting with a financial professional if they had higher levels of generalized trust. And low trust levels have more of an effect on African Americans' decision whether to consult a financial professional than cultural socialization. (Cultural socialization is the process through which young people learn about their culture and begin identifying with a certain group.) Among Latinos, trust is not the main barrier to using a financial professional; Latinos are only 29% less likely to consult a financial professional than are non–African American, non-Latino respondents.

And there is no indication that working with a financial professional has a larger effect on accumulating retirement savings among African American or Latino households than it does among non–African American or non-Latino households.

Finally, because there are few African Americans and Latinos who work as financial professionals—only 6.5% of whom were African American and 5.2% were Latino in 2013—African Americans and Latinos might be hesitant to seek advice from a financial professional who does not share a similar racial or ethnic background.

To learn more, visit the Retirement Income Institute at
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KEY TERMS ARE SOURCED FROM THE ALLIANCE FOR LIFETIME INCOME'S ANNUITIES LANGUAGE GLOSSARY AND INVESTOPEDIA

Consumer: *Someone who invests in annuities.*

Financial professional: *A qualified person who can help you understand your options and make financial decisions to work toward your financial goals.*

Risk tolerance: *The level of market risk you're comfortable with.*

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