Financial Literacy: Implications for Retirement Security and the Financial Marketplace

Pension Research Council

July 2010

PRC WP 2010-11
Pension Research Council Working Paper

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This Pension Research Council Working Paper represents a summary of presentations at the Wharton Impact Conference sponsored by the Wharton School's Pension Research Council and Boettner Center for Pensions and Retirement Research, May 2010. Conference co-organizers were Annamaria Lusardi and Olivia S. Mitchell. Susan Warner provided conference redaction. Financial support for the conference was provided by the Wharton School, the Senior Partners and Institutional Members of the Pension Research Council, and the Boettner Center. For further information see http://prc.wharton.upenn.edu/prc/prc.html. © Pension Research Council, 2010. All rights reserved.

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The Pension Research Council

Government officials, private-sector experts, and leading academics convened at the Wharton School recently to explore financial literacy at an Impact Conference sponsored by the Pension Research Council (PRC) and the Boettner Center for Pensions and Retirement Research at the University of Pennsylvania.[1] Co-organized by Olivia S. Mitchell, Executive Director of the Pension Research Council and the Boettner Center, and by Annamaria Lusardi, Professor of Economics at Dartmouth College, the conference focused on ways to measure and remedy low levels of financial literacy in the United States and around the world.

The discussion at Wharton examined several key reasons for widespread financial illiteracy, including general innumeracy as well as behavioral patterns that play an important role in determining how well individuals plan for retirement and meet their needs after they stop working. There are many interesting research efforts underway exploring how to enhance financial literacy, particularly among low-income and less educated workers at risk of facing old age without adequate retirement saving. In response to the global economic crisis, financial literacy is now also an imperative for future economic growth, innovation, and stability in countries with rapidly aging populations.

[1] Conference presentations are available online at www.pensionresearchcouncil.org/conferences/conf-2010.php. The Pension Research Council and Boettner center anticipate publishing a refered volume with many of the research papers.

Financial Capability: Policies and Priorities

Deeply committed to financial capability in the U.S., Michelle Greene from the U.S. Department of the Treasury is also focused on policy implementation. She argues that retirement security is critical to improve financial literacy and competences protective against key life challenges. She notes that that 78 million Americans – half the U.S. workforce – lack retirement saving plans from their jobs, and fewer than 10 percent of those without employer plans contribute to a retirement program on their own. Furthermore, only 42 percent of U.S. adults have even tried to calculate how much they need to save for retirement. Greene observes that "people think they're doing really well, even though when we look at their behaviors, they have a long way to go." In response, the federal government is working to change cultural roadblocks to retirement saving, including initiatives to increase automatic enrollment in Individual Retirement Account (IRA), 401 (k), and other retirement saving plans; and efforts to expand the Internal Revenue Service's Saver's Credit and make it easier for families to save their tax refunds.

Greene identifies five priorities for improving financial capability. The first is evidence-based research to identify programs proven to work, with an emphasis on developing core competencies such as saving, borrowing, and spending, along with clear-cut metrics to track results. She compares this effort to the government 'food pyramid,' to help citizens gain a better understanding of sound financial behavior. Second, she seeks to integrate efforts to strengthen financial capabilities throughout government and society, by bringing diverse government branches together to address financial capability. In addition to establishment of the Financial Literacy and Education Commission (FLEC) and the President's Advisory Council on Financial Capability, interagency efforts include the White House Council on Women and Girls'

Interagency Working Group on Domestic Violence, among other groups, seeking to build financial literacy. Third, Greene is targeting financial literacy programs in communities with less capability that may be set apart from the broader population by geographic or ethnic divides, or by age. Indeed, she suggests, the financial crisis presents a teachable moment, noting that "we must get financial capability right and a huge part of that is reaching kids starting as early as possible, not when they are in college with credit cards and debt already." Fourth, her office wants to increase access to financial institutions to prevent people from turning to high-cost alternatives such as street corner payday loans. One quarter of the U.S. population does not have bank or credit union account, and regularly uses alternative financial products such as non-bank money orders. Finally, she indicates that the federal government intends to work with state and local officials, non-profit organizations and the private sector to enhance financial capability. "We want to make sure every agency from housing to Head Start to the military is thinking about how to encourage savings," Greene concludes.

Financial Literacy and Financial Decision Making

A panel on financial literacy and financial decisionmaking takes up the behavior of savers and resulting impacts on retirement wellbeing. Peter Tufano from Harvard has developed an intriguing prize-based model designed to to encourage retirement saving in work entitled "*Making Savers Winners: An Overview of Prize-Linked Savings Products."* He and his coauthors, Chicago economists Erik G. Hurst and Jonathan Ugrian, and Melissa Kearney from the University of Maryland, illustrate how a lottery-like system could harness the popularity of low-probability, high-reward schemes to build retirement saving. The authors' proposal is likely to appeal to those who prefer to face low odds in order to "win big" by distributing returns on

investment while preserving initial capital. For issuers, the program would be easy to market driving down costs of customer acquisition because lotteries are already well-understood and popular. A major drawback, Tufano concedes, is a lottery savings program would likely be illegal in most jurisdictions since it would compete with government-run lottery operations. Currently, 42 states and the District of Columbia sponsor lotteries with annual sales of $60 billion; in Massachusetts, the average resident spends $725 a year on lotteries.

Tufano notes that lotteries have long been used as finance mechanisms around the world, in fact, for over 300 years. In Britain, so-called Million Adventure bonds were sold to finance war debt in 1694. To encourage saving after World II, the U.K. launched prize-based Premium Bonds with the slogan “Savings with a Thrill!” Today, this program has 23 million bondholders. A privately-run plan sponsored by South Africa’s First National Bank called the Million a Month Account (MaMA) has enjoyed a take up rate higher than any other bank product, but ultimately was shut down by government officials as an illegal lottery. In the US, Tufano discusses a program run by a credit union in Michigan that operated a prize-based savings system under a legal loophole that allowed credit unions to sponsor savings promotion “raffles.” The 2009 Save to Win program ran for 11 months and attracted 12,000 members of eight collaborating credit unions who invested a total of $9 million. Of the participants, 66 percent had no regular savings plan, but 59 percent had played a state lottery in the past four months.

Following the Great Depression, 1930s era laws designed to strengthen banks strictly limited any financial institutions from offering lottery products. Now state and local officials are likely to place legal roadblocks to private lottery systems that might compete with government-run lotteries, according to Tufano. He suggests this legal opposition is the main factor standing in the way of an idea that could help many low-income families save and attain financial security.

He notes that “states have a monopoly on lotteries. That’s how they finance education and other things. They are very particular about not letting private parties into the lottery business.”

A different approach to understanding retirement saving shortfalls is described by Wharton’s Gal Zauberman and B. Kyu Kim, in a study entitled *“Time Perception and Retirement Savings: Lessons from Behavioral Decision Research.”* Zauberman seeks to understand the role of time perception on savers, and he has shown that people tend to weigh the present more heavily than the future. This pattern still holds when people know their short-term decisions will interfere with their important long-term goals, such as saving for retirement. This is explained by resource slack theory, or the notion that one’s preference for something today versus some time in the future depends on the amount of resources available now versus later. He points out that time is often viewed in economics models as a limited resource. But he shows that people instead believe that they will have more time in the future than they actually do, leading them to put off saving.

Another problem playing into the apparent disconnect between the ability to save now for future benefits is a lack of understanding about time itself. According to Zauberman, time seems expansive in the present but crunched in the future: “If retirement is 20, 30, 40 years away, it all seems the same – it blurs in the future.” In addition to believing they have more time to save than they actually do, people also think they will have more money in the future than in the present, which further prompts them to put off saving for retirement. In general, psychology research shows that many people do not grasp the linear nature of time and hence develop hyperbolic rates of future discounting.

One way to reduce the effect of time misperception on retirement saving is to structure programs based on precommitment, says Zauberman. Accordingly he applauds recent

government efforts to tie retirement saving into the annual tax filing process. “You already have to go through the hassle of doing your taxes anyway, so this only adds a little more hassle,” he points out. Of course this prompts discussion of the question of whether it might be better to use behavioral approaches to encourage saving by default, or whether it might be better to construct mandates or default programs that require people to adequately fund their own retirements. He argues: “If we understand people’s version of reality, how they perceive the world, we can help them make better decisions. If we impose how they should look at the world, we will have a much harder time.”

Taking a different perspective, Mike Orszag from TowersWatson, argues that more attention should be focused on the structure of financial products and their distribution. He suggests that “if decisionmaking were good, this would force product markets and distribution systems to change se we wouldn’t need to provide workers with more advice.” But “if product/distribution systems were better, if products were simpler, and advice were good, we won’t need as much financial literacy.” On the other hand, Orszag worries that sometimes people focus too much on getting “as much money into the financial services sector and not enough on protecting the most vulnerable members of society.” Further, he questions precommitment plans: “The problem I have with defaults is that we use authority, our own judgment, rather than teaching them.” Stephen Zeldes from Columbia University seeks to reconcile the tension between the financial literacy movement and proposals to design saving programs around human psychology, saying: “The only way out is to see if people actually become more financially literate after engaging in these products.”

Another consideration is that stock market participation is important for long-term wealth accumulation and retirement security, yet many people underinvest in equities. RAND economist

Joanne Yoong explains her study entitled "*Financial Literacy, Ignorance and Stock Market Participation,"* by showing how lack of understanding about equity markets discourages investment. Her research relies on the American Life Panel to link financial literacy, stock market participation, and other factors; her findings indicate that lack of stock market holdings is distinct from mistaken financial beliefs, and it is not linked to risk aversion, income, or formal education. She concludes that people shy away from the stock market primarily because they don't understand it, pointing out that "familiarity is needed to overcome this barrier to investment." Even if default mechanisms are developed to encourage savers to contribute to retirement plans and shift investment toward equities, she believes that investors would still benefit from understanding how financial markets work. This is because "understanding what they are doing will make them comfortable with the default." Behavioral approaches aside, she also proposed that savers should understand how the underlying investments in their portfolio behave, in order to make sensible choices throughout life. "They will be happier and savvier, and if the economic environment changes, they will know what to do," according to Yoong.

The workplace is an important source of financial education, particularly as workers approach retirement. In their study of the effect of employer financial literacy programs on retirement savings distribution, entitled *"Pension Plan Distributions: The Importance of Financial Literacy,"* Robert L. Clark, Melinda S. Morrill, and Steven G. Allen, all from North Carolina State University, investigate workplace retirement planning sessions. Drawing on case studies, they investigate seminars offered at mandatory defined benefit (DB) plans and voluntary defined contribution (DC) plans. At the seminars, employees learn about retirement planning in general and details about their own benefits and pension distribution rules Participants are asked

about retirement plans *before* and *after* the sessions, to learn whether the information they received lead to a change in retirement intentions and plans.

The analysis shows that one-third of those who originally thought they would take the lump sum DB payment decided not to take that option, after the seminar. Of those who originally planned not to take the lump sum, almost half change their minds post-seminar. As for annuitizing DC plans, almost half change their plans and decided not to annuitize following the information session, compared to one-fifth who decide to annuitize after learning more about their retirement options. Clark notes that those who indicated they would take the lump also have more knowledge about retirement-related finance. In this sense, many people who indicated they would not take the lump sum distribution actually did not know they had that option prior to taking the seminar. Of course the study reflects what the employees say they plan to do, rather than what they actually do. Nevertheless, when it comes time to actually make a final decision, about two-thirds of employees in fact opt for the lump sum distribution, saying: “When you offer people money, you better expect them to take it.”

Sarah Holden from the Investment Company Institute (ICI) notes that shows stock market ownership by U.S. households has increased in the past two decades, from 32 percent in 1988, to 46 percent in 2008. Much of the increase occurred due to employer retirement schemes. Also many households have no financial assets at all; some 13 percent of U.S. households had zero financial assets in 2007, and 46 percent had only a bank account. “That group has not taken the first step toward saving, much less investing,” Holden worries. A key entry point to the stock market is through a financial advisor, she points out. Of those holding mutual funds outside employer plans, 47 percent reported in 2009 that an advisor had suggested they buy stocks.

Holden argues that investor enthusiasm for equities tends to swing up and down with share prices.

Further to this point, David Laibson from Harvard suggests that it is crucial to measure intentions as we seek to understand how financial literacy is linked to actions leading to greater retirement security. Only one in eight potential 401 (k) participants saying they intend to join a plan actually enrolls within two months unless they are defaulted into the plans. He suggests a three-pronged approach investigating how education affects knowledge, how education affects intentions, and how education ultimately affects behavior.

International Lessons on Financial Literacy

Annamaria Lusardi focuses on ways in which limited understanding of the economic landscape can shape how individuals make decisions that ultimately impact their long-term financial security. She contends that "many people are articulate about what they want to achieve, but there is a gap in how they can achieve those objectives." She views financial literacy as a way to empower people, and she indicates that policymakers and academics can help, in concert with the Financial Literacy Center (FLC), created in 2009 with support from the U.S. Social Security Administration, a joint research collaboration of Dartmouth College, Wharton, and RAND.[2] The Center's mission is to direct evaluations regarding the causes of and causes for financial illiteracy, and to evaluate the effectiveness of efforts to make people more knowledgeable about their finances and the need to plan for retirement.

Lusardi and her co-author Olivia S. Mitchell track financial literacy in the U.S. Health and Retirement Study using three questions focused on percentage calculations, division, and compound interest. The authors uncover alarmingly high levels of financial illiteracy in the

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[2] http://www.rand.org/labor/centers/financial-literacy/

United States. For those already engaged financial decisions such as paying a mortgage, or managing checking and saving accounts, people over age 50, financial literacy is surprisingly low. Among early Baby Boomers, 84 percent answer the percentage calculation correctly, but only about half can compute the division problem and only 18 percent understand the concept of compound interest, a key element of retirement planning. For younger people on the verge of making major financial decisions such a purchasing a home or entering an employer pension plan, the lack of financial literacy is even more marked.

"When you look at the young, the results are more depressing," according to Lusardi. She finds that the most financial illiterate came from college-educated families where the parents hold stocks and bonds and have retirement saving. A mechanism for transfer of financial knowledge therefore appears to be transfers within families. Women show lower levels of financial literacy and capability than men, and Blacks and Hispanics are less likely to answer the research questions correctly than Whites. Research also shows that those who are less knowledgeable about finance are also less likely to plan for retirement, particularly those who fail to grasp the power of compounding in building retirement savings. Failure to plan, according to Lusardi, results in a failure to save.

Poor financial understanding is not limited to the United States; indeed Lusardi points out that studies in Germany, Italy, New Zealand and Russia show the same thing, so that "the surprising result is not how different we are, but how similar countries are regarding the lack of financial literacy." New studies are planned for India, Thailand, Sri Lanka, Colombia and Chile that will allow researchers to expand their understanding of financial literacy.

Documenting financial illiteracy is only part of the challenge, since according to Lusardi, "the next question is how does it matter, and what can be done to build capability?" She

contends it is essential include carefully-thought out evaluation mechanisms when programs are implemented, so analysts can prove what works and along what dimensions. Further, targeted counseling for different audiences is also essential for improving financial literacy. “One size doesn’t fit all,” says Lusardi. Instead, “we must take specific steps to engage people when they make financial decisions.” Acknowledging the debate about whether it is better to educate people about finance or enact consumer-oriented regulations to protect them from making financial mistakes, she contends there actually is no need to choose. “Financial education is a key component of consumer protection, but not the only one,” Lusardi argues. “We must also develop regulation and design products that people can understand and implement.”

In thinking about which factors shape financial understanding and outcomes, Lusardi noted that employers and peers are often an important source. She told of one community in which the local butcher turned out to be the main source of financial information. In other cases families play a role, as well as school-based financial literacy programs as a way to reach all populations. “Not everybody comes from a family in which the parents are college educated or affluent and have stocks and bonds,” she remarks. “If we don’t provide financial literacy in school, we are letting people start their adult lives from unequal positions.” She says that adding financial literacy programs to school curricula is a “win-win” for individuals as well as the financial service industry. “You can’t add complex products without education. That’s why the effort to add financial literacy to schools is really important,” Lusardi concludes.

Evaluating Financial Literacy Interventions

The gathering next explored efforts to improve financial literacy. Justine Hastings from Brown University is working with coauthors Mitchell and Eric Chyn from Yale, to study *“Fees,*

Framing, and Financial Literacy in Pension Manager Choices in Chile." Their work is prompted by the movement toward increasing choice and privatization in traditional public goods markets such as education and healthcare, and recent calls for Social Security privatization. Choice allows people to act on private information, yet Hastings argues that consumers do not always make the best choices when they are faced with complex decisions, risk and lengthy time horizons. Instead, they tend to follow the path of "least resistance" which might not help them attain an optimal outcome profile. "If consumers or investors take shortcuts they may be overly reliant on defaults and easily influenced by advertising and irrelevant information," according to Hastings. "They might not think about how information is framed and how information is put forward."

To explore the role of regulators or the government in communications, the researchers are looking at how people decide to invest their private Social Security accounts in Chile. Using household data, the researchers delve into participants' financial literacy and the way they select from among five fund managers who might handle their retirement investment. The top three reasons given include recommendations from friends, the fund's profitability and to help a salesman (the latter might entail the possibility that the salesman would in turn do a favor for, or provide some sort of gift to, the participant). The researchers also ask the interviewee whether the fund manager provides good service and what he or she perceives relating to advertising, commissions, and employer recommendations. Their analysis shows that better-educated workers, and those with higher median incomes, are more likely to select the fund manager generating the highest returns. They are more likely than others to turn to their employers for recommendations on which manager to select. Lower-income respondents rely more on advertising and recommendations from friends. According to Hastings, this suggests that the

less-educated are more susceptible to how information is framed. Conseuqently, this offers a role for regulators in monitoring information and plan design.

Retirement investors are eager for advice, but they are also often confused about what the various financial service providers and advisers do. In other words, the public is often unclear about what different financial service professions do, according to Angela Hung, Noreen Clancy, and Jeff Dominitz from RAND in work entitled *"Investor Knowledge and Experience with Investment Advisers and Broker-Dealers.*" Notes Hung, "People say you don't have to have a financial background, since you can always hire someone. But it's not that straightforward. You need some key knowledge about financial service providers, before you can make a decision about whom you want to hire to give you the financial advice."

She explains that, in theory, broker-dealers and investment advisors have distinctly different roles: brokers conduct security transactions, dealers buy and sell securities for others, and investment advisors provide advice regarding securities. But the lines have blurred. To gain a better sense of how well consumers understand the distinctions between financial service professionals, Hung has surveyed 654 members of the RAND American Life Panel in 2007 and additional focus groups in Virginia and Indiana. She finds many understand the different roles of a broker-dealer and investment advisor, but few understand how to differentiate a financial advisor versus a financial consultant. She explains: "the words *financial advisor* and *financial consultant* are generic terms used by investment advisors and broker-dealers. The interchangeable titles compound the confusion." She also reports that respondents feel they do not need this type of financial service because they have insufficient assets.

While there is little evidence linking satisfaction with a professional to actual financial returns or costs, those who have worked with financial professionals tend to have long-term

relationships with their advisors. They cite attentiveness and trust as key attributes of financial services providers. And while investors lack clear understanding of what financial professionals do, they are hungry for financial advice; they understand they lack financial literacy and want help. She concludes: "A key challenge for the financial industry is to offer unbiased, experienced and high-quality investment advice for people with widely varying financial situations and needs."

For those with little money, alternative financial providers play a key role, including payday loan offices and pawn shops. These provide needed cash but at a heavy price, according to a new study by Jeremy Tobacman of Wharton, and Paige Marta Skiba and Susan Carter from Vanderbilt University. Their presentation is entitled, *"Payday Borrowers: Transaction Habits, Credit Score Changes, and Pecuniary Mistakes,"* and it discusses the over 10 million Americans who turn to payday loans each year. These small loans -- typically for about $300 – are usually for a short term of two weeks, and they carry an interest rate of 15 percent. To better understand this practice, the authors study credit union members who had an electronic debit charge to a payday lender in the first half of 2006, compared to other members with an open account in January of the same year. Those who took out payday loans had higher credit scores, higher inferred income, and smaller loan amounts than other credit union members. Further, those who turn to alternative financial services have higher initial account balances, but those balances are falling faster over time relative to others. "Perhaps they have financial troubles, which leads them to make these mistakes," suggests Carter. Interestingly, half of the payday borrowers could have used liquidity in their checking or saving accounts, or used lines of credit, instead of the high-cost payday loans. For those who used payday loans, interest losses averaged $49 for the six-month time period in the study.

These findings show that it is important to examine all the financial pathways that influence long-term financial security. In addition, it is critical to help individuals with the lowest levels of financial literacy and fewest assets because they seem the least likely to be able to get financial planning advice. While the indigent elderly do receive income support, the availability of these programs might discourage not only saving but also impede the development of financial literacy. In other words, some people may not save, hoping that the social safety net will catch them.

Experiences in the International Arena

To expand understanding about financial literacy globally, three panels explored interventions taking place in different parts of the world. Diana Crossan, New Zealand's Commissioner of the Office of Retirement, emphasizes the importance of a national strategy for financial literacy in her work entitled *"How to Improve Financial Literacy: Some Successful Strategies."* Two years ago, her country adopted a national strategy to improve retirement readiness that was initiated with numerous private-sector and non-government partnerships. She worked with banks and other organizations to help assess needs and develop a strategy to improve financial literacy and retirement saving adequacy.

She particularly stresses the importance of her group's website, and the Commission's web presence became particularly important after the agency shifted its focus to young people still in the process of saving for retirement. The website is called "sorted.org.nz" which builds on the word "sorted" -- in New Zealand this means "prepared" or "ready-to-go." One third of the entire population has used the site since 2001, undertaking 31 million calculations. She also highlights the role of financial education in schools and in tertiary educational institutions. But

her Commission faced challenges when introducing financial literacy programs into the nation's schools, as they are fiercely independent. Nevertheless, bringing financial literacy to the schools is a matter of social equity, in her view: "every child has the right to have financial information in today's world -- every child, not just rich kids." Her group has also reached out to the native Maori population which makes up 15 percent of New Zealand's population.

The World Bank is also reaching out to poor populations around the world to improve financial literacy. Robert Holzmann from the World Bank is working on a project entitled *"Bringing Financial Literacy and Education to Low and Medium Income Countries,"* which involves outreach to emerging economies. After noting that a number of high-income countries around the world have begun to place a new emphasis on financial literacy Holzmann suggests that programs must be tailored to meet specific characteristics of low and middle-income countries. For instance, people in low income countries may lack access to financial services, and poverty can lead to a much greater focus on day-to-day survival than in higher-income nations. The rural nature of poor countries also is a factor he notes, pointing out that assets in these nations are likely to be seeds or cattle, rather than financial assets. Poor countries also have a far greater number of people working in the informal economy, limiting organized interventions in developing financial capability. Finally, risk – political, natural, economic – tends to be greater in poor countries, further hampering incentives to develop long-term financial capability.

To improve financial capability in poor countries, he proposes that policymakers develop programs to monitor and evaluate ideas that work. He also favors direct approaches that change behavior such as propaganda and social marketing; these have worked to improve health

outcomes (particularly with HIV-AIDS) and they could be used to improve financial capability in low and middle-income nations.

In work underway in the Financial Affairs Division of the Organization for Economic Cooperation and Development (OECD), Flore-Anne Messy and Andre Laboul are working on the theme of *"Financial Literacy: Implications for Retirement Security and the Financial Marketplace."* The OECD defines literacy as a process of building capability, and improving consumers' financial education is critical if financial services regulation is to succeed. In Messy's view, the global financial crisis provides a "teachable moment," forcing analysts to recognize the importance of preparing individuals for added financial risk as financial services products become more complex. She adds," most often, consumer protection requirements are useless if the consumer is unable to make sense of the information provided." The growing asymmetry of information between financial service providers and consumers not only weakens household financial positions, but it also diminishes the strength of the financial service companies and the broader economy over time. Most critical is the startling and widespread misunderstanding of risk. Finally, Messy argues "local networks are key and coordination with national policy is a necessity."

Shaping the Financial Literacy Environment

Next we turn to entities which provide financial education interventions. The role of nonprofit organizations is the focus of work by J. Michael Collins from the University of Wisconsin, entitled "*Improving Financial Literacy: The Role of Nonprofit Providers."* The author points out that nonprofit organizations can enjoy more public trust because these institutions are not designed to benefit other stakeholders. In addition, nonprofits are viewed as a

force for pluralism because they are able to reach pockets of populations that are not well-served. Collins has reviewed over 2,000 tax-exempt organizations with the terms "credit counseling" or "financial education" in their tax filings, and he concludes that these organizations tend to be small and very diverse. The groups range from small community-based organizations with volunteer educators, to large agencies with professional staff providing multiple services. It is interesting that very few nonprofit organizations are designed specifically to deliver financial literacy programs; instead, many began to offer financial education programs as part of some other funding mechanism or service. For instance the U. S. Department of Housing and Urban Development housing counseling program funded more than 1,000 nonprofits geared to financial counseling related to housing. In 2009, the U.S. Treasury Community Development Financial Institutions Fund also began a financial education and counseling pilot program to provide grants to nonprofits focusing on financial literacy.

Collins also examines the content of nonprofit programs, and he concludes that low-income clients do receive basic help on goal-setting and budgeting. As the organizations increase in sophistication, they move into offering credit management and help with access to financial institutions. Beyond that, they might provide assistance with income tax and saving strategies. While some may believe that nonprofits are a less expensive source of financial education, there is little evidence that nonprofits are any more or less efficient in providing financial literacy services. The author also concludes that there is little concern that nonprofit services crowd out private sector providers (although this may be true when it comes to healthcare nonprofits).

For some, the 401 (k) accumulation at the workplace can be a tempting source of easy finance. In his work with Jean Young, Steve Utkus from the Vanguard Center for Retirement Research explores this thesis in a study entitled "*Financial Literacy and 401(k) Loans.*" Almost

one-fifth of 401 (k) participants had loans outstanding at any given time, with the loans averaging 16 percent of the balance. This work shows that the most significant factor predictive of the likelihood of taking out a 401(k) loan is tenure on the job, probably linked to being more informed about 401 (k) loans. The most surprising result of the study is that higher-income people are more likely to borrow; the authors also find that lower financial literacy is linked to a higher level of loan-taking. In sum, borrowing against 401 (k) plans cannot be viewed in isolation from the rest of the household balance sheet.

A different take on the role of financial literacy in retirement wellbeing is offered by Julie Agnew and Lisa Szykman from William and Mary's Mason School of Business. Their work, entitled *"Annuities, Financial Literacy, and Information Overload,"* focuses on the reluctance of investors to annuitize retirement wealth, even when annuities can provide much-needed protection against longevity risk. Specifically the authors first give plan participants a short test to assess their financial literacy levels. Next they play a game simulating investment versus annuitization decisions that might unfold for someone leading up to and through retirement. The experiment is structured to make the annuity choice simple, allowing the researchers to measure participants' financial literacy against self-reported levels of cognitive and emotional overload, confidence, and satisfaction. They report that individuals with high levels of financial literacy are more likely to pick the investment option, while those reporting emotional overload tend to select the annuity. Agnew argues that her results indicate that plan sponsors might do well to simplify decisions about retirement plans. "Sponsors need to look at their plans and find the path of least resistance and realize that's where the least financially literate people are going to go," Agnew asserts.

Financial illiteracy can be costly not only to individuals but also to society, implying that programs could be designed to help consumers and plan providers achieve better retirement security. This topic is taken up by Itzhak Ben-David from the Ohio State University's Fisher College of Business, with Sumit Agarwal, Gene Amromin, and Douglas D. Evanoff of the Federal Reserve Bank of Chicago, and Souphala Chomsisengphet from Office of the Comptroller of the Currency. Their work, entitled *"Financial Counseling, Financial Literacy, and Household Decision Making,"* explores how counseling works to influence mortgage demand. The authors evaluate two treatments: a mandatory two-hour review of mortgage offers in Chicago, and a voluntary two-year counseling program in Indiana. In the former case, for a four-month period, the State of Illinois required borrowers in 10 zip codes to submit mortgage offers to review by HUD-certified counselors. Borrowers with a low credit score, or selecting risky mortgage products, were required to attend counseling. The team finds that, in order to avoid counseling, small lenders with loose lending criteria and consumers with low borrowing capability dropped out of the market, and other potential borrowers chose less risky products to avoid the counseling requirement. "In a way, the program achieved its goals without actually providing the counseling," Ben-David asserts. In the voluntary program, participants learned about credit and budgeting and developed a financial plan. They met with counselors one-on-one each month and if they remained on track with their financial plan received loans from partner lenders. The loans made to graduates of the program performed much better than those of a control group. "There was a lot of hand-holding and close monitoring," according to Ben-David. "Whenever there was some cash-flow difficulty, the counselor sat with the borrower and helped him or her sort out the situation."

Key Takeaways

Several themes thread their way through this set of discussions. One issue is the fact that financial products are becoming increasingly more complex, perhaps at a faster rate than we can keep up. A proponent of this view is James B. Lockhart, former Director of the Federal Housing Finance Agency. While the idea of an "ownership society" was to build net worth for individuals, particularly minorities, through homeownership, the opposite has occurred: financial net worth has been destroyed with 25 percent of mortgages underwater. Clearly the financial meltdown had many causes, but a lack of financial understanding about the dangers of subprime or adjustable-rate mortgages with teaser rates was key – even though sophisticated buyers made mistakes too.

Several speakers noted the key role played by Social Security in the retirement mix, including Melissa Moye from Maryland State Treasurer's Office who suggests that the agency's annual statement to program participants could add information about life expectancy and spousal benefits. Indeed, SSA's online retirement calculator is adding a life expectancy factor explaining clearly that, for instance, retirees who live to 85 would need 20 years of assets beyond age 65. Sometimes people "don't make the connection that 85 means 20 more years. We're trying to give them the idea that retirement might be longer than they think," explains Jason Fichtner of the U.S. Social Security Administration. In New Zealand, media campaigns are used to promote the use of planning tools.

In sum, the Wharton event has identified several explanations for widespread financial illiteracy, and we also evaluated several programs and experiments that can be useful in rectifying the problems. Participants now understand more clearly the critical importance of evidence-based research and evaluations, projects that take into account peoples'often

complicated economic and behavioral considerations when planning for a successful retirement. Yet this work remains only a first step, since much remains to be done to enhance financial literacy. This is particularly among women, the low-paid, and the least-educated members of society. Without more financial literacy, people will be increasingly at risk of making poor financial decisions and facing old age without adequate retirement saving.

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