NEWS REVIEW

Heartland Institute of FINANCIAL EDUCATION

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February 2015

The Financial Education Imperative

Kellie Richter, Rusty Field, Ward Armstrong, PFEEF

Employee financial health has a direct impact on the financial health of America's corporations.
The challenge is one of execution.

Financial education in the workplace is central to the success or failure of American workers to save adequately for their retirement. However, it is becoming increasingly clear that the success of financial education is a function neither of print-based education nor of technology but is, instead, dependent on a more personal level of interaction with advisors who can execute a more complete financial education approach and help bridge the growing divide between employers and employees in the benefits arena. PLANSPONSOR talked to three American Express Retirement Services executives about the role of advisors in the workplace: Ward Armstrong, president of American Express Retirement Services; Rusty Field, vice president, and Kellie Richter, vice president of products and marketing, both with American Express Financial Education and Planning Services.

PS: When it comes to benefits, we seem to be in the midst of a sea change in the relationship between employers and employees. What has happened to bring that about?

Armstrong: There have been some dramatic shifts. At a macro level, there's been this transfer of responsibility and risk to employees—the most obvious indication of that has been the growth in defined contribution plans, but you are also now seeing it in the employer approach to health care. More recently we have seen a shift away from reducing costs in the workplace—which many employers have focused on to the exclusion of all else in the last few years—toward a focus on attracting and retaining talent. The challenge for employers is to deliver a benefits package centered on a defined contribution solution that also really delivers retirement security to employees.

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Field: The hard truth is that too many DC plans don't deliver and, for the first time ever, many employees are entering the workforce with an expectation to live and retire less well off than their parents. Now, the general trend toward shifting this responsibility from the employer to the employee is not going to be reversed, but many employers are beginning to understand the high cost of having financially unhealthy employees. There's a significant cost if your employees are preoccupied with their financial health, or their lack of it, and a significant cost to the company if you can't retire employees and bring new employees in.

PS: If the problem is that DC plans, as presently constituted, don't deliver what they should, what's the solution?

Armstrong: Financial education is the solution, but we're talking about an approach that's very different from what we've seen in the past. For a start, you have to provide advice using a variety of media and, perhaps most importantly, you have to be able to deliver it face to face.

Field: If you think for a moment about the decisions we have to make as employees today—vital decisions on benefits that our parents never even had to think about—these are not decisions that can be made easily: Choosing from multiple health-care coverage plans and handling ever-increasing costs versus the basic, all-inclusive medical coverage of the past, or choosing among 15-plus 401(k) investment options and a self-directed account versus a traditional pension plan. All of our research leads us to believe that, if you're going to help participants make these decisions, you need to be able to interact with them when and how they prefer. Moreover, all these financial decisions are interconnected; they can't be made in isolation. Our own experience has shown us that the best way to help people make these decisions is by giving them face-to-face support leveraging a financial planning approach.

Armstrong: In the late 1990s, all of us scrambled to get our information online, and we all found third parties to do Web-based advice and education, but the end results were that only a small percentage of participants chose to go that route. The fact is, it is live interaction—advice delivered in person or on the phone—that changes participant behavior for the better.

Richter: And not just for the better for the employee. You also can give employees a much better understanding and appreciation of their benefits package, and that can change the way they regard their employer. Companies invest heavily in their benefits packages; the right education delivered the right way gives them a return on that investment. It is counterproductive for a company to be paying for a benefit that is not being utilized.

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Field: Unfortunately, many companies have become inured to this. However, if you look at some of the companies we have worked with where we have been able to bring into the plan the breadth of financial education that we can harness now, the results have been eye-opening. Just to cite one example: We recently dealt with a pension termination that affected some 1,500 employees, and we had 45 days to help each of them through the decision making process. We picked 300 of what we call our Platinum Advisors—they're the American Express top advisors around the country—and gave them 15 to 20 hours of training on the particulars of this extremely complex pension fund. The end result was that we were able to get 650 of these employees to do a formal financial plan on that pension elimination decision. The client had hoped for perhaps 300 at most to do that— we got 650 to do it.

Employee Financial Health and the Bottom Line

E. Thomas Garman is a renowned author, advisor, and academic—he is a Fellow and professor emeritus at Virginia Tech University. Garman is identified particularly with research linking the financial fortunes of corporations with the financial health of their employees.

He talked to PLANSPONSOR about this linkage, and what it means for corporate America.

PS: What has your research told you about the state of personal finances of American workers?

Garman: It is not a happy story. One-third to half of employees say they are dissatisfied with their personal financial situation—three in 10 are very or somewhat concerned about paying the monthly rent or mortgage, and half say they live paycheck to paycheck. More to the point, some 85% use work time to deal with personal financial matters, and one-third typically waste more than 20 hours a month. In addition, about 40% of financially distressed employees say their financial problems have affected their health negatively. In a way, financially troubled employees are like sharks swimming around the workplace taking bites out of the bottom line.

PS: How should American corporations deal with this?

Garman: I will go so far as to argue that the financial organization that provides sound financial education is the single most important tipping-point resource for employers today, and that includes the CFO who is doing what needs to be done to bring more profits to the table. Workplace financial education has almost boundless value to employees, and that spills over on the positive side for employers.

Employee Financial Health and the Bottom Line continued…

PS: Is this widely appreciated?

Garman: Not as widely as it should be, although a study by the Florida Department of Financial Services found that two-thirds of employers "said they feel worker productivity would be enhanced by financial literacy training." The research done on this indicates that an employer's return on investment for workplace financial education is at least three to one.
My message to employers is: "Don't give employees a raise; instead, give them access to quality financial information, education, and advice." Ten years from now employers will realize they were crazy not to spend $200 to $300 per year per employee on workplace financial education, including face-to-face counseling, because financial education is so good for the employer's bottom line.
E. Thomas Garman is one of several featured authors in The American Express Guide to Workplace Financial Education and Advice.

Financial Literacy, Beyond the Classroom

By RICHARD H. THALER, NY Times

EVEN if we grade on a very generous curve, many Americans flunk when it comes to financial literacy. Consider this three-item quiz:

• Suppose you had $100 in a savings account and the interest rate was 2 percent a year. After five years, how much do you think you would have if you left the money to grow? More than $102, exactly $102 or less than $102?

• Imagine that the interest rate on your savings account was 1 percent a year and that inflation was 2 percent. After one year, would you be able to buy more than, the same as or less than you could today with the money?

• Do you think this statement is true or false: "Buying a single company stock usually provides a safer return than a stock mutual fund"?

Anyone with even a basic understanding of compound interest, inflation and diversification should know that the answers to these questions are "more than," "less than" and "false." Yet, in a survey of Americans over age 50 conducted by the economists Annamaria Lusardi of George Washington University and Olivia S. Mitchell of the Wharton School of the University of Pennsylvania, only a third could answer all three questions correctly.

This is particularly troubling given the inherent complexity of our modern economy. Whether in taking out a student loan, buying a house or saving for retirement, people are being asked to make decisions that are difficult even if they have graduate training in finance and economics. Throwing the financially illiterate into that maelstrom is like taking students currently enrolled in driver's education and asking them to compete in the Indianapolis 500.

Financial Literacy, Beyond the Classroom continued…

A popular approach to this problem is to work harder to improve financial literacy — for example, by including household finance in the basic high school curriculum. One reason to think this solution will have big payoffs is that people who are more knowledgeable about financial matters, as measured by a test, perform better at tasks like saving for retirement and staying out of debt. This may seem a straightforward argument in support of financial literacy courses. Unfortunately, it isn't.

The problem is that measured financial literacy is highly correlated with other factors, most notably higher education in general, so it's hard to sort out causes. (The ability to solve the Sunday crossword puzzle is probably also positively correlated with good financial outcomes.) So to see whether a financial education curriculum is likely to pay dividends, we should review specific efforts to shore up financial skills in those who are deficient and not just measure what people already know.

A new paper by three business school professors — Daniel Fernandes of Erasmus University in the Netherlands and the Catholic University of Portugal, John G. Lynch Jr. of the University of Colorado and Richard Netemeyer of the University of Virginia — presents a discouraging assessment of attempts to teach people how to deal with money. Their article uses a technique called meta-analysis, looking at results from 168 scientific studies of efforts to teach people to be financially astute, or at least less clueless.

The authors' conclusions are clear: over all, financial education is laudable but not particularly helpful. Those who receive it do not perform noticeably better when it comes to saving more, for example, or avoiding ruinous debt. Even more depressing, the results of efforts aimed at low-income people are particularly weak. Those who need the help most seem to benefit the least.

DON'T get me wrong. I am all for trying to teach household finance in schools, starting as early as possible. And when it comes to high school, I think learning about compound interest is at least as important as trigonometry or memorizing the names of all 50 state capitols. If we try enough approaches, and evaluate what works, we may improve such programs' effectiveness. But, we shouldn't fool ourselves into thinking that adding a household finance class to a high school curriculum will, in itself, create knowledgeable consumers who can understand today's wide array of financial products.

In some ways, the finding that financial education doesn't provide long-term payoffs is hardly surprising. After all, how much do you remember from your high school chemistry class? Unless you use chemistry at work, you probably don't recall much about ionic bonding. In the meta-analysis, even the most time-intensive programs — those with more than 24 hours of education and training, almost the length of a college course — had no discernible effects just two years later.

Financial Literacy, Beyond the Classroom continued…

It would be premature to conclude that all efforts at improving financial literacy are futile. But it is a fair conclusion that simply doing more of the training commonly used now will not produce significant results. So what else might we try? Although no approach offers a panacea, three types of efforts seem worthy of more attention.

The first is what Professor Lynch, one of the authors of the meta-analysis, calls "just-in-time education". Because learning decays quickly, it's best to provide assistance just before a decision is made. High school seniors should receive help in how to think about a student loan and how to make sure that the education bought with the loan offers good prospects for repayment. Just-in-time education can be offered at other crucial moments — when taking out a mortgage or figuring out when to retire. But unless such education is compulsory, many of the consumers most in need of help don't take advantage of it. And, we need to be sure not to confuse self-serving marketing with objective advice.

Another approach is to offer simple rules of thumb to help people cope. Because few people can calculate how much they need to save for a comfortable retirement, it might help to offer simple guidelines like "invest as much as possible in your 401(k) plan," "save 15 percent of your income" or "get a 15-year mortgage if you are over 50."

One example comes from a field experiment involving micro entrepreneurs in the Dominican Republic. Of those who expressed an interest in receiving help, some were offered training in basic accounting principles while others were given simple rules of thumb. The accounting education did not have apparent effects, but simple rules — like keeping personal money and business money in separate drawers — led to better outcomes. This seemingly trivial concept helped small-business owners keep better track of how their businesses were faring.

The third approach, and the one I believe offers the best prospects of immediate help, is to make our financial system more user-friendly. You don't need to be a computer scientist to use a smart phone. If we made choosing a suitable mortgage as easy as checking the weather in Timbuktu, fewer households would find themselves underwater when real estate markets tumble.

In the case of 401(k)'s, many companies have made their employees significantly better off by providing a well-designed default investment option, like a low-fee target-date fund. Most unsophisticated investors are better off using that option than trying to be their own portfolio managers.

The same principle can be used in other areas, from credit cards to checking accounts. The financial services industry — either on its own or as required by government regulators — needs to find ways to make it easier for people to make sound decisions. And those financial firms that engage in fraudulent practices should be prosecuted and stopped.