NEWS REVIEW

The Heartland Institute Of Financial Education
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March 2015

Financial Education Needed to Improve Outcomes For Employees in 401(k) Plans

By PFEEF February 2015

Many companies encourage their employees to participate in 401(k) plans and, even though the participation rate may be high, the plan may not be fulfilling its purpose. The ultimate purpose of a 401(k) plan is to provide an opportunity for adequate income replacement upon retirement. So how much money is needed? There are many factors determining how much money is needed for retirement, and that is why financial education is so important. Each person has to factor in their specific situation to see what they should be doing to reach their retirement goal.

Most employees would think having $196,000 in a 401(k) at retirement would be good news but according to BTN Research, a person needs $196,000 for every $1000 per month payout for a 20 year period. This assumes a 5% return and 3% inflation without regard for taxes. Having a $1000 per month drawdown in retirement still puts the retiree at the federal poverty level for 2013 ($11,490 for a one person household). The bad news is that the average 401(k) balance reached an all time high of $75,900 in the third quarter of 2012 (Fidelity Investments). Of course these averages are for illustration and do not figure on any Social Security or pensions, but it is important to remember that Social Security can be changed; and, not too many companies still have pensions, which means younger employees really need to plan for themselves.

Companies can maximize the effectiveness of their 401(k) plan by implementing an education plan that addresses individual employee participation, savings rate, and monthly income projected at retirement. There are additional factors each person should consider in deciding how to plan for retirement, and by learning financial terms and outcomes, they can make adjustments in order to lessen the changes that retirement may cause.

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The Inexorable Logic of Financial Literacy

By John Hoffmire & Pankaj Upadhyay PFEEF February 2015

The future of humanity is irrevocably tied to empowered individuals capable of discharging their obligations and responsibilities. Literacy was a key enabler in our collective civilizational advance. In a similar vein, the evolving context is placing big financial burdens on individuals, demanding an enhanced level of financial ability.

Should we continue to trudge in a cloak of fatalism where financial well-being is tethered to the benevolent designs of vigilant legislation, or do we let the markets make provision for this good? Concerns about poor financial decision-making and weak consumer protection have elicited feverish regulatory and legislative responses. The overriding intent is to empower consumers about personal financial management and the role of economic literacy as an antidote to limited individual financial capabilities.

The global financial crisis, rapidly changing economic climate, bewildering array of financial products, increased life expectancy and greater focus on personal investment management have brought a heightened attention to financial capabilities and fitness. The complexity of the financial terrain calls for a more effective response than is provided by some people in government who sometimes do not understand the complexities of the marketplace.

The market forces will only help consumers overcome their fallibilities while the incentives to such interventions align with their interests. There is some evidence suggesting that markets help individuals surmount the affliction of limited financial capabilities.

Academic studies shed some light on the positive correlation of financial literacy with planning for retirement, savings and wealth accumulation. Financial literacy has also been found to lead to greater financial inclusion, participation in capital markets, better diversification and choosing a low-fee investment portfolio.

On the other hand, low financial literacy is associated with insidious outcomes such as debt accumulation, high-cost borrowing and poor mortgage choices among others. While a cautious response should make us guard against an unabashed acceptance of the redemptive powers of financial literacy, waiting interminably for big government and big companies to solve this problem will not work.

The Inexorable Logic of Financial Literacy continued…

Globally there are nearly 2.3 billion working-age adults who are financially excluded, and financial inclusion can help break the vicious circle where people incur inordinate costs on account of lack of access to mainstream financial products and knowledge. Financial development matters for the distribution of incomes and poverty. With increasing sophistication of financial markets, the enhanced capacity to embrace investment opportunities may help reduce inequality.

Economic literacy has been found to mediate the empirical association between financial development and reduced inequality, suggesting that financial development in the absence of economic competences may do little to reduce inequality.

However, in the final analysis, financial efficacy and competences are driven by the judicious mix of content, delivery, knowledge retention and instigation to transform intent into action. "Teachable moments" just prior to making key financial decisions are especially pertinent. Joe Saari, who co-founded Precision Information LLC, a leading provider of interactive financial education products, echoes this sentiment about context when he says that "the best place to administer wealth education is where people make money, namely the workplace."

Financial education in the workplace complements a wide array of other imperatives such as learning about these matters in the home, religious institutions and at school. Financial inclusion, financial literacy, companies that are willing to help, and even consumer protection by government and nonprofits are recognized as four pillars of a financial education strategy. Together they might yet help to realize the ideal of developing a financially literate populace.

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Why Anti-Poverty Aid Needs Financial Literacy

By John Hoffmire & Ben Young PFEEF February 2015

Across the United States, it is not uncommon to see billboards and advertisements for a local lottery. These are often joined by other joint lotteries, some of which cover several states. While the variety is seemingly endless, all the ads and sponsorships of the games share one trait: a warning. Often found in the fine print of a ticket or displayed along the bottom of a massive billboard, some variation of the following wording is included by the organizations running the lotteries: "Not to be used for investment, retirement or savings purposes."

These warnings hardly seem necessary. The odds of winning big at the lottery are one in tens of thousands, often millions. And yet, people keep purchasing tickets and entries, especially the poor. Nationally, according to a survey from the Consumer Federation of America, 21 percent of Americans believe the lottery is the most effective and practical strategy to accumulate several hundred thousand dollars. This percentage jumps to 38 percent for low-income respondents.

Herein lies one of the most difficult problems facing anyone concerned with poverty alleviation: a lack of basic financial literacy. Whether it relates to wealth accumulation, credit-card debt, or simply saving money for a rainy day, financial literacy around the globe is remarkably low.

A Harvard study in 2007 found that 40 percent of American credit-card holders do not pay the full amount due each month despite high interest rates. Similarly, a survey in England found that one-quarter of adults did not realize that pensions were often invested in the stock market.

This lack of knowledge has serious repercussions for programs, especially those aimed at breaking the devastating cyclical poverty that is all too common in inner cities as well as poor rural regions. Without the proper accompanying financial literacy, all the money in the world will not solve the plight of those families caught in the cycle of poverty. Thankfully, the problem of financial illiteracy is gaining more attention worldwide, leading to new efforts and organizations stepping forward to help those in need.

One of the most successful and well-known organizations is the nonprofit Operation HOPE. Founded in 1992 after the Rodney King riots in Los Angeles, Operation HOPE's stated goal is to "make free enterprise work for everyone," especially focusing on the working poor and the struggling middle class. Its main weapon of choice in this fight for those in need: financial literacy.

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How Social Security Can Help You Play Catch-up on Retirement

Mark Miller MSN Money February 2015

More Americans over 55 are finally getting back to work after the long recession. The strong national employment report for January released last week confirmed that. The unemployment rate for those over 55 was just 4.1 percent in January, down from 4.5 percent a year ago and well below the national jobless rate. The 55-plus labor force participation rate inched up to 40 percent from 39.9 percent.

That is good news for patching up household balance sheets damaged by years of lost employment and savings and also for boosting future Social Security benefits.
Social Security is a benefit you earn through work and payroll tax contributions. One widely known way to boost your monthly benefit amount is to work longer and delay your claiming date. But simply getting back into the job market can help.

Your Social Security benefit is calculated using a little-understood formula called the Primary Insurance Amount (PIA). The PIA is determined by averaging together the 35 highest-earning years of your career. Those lifetime earnings are then wage-indexed to make them comparable with what workers are earning in the year you turn 60, using a formula called average indexed monthly earnings (AIME); finally, a progressivity formula is applied that returns greater amounts to lower-income workers (called "bend points").

But what if you are getting close to retirement age and have less than 35 years of earnings due to joblessness during the recession?

The Social Security Administration still calculates your best 35 years. It just means that five of those years will be zeros, reducing the average wage used to calculate your PIA.

By going back to work in any capacity, you start to replace those zeros with years of earnings. That helps bring your average wage figure up a bit, even if you are earning less than in your last job, or working part time.

"Any earnings you have in a given year have the opportunity to go into your high 35," notes Stephen C. Goss, Social Security's chief actuary.

I ran the numbers for a an average worker (2014 income: $49,000) born in 1953, comparing PIA levels following 40 years of full employment with the benefit level assuming a layoff in 2009. The fully employed worker enters retirement at age 66 (the full retirement age) with an annual PIA of $20,148; the laid-off worker's PIA is reduced by $924 (4.6 percent). Getting back into the labor force in 2014, and working through 2015, would restore $720 of that loss.

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How Social Security Can Help You Play Catch-up on Retirement continued….

That might not sound like much, but it would total nearly $25,000 in lifetime Social Security benefits for a female worker who lives to age 88, assuming a 3 percent annual rate of inflation. And for higher income workers, the differences would be greater.

You also can continue "backfilling" your earnings if you work past 60, Goss notes. "You get credit all the way along the way. If you happen to work up to age 70 or even beyond, we recalculate your benefit if you have had more earnings.“

The timing of your filing also is critical. You're eligible to file for a retirement benefit as early as age 62, but that would reduce your PIA 25 percent, a cut that would persist for the rest of your life. Waiting until after full retirement age allows you to earn delayed filing credits, which works out to 8 percent for each 12-month period you delay. Waiting one extra year beyond normal retirement age would get you 108 percent of your PIA; delaying a second year would get you 116 percent, and so on. You can earn those credits up until the year when you turn 70, and you also will receive any cost-of-living adjustment awarded during the intervening years when you finally file.

Getting back to work will be a tonic for many older Americans, but what they might not realize is that it is also a great path to filling their retirement gap with more robust Social Security checks.