

**OECD - Bank of Italy
International Symposium on Financial Literacy**

**The Great Shift: From DB to DC Pensions.
The importance of Financial Literacy**

**Annamaria Lusardi
Dartmouth College and Financial Literacy Center**

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Relevance

Transitioning to a new system:

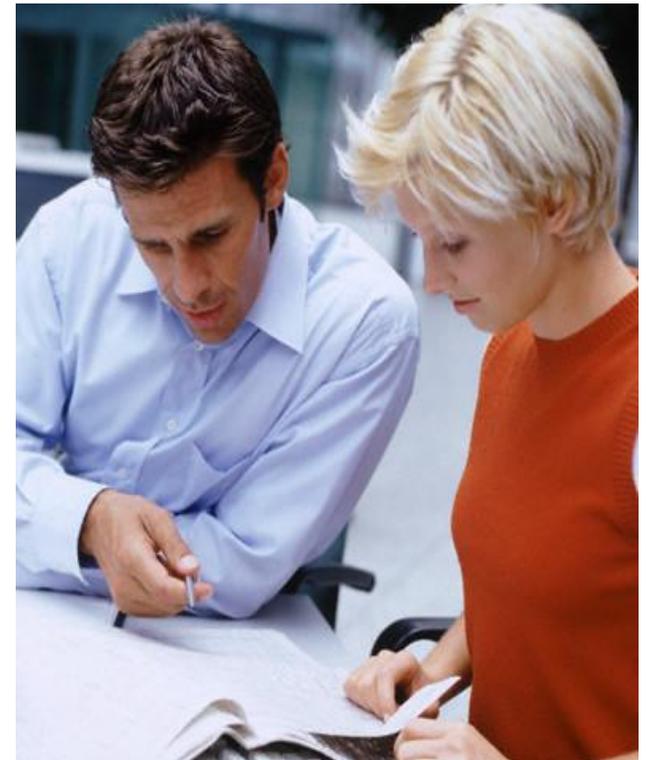
- Individuals must manage own financial security pre/post retirement:
 - ❖ Demographic changes
 - ❖ Labor market changes: more mobility
 - ❖ Pension changes: From DB to DC
- Financial markets more complex:
 - ❖ Proliferation of mutual funds
 - ❖ Globalization of financial markets



Relevance

How equipped are workers to deal with DC pensions?

- How much do workers know about basic economics and finance?
- How informed are workers about their pensions?
 - Half of older workers in the US are incorrect about their pension plan



Measuring Financial Literacy

To test numeracy and understanding of interest rates, we asked:

“Suppose you had \$100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?”

- i) more than \$102
- ii) exactly \$102
- iii) less than \$102
- iv) don't know (DK)
- v) Refuse to answer

Measuring Financial Literacy

To test understanding of inflation, we asked:

“Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, with the money in this account, would you be able to buy...”

- i) more than today
- ii) exactly the same as today
- iii) less than today
- iv) DK
- v) refuse

Measuring Financial Literacy

Finally, to test understanding of risk diversification, we asked:

“Do you think the following statement is true or false? Buying a single company stock usually provides a safer return than a stock mutual fund.”

- i) true
- ii) false
- iii) DK
- iv) refuse

How much do Americans know?

Source: 2009 Financial Capability Study

Distribution of Responses to Financial Literacy Questions (%)

	Responses			
	<i>Correct</i>	<i>Incorrect</i>	<i>DK</i>	<i>Refuse</i>
Interest rate	65%	21%	13%	1%
Inflation	64%	20%	14%	2%
Risk diversif.	52%	13%	34%	1%

NB: Only 30% correctly answer all 3 questions correctly; less than half (46%) got the first two questions right.

These questions have been asked in other countries

These questions have been added to national surveys in:

- ❖ The Netherlands
- ❖ Germany
- ❖ Italy
- ❖ New Zealand
- ❖ Russia
- ❖ Indonesia
- ❖ India
- ❖ Survey of pension funds in Mexico
- ❖ Japan
- ❖ Chile and other Latin American countries



Linking financial literacy to behavior: Academic research

- Debt and debt management



- Investments

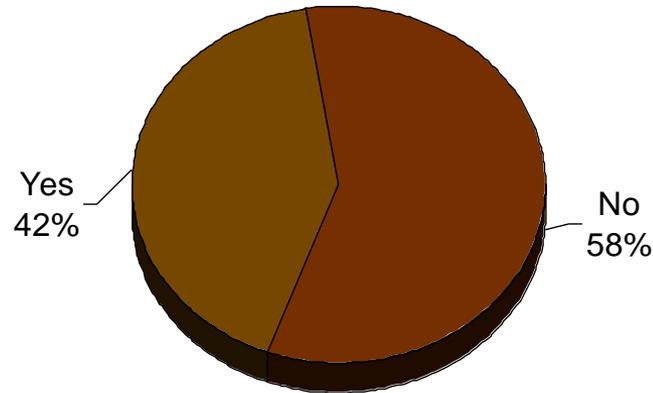


- Planning and wealth accumulation

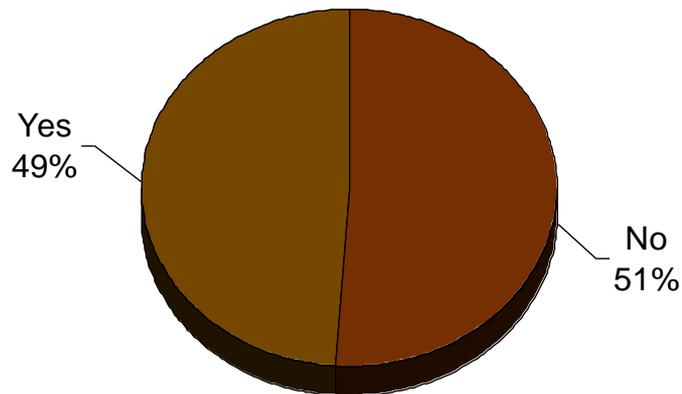
Planning ahead: Most Americans don't

(Source: Financial Capability Study)

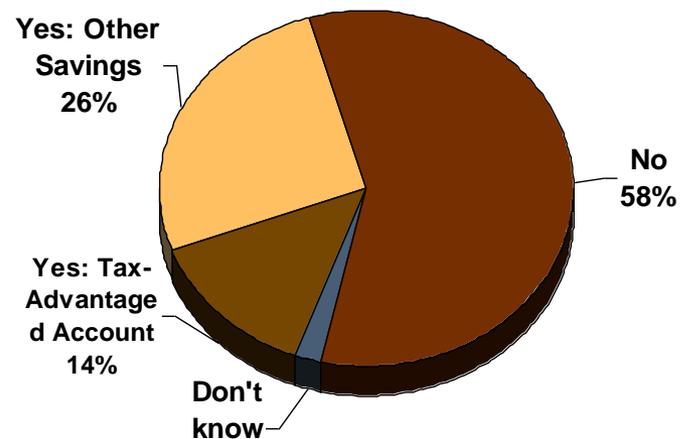
Have you ever tried to figure out how much you need to save for retirement?



Have you set aside an emergency or rainy day fund?



Are you setting aside any money for your children's college education?



Asset building & debt management

Many individuals carry debt

- High cost methods of borrowing
- Credit card debt
- Mortgages
 - Low down payments
- Borrowing on “themselves”
 - 9% took out a loan on their retirement accounts
 - 5% took a hardship withdrawal on ret. accounts

High-cost borrowing

(Source: Financial Capability Study)

Many Americans use high-cost borrowing methods

23% have used one of these methods in the past 5 years:

- Pay-day loans
- Pawn shops
- Tax refund advances
- Auto title loans
- Rent-to-own



Credit Cards

(Source: Financial Capability Study)

In the past 12 months...	Total	18-29	30-44	45-59	60+
I always paid credit cards in full	54%	51%	45%	44%	75%
In some months, I carried over a balance and was charged interest	51%	46%	62%	58%	33%
In some months, I paid the minimum payment only	29%	41%	35%	31%	11%
In some months, I was charged a fee for late payment	23%	24%	27%	29%	11%
In some months, I was charged a fee for exceeding my credit line	8%	14%	8%	9%	2%
In some months, I used the cards for a cash advance	8%	11%	10%	8%	5%

12% of respondents who do not pay in full each month do not know the interest rate on their credit card.

Automatic enrollment into pensions

Some limitations

- **Not ideal if workers carry debt**
- **One size does not fit all**
 - Workers have different needs and economic circumstances
- **Workers make many financial decisions**
 - Financial decisions are interrelated
 - Workers may need help with those decisions too
 - Workers need to know some basic principles of economics/finance to make decisions

What to do given widespread illiteracy?

■ The Dartmouth Project

- Simplify financial decisions
- Provide information
- Target specific groups
- Use communication that does not rely on figures and numeracy

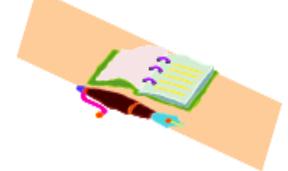
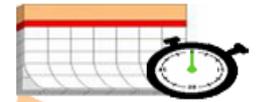


The Dartmouth Project: Planning Aid

Together with Punam Keller, I designed a planning aid intended to help college staff enroll in the college supplementary retirement account (SRA)

We have outlined 7 simple steps to help you complete the application.

1. **Select a 30 minute time slot** right now to complete the online contribution to your Supplemental Retirement Account (SRA) during the next week.
2. 3 minutes. **Check to see if you have the following materials:** a) worksheet in your benefits packet √, and b) the name and social security number of a beneficiary √.
3. **Select the amount you want to invest for 2006** (minimum: \$16/month, maximum: \$1,666.67/ month), even if you don't know your take-home pay in your first month. If you want, you can change this amount at a later date. This voluntary contribution is tax-deferred, you will not pay taxes on it until you withdraw the funds.
4. 5 minutes. **Select a carrier.** if you do not select a carrier, Dartmouth will invest the non-voluntary portion of your college funds in a Fidelity Freedom Fund, a fund that automatically changes asset allocation as people age.
5. 5 minutes. Now you are **ready to complete your worksheet.** Complete the worksheet even though you may be unsure of some options. You can change the options in the future.
6. **Take your completed worksheet to a computer** that is available for 20 minutes. If you like, you can use the one in the Human Resources office at 7 Lebanon Street, Suite 203.
7. 15-20 minutes. **Log on to Flex Online and complete your online SRA registration** within the 20 assigned minutes. Be sure to click on the investment company (TIAA-CREF, Fidelity, or Calvert) to complete the application. You need to set up your account – otherwise your savings will not reach the carrier.



Fidelity.com



Calvert



The Dartmouth Project: Planning Aid

Don't give up! Contact the Benefits Office (6-3588) if for any reason you could not complete the online application.



It takes no time to prepare for your lifetime!

Most people plan on electing a supplemental retirement account, but feel they don't have the time or information right now. We have outlined 7 simple steps to help you complete the election process. It will take between 15 – 30 minutes, from start to finish. It will take less time for you to start to insure your future than it takes you to unload your dishwasher!

Program Effectiveness

There was a sharp increase in savings enrollment within 30 and 60 days of hiring among participants who received the brochure

	30 days After Hire	60 days After Hire	Number of Observations
Control Group	7.3%	28.9%	210
7-Step Planning aid	21.7%	44.7%	166

Concluding comments

Financial *literacy* is a necessary skill, like reading and writing

- **Financial education and automatic enrollment are a complement not a substitute**
- **Need to equip workers with tools to make decisions**
 - Workers make many financial decisions and these decisions are interrelated
- **Cost of financial illiteracy at both the individual and macro level**
 - It is expensive NOT to do financial education

Financial Literacy Center

A new center focused on financial literacy

- **Joint Consortium: Dartmouth, Wharton and Rand**
- **Supported by Social Security:**
 - We received \$3.1 million in the first year
- **We are working on ten projects, including:**
 - Employer provided fin. education programs
 - Five steps to planning success
 - Financial health check-ups
 - Video games to teach working of credit cards