

A Little Bit of Knowledge:

How 401k Education Must Evolve

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A little bit of knowledge is a dangerous thing the old adage goes. But did any of us realize just how dangerous? This year's decline in the stock market coupled with the housing crisis and broadening economic downturn has thrown into shocking relief the widespread financial illiteracy among adults in this country. Let's take a look at just how ill-equipped many employees are in understanding basic financial concepts, what they need to know, and what we in the retirement plan industry can do about it.

How Much Do Employees Know?

The Michigan Retirement Research Center pioneered the insertion of questions measuring financial literacy into U.S. surveys, questions about fundamental concepts such as the working of interest rates, compounding, and investment risk and return. Research by Annemarie Lusardi and Olivia Mitchell entitled "Financial Literacy: An Essential Tool for Informed Consumer Choice?" poses three questions. They are:

- 1) 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?
 - a. More than \$102
 - b. Exactly \$102
 - c. Less than \$102
 - d. Do not know

- 2) Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, would you be able to buy more than, exactly the same as, or less than today with the money in this account?
 - a. More than today
 - b. Exactly the same as today
 - c. Less than today

d. Do not know

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

a. True

b. False

c. Do not know

The correct answers are obviously a, c, and b and I would hope that anyone reading this article scored 100%. However, among survey respondents age 50 and older only half got the first two answers right and only one-third got all three answers right.

If you’re thinking that younger individuals might be more well-versed in economics education, consider the findings of the latest annual survey by the JumpStart Coalition for Personal Financial Literacy in which a mere 48% of high school seniors answered all three questions correctly. A further note of concern: although **illiteracy cuts across all age, race, gender, income, and education demographics**, Lusardi points out “those with low education, women, African-Americans, and Hispanics display particularly low levels of literacy.”

Furthermore, the Princeton Survey Research Associates International (PSRAI) for the National Foundation for Credit Counseling 4/10/2007 established a benchmark survey identifying what Americans know about their finances. Its findings include the following: 66% of respondents have 1 or more credit cards, 29% do not know the interest rate being charged, 51% have never ordered a credit report, and only a minority keep close track of typical monthly expenses.

Where do individuals get the scant information they have? 35% learned nothing or not too much about managing money, balancing a checkbook, and building savings in their homes growing up, 55% learned nothing or not too much in school, and 64% have never received professional advice about financial issues.

We shouldn’t need the well-documented findings of the Michigan Retirement Research Center or the PSRAI to jar us into consciousness. **If we’ve made employee presentations, we have seen the signs.** How often have we explained an employer match – let’s say it’s 100% of the first 3% of deferral? Offering a simple hand-held calculator to the audience so that they might figure out the dollar amount of 3% of their paycheck, we are startled to find them queuing up, handing us the calculator, and requesting that we manage the computing. I’m always happy to do it. But frankly, it’s rather disconcerting that an erstwhile English major is considered more adept at figuring out mathematical axioms, even very simple ones, than most of today’s workers.

What Do Employees Need To Know?

Illiteracy in the rudimentary issues of compounding, how interest rates work, and risk and return has serious consequences on economic behavior (Lusardi, Annamarie and Olivia Mitchell (2008) "How Much Do People Know About Economics and Finance?"). In other words, individuals who do not have a basic handle on money matters are less inclined toward the very behaviors we encourage: participation in their 401(k) or 403(b) plan, systematic increases in deferrals, responsible handling of loans, and understanding the differences in asset classes. If an employee doesn't know how to check his credit report and improve his score, how can the burden of high interest rates on mortgage and car payments allow him to save responsibly? If he does not have the ability to figure out 3% of his paycheck, how can he be expected to devise a systematic increase in deferrals in his retirement plan?

Where Do We Start?

Good educators know that education starts where the student is. If employees don't know how to budget or save, why are we trying to teach them to invest? We've got to get basic. If workers can't imagine saving money from their paychecks, let's show them how. If they don't know the steps to creating a meaningful budget, let's walk them through those steps. If they don't understand the concept of compounding, let's demonstrate it. If they view their loan feature as the gateway to a checking account and a Bermuda vacation, let's talk tough realities.

Employee Education Needs to Evolve

A July 2008 New York Times article by Stephen J. Dubner entitled "Are We a Nation of Financial Illiterates?" reiterates the evidence that only a small segment of the adult population considers itself financially literate, and that this knowledge was usually a result of digging it out on their own. The research is in; the consensus is unanimous. We've got a job to do!

On going retirement plan education must address Financial Literacy issues. I am a strong proponent of the philosophy that education is most effective when it is provided in small digestible bites. Here, then, are 6 bites to begin with:

1. Budgeting – What's That?
2. Who Can Save In This Economy?
3. Change Your Life - Read, Monitor, and Improve Your Credit Report
4. 401k Loans – the Good, the Bad, and the Ugly
5. What Do Asset Classes Have To Do With Me?
6. Getting The Biggest Bang Out Of Your Retirement Plan

Format

These should be interactive, hands-on workshops in which attendees are given information, tools, a step by step process, and individualized attention. Workshops without abstract theories, statistics, or ponderous data. **Workshops that are personally relevant and that incite action.** They should be offered at the workplace (where employees have indicated they want them) and they must be brief – 30 to 40 minutes, each session focusing on only one topic. Small, digestible bites, remember? Compelling bites.

Remembering What It Was Like Not To Know

What are the most valuable attributes for an educator to possess? Knowledge, humor, the ability to connect, listening skills. And most importantly: the ability to remember what it was like not to know.

Who in our industry doesn't prefer scrutinizing a Value Line analysis to showing a healthcare worker how to create a household budget? But it's time to step back from what we discern as fascinating discussions of the merits of growth versus value management strategies, the intricacies of sector funds, and alphas, betas, and standard deviations. Please don't quote Barrons!

Our industry is accustomed to talking about 'Gaps', Dollar Gaps between the projected value of current savings and the amount of assets we will need to see us through increasingly lengthy lifetimes. **Now it's time to address another kind of Gap, an Information Gap.**

What's In It For You?

Financial Literacy workshops, positioned as part of your employee education component, are powerful means of giving you a significant edge in competing for business. Additionally, they can support your fiduciary responsibilities, contribute to the overall success of the plan, assist you in retaining that plan, and enhance your relationship with both employer and employees.

Let's Get Employees On Course

Former Secretary of the Treasury, Paul O'Neill, has said that *"Financial education can be compared to a road map to the American Dream. I believe that we need to teach All Americans the necessary tools to read that map, so they can reach the Dream."* **If financial education is the road map to the life Americans dream of, many are way off course, if not totally lost.**

Road maps permit us to know exactly where we are. They provide us with a legend, a north arrow, an index – tools and symbols that present us with the gift of control. We are able to plot a course from our current location to our desired destination. When my 24 year old son took off on a cross-country trek to relocate, his Honda crammed with camping equipment, five cameras, and a prized baseball card collection, I made sure he also had impeccably detailed AAA maps from Western Massachusetts to Portland Oregon, money in his pocket, a cell phone to call me if he was in trouble, and a homemade apple pie still warm. Did he take a detour to Chicago for the art museums and to St. Louis for a Cardinals game and a view from the top of the arch? You bet. But he always had what he needed to get back on course. He made it, without incident. Today's workers deserve no less. Well, maybe not the pie.

Sue Ellen Lovejoy is owner of Lovejoy Associates, a national network of professional retirement plan educators. They partner with plan providers, financial advisors, and third party administrators in providing quality enrollment, on-going education, and translation services to employees throughout the country.

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