Financial Literacy Among Retail Investors in the United States

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FRD Research for the SEC Office of Investor Education and Advocacy

- Behavioral Patterns and Pitfalls of U.S. Investors (August 2010)
- Annotated Bibliography on the Behavioral Characteristics of U.S. Investors (August 2010)
- Financial Literacy Among Retail Investors in the United States (December 2011)

Differences in Two Assignments

Topic	Investor Literacy	Investor Behavior
Issue	What do retail investors know?	What mistakes do retail investors make?
Sources	Investor surveys	Academic studies
Special considerations	Subgroups, research gaps, fraud	Behavioral finance, psychology

Sources for Financial Literacy Report

- 40 financial literacy reports were considered
- Of these, 11 were selected for analysis because they featured quantitative surveys of retail investors
  - Five pertained to the general population
  - Five pertained to subgroups (older Americans, high school seniors and college students, the military, minorities)
  - One pertained to investment fraud

Report Mechanics

- Each survey was summarized in an identical concise table, with each question identified by general topic
- The results were analyzed
- Details, including the specific wording of questions, were placed in the Appendix

2009 National Survey of Financial Capability (FINRA)

Question	% Correct	% Incorrect	% Don't Know
Inflation	64	21	13
Bond price	21	44	34
Compound interest	65	21	13
Mortgage interest	70	16	12
Risk	52	13	34

Results of the 2009 National Survey of Financial Capability in the United States

- Average number of correct answers: 2.72 out of 5
- Men: 3.00, Women: 2.46
- Young adults: 2.16 (worst), Adults aged 45 to 49: 3.04 (best)
- Performance correlated with income and educational level: 3.42 for high-income individuals and college graduates
- Asian Americans: 2.99 (best), Hispanic Americans: 2.07 (worst)

FINRA Analysis

- The results demonstrate "relatively low levels of financial literacy among Americans."
- "While the correct answer to any single question sometimes exceeded 60 percent, fewer than half of respondents (46 percent) correctly answered both a question about interest rates and a question about inflation. Less than one-third (30 percent) correctly answered these questions plus a question about risk and diversification correctly. And fewer than 10 percent of respondents were able to answer all questions correctly."

Early-Life Schooling and Cognition and Late-Life Financial Literacy in the Wisconsin Longitudinal Survey

- Instead of determining the respondents' knowledge of fundamental financial concepts, the study sought to measure their awareness of their own financial situation, such as their knowledge of how much money they held in retirement and bank accounts.
- They found that low IQ and the lack of exposure to mathematics courses in high school correlate with difficulty later in life managing finances and saving for retirement.
- The policy implication is that given the trend toward defined contribution programs, strategies are needed to help those with limited cognitive ability to manage their finances.

Key Findings: General Knowledge

- Although a significant majority of respondents indicated they were knowledgeable about finance and highly competent in handling day-to-day financial matters, they performed poorly on basic financial questions. (FINRA)
- Financial literacy increases with age. (American Savings Education Council)
- Women, the elderly, African- and Hispanic-Americans, and those with low levels of education perform worse than average. (Health and Retirement Survey)

Key Findings: Fraud

- Contrary to expectations, fraud victims scored higher than non-victims on a financial literacy quiz, indicating that even knowledgeable investors are vulnerable to fraud. (FINRA)
- The elderly are particularly susceptible to fraud because almost half believe that securities registered with the SEC are safe. (Investor Protection Trust)
- Only 15% of respondents checked an advisor's background or credentials with a regulator. (FINRA)
- Con artists frequently target individuals who are young, Southern, or poorly educated. (Investor Protection Trust)

Key Findings: Fees

- Only 25 percent of respondents knew that classes of mutual funds vary by the levels of fees they charge. (Mandatory Disclosure Document Survey-MDDS)
- Slightly fewer than 40% of older Americans (at least 55 years old) surveyed considered it easy to find mutual funds charging annual fees of less than 1% of assets, suggesting that many were unaware of the existence of index funds. (Health and Retirement Survey)
- Surprisingly, only 45% of fraud victims and 21% of non-victims knew that no-load mutual funds actually do involve sales charges or other fees. (NASD)

Key Findings: Risks

- A slight majority (52%) of respondents knew that mutual funds provide a safer return than a single company stock. (FINRA)
- 79% percent understood the correlation between risk and return. (MDDS)
- 62% recognized that if a company files for bankruptcy, the company’s common stock is most at risk of becoming worthless. (MDDS)
- 39% selected the correct definition of diversification: balancing both risk and return in pursuit of financial returns. (MoneyTrack/IPT)

Key Findings: Research Gaps

- It would be helpful to investigate the root causes for why several categories of respondents (women, African- and Hispanic-Americans, the elderly, and poorly educated) perform worse than average on investor literacy surveys.
- In particular, researchers have no plausible explanation for why women consistently perform worse than men. Women underperform men by 0.7 standard deviations. Differing attitudes toward risk and paths to becoming financially literate may offer partial explanations for this discrepancy. These explanations merit closer study.

Thank you for your attention.
Any questions?