

Financial Literacy

Professor Annamaria Lusardi, GWSB
Academic Director, Global Center for Financial Literacy

February 26th, 2012

The Importance of Financial Literacy

The best line of defense

"Well-informed consumers, who can serve as their own advocates, are one of the best lines of defense against the proliferation of financial products and services that are unsuitable, unnecessarily costly, or abusive."

-Ben Bernake, Chairman of the Fed

Two Extraordinary People

Leading the fight for financial literacy



What You Will Learn Today:

Three topics

1. Why is financial literacy important?
2. Why does financial literacy matter so much for athletes and young STARs?
3. How to make a difference by promoting financial literacy

1. A New Economic Landscape

The “great risk shift”

➤ Risk shift from the government to individuals

- The government is promoting retirement savings by providing tax incentives for individual accounts, for example Individual Retirement Accounts (IRAs).

➤ Risk shift from the employer to individuals

- Most firms have 401(k) plans rather than DB plans. So, while in the past, a CFO with an MBA in finance was making decisions about pensions, now each individual worker has to make the decision about how much to save and how to invest his/her pension wealth.

A New Economic Landscape (cont.)

More opportunities?

➤ **Global financial markets**

- The opportunity to invest globally provides ways to diversify risk but also to increase the exposure to risk, for example exchange rate risk

➤ **Increased opportunities to borrow**

- One similarity between credit cards and sub-prime mortgages is that the borrower alone is in charge of deciding how much to borrow

One Important Question

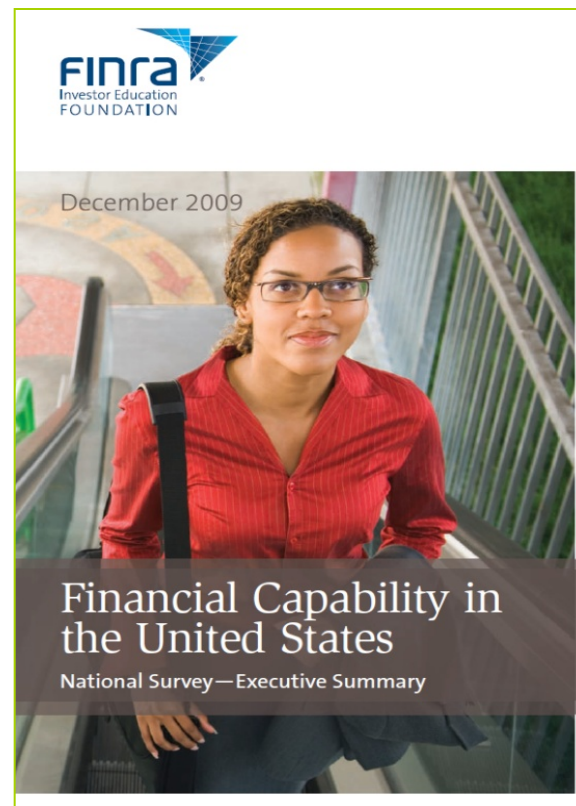
Ready for the increased individual responsibility?

- **How well-equipped are people to make financial decisions while facing complex financial markets?**
- **The data can tell us**

2009 FINRA National Financial Capability Study

The National Financial Capability Study includes three linked surveys:

1. **National Survey**: Nationally projectable telephone survey of 1,488 American adults
2. **State-by-State Survey**: Online survey of approximately 28,000 respondents (roughly 500 per state + DC)
3. **Military Survey**: Online survey of 800 military personnel and spouses



Findings

A dismal level of financial literacy

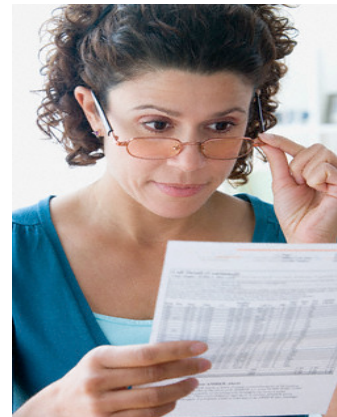
- Very low level of financial knowledge in the entire population
- Basic concepts people had difficulties with
 - Interest compounding
 - Inflation
 - Risk and risk diversification

Findings

Large Differences among Sub-groups

The groups that display the lowest knowledge are:

- *The Young
- *The Old
- *Minorities
- *Women
- *Those without a college degree
- *Those with low Income



Financial Literacy Around the World

The questions we designed were added to national surveys in eight countries

- ❖ USA
- ❖ The Netherlands
- ❖ Germany
- ❖ Italy
- ❖ Sweden
- ❖ Japan
- ❖ Russia
- ❖ New Zealand



Evidence Across Countries

The world is “flat” in financial literacy as well

- **The young are strikingly similar across countries**
- **Women answered in the same way across 8 countries. They responded with “do not know”**
- **The divide in financial literacy cuts across similar demographic groups**

Looking closely at gender differences

The Gender Gap in Financial Literacy



Financial Literacy and Behavior

- Financial literacy is not just about how much people know.
 - It affects behavior.



Financial Literacy Matters

- Debt and debt management



- Investments



- Planning and wealth accumulation

Financial Literacy and Mortgages

- Those with low literacy are more likely to be delinquent and default on subprime mortgages
- Those with low educational attainment are less likely to refinance mortgages during a period of falling interest rates



Source: Campbell (2006), Gerardi et al. (2010)

The Cost of Ignorance

Why financial literacy hurts

- It is those with low financial literacy that pay more for financial services
 - Higher fees and interest payments
- It is those with low financial literacy that do not take advantage of the opportunities offered by the financial markets

Another Cost: A More Unequal Society

**Financial decisions- *not just income-*
will create inequality**

- Example: Take 2 people with the same income
- Both have \$10,000 in savings at age 30.
- One puts the money in a checking account at 1%
- The other in stock mutual funds at 7%.
- At age 65, how much do they have?

• \$14,166 versus \$106,766



We are Starting Unequal

Not all young people are financially illiterate

If we look at high school students or young people (23-28), we find that the financial literate are:

- **Male**
- **White**
- **From college educated parents**
- **From families with stocks and retirement savings**

How We Can Change This:

Living in a world of individual responsibility

- **Need to equip people for the new changed world**
 - Financial literacy is what *reading and writing* was in the past
- **Need to add financial literacy in school**
 - Everyone has an opportunity to learn
 - We need to be financially literate *before* we make financial decisions

2. Implications for athletes

Why does financial literacy matter so much for athletes?



The Facts



1 The average person works on average 40 years

The average NFL player plays on average 3-5 years



The Facts cont.



2 The risk of injuries for an average worker is 3.6 injuries per 100 workers

The risk of injuries for spectator sports is 9.7 injuries per 100 players



The Facts cont.

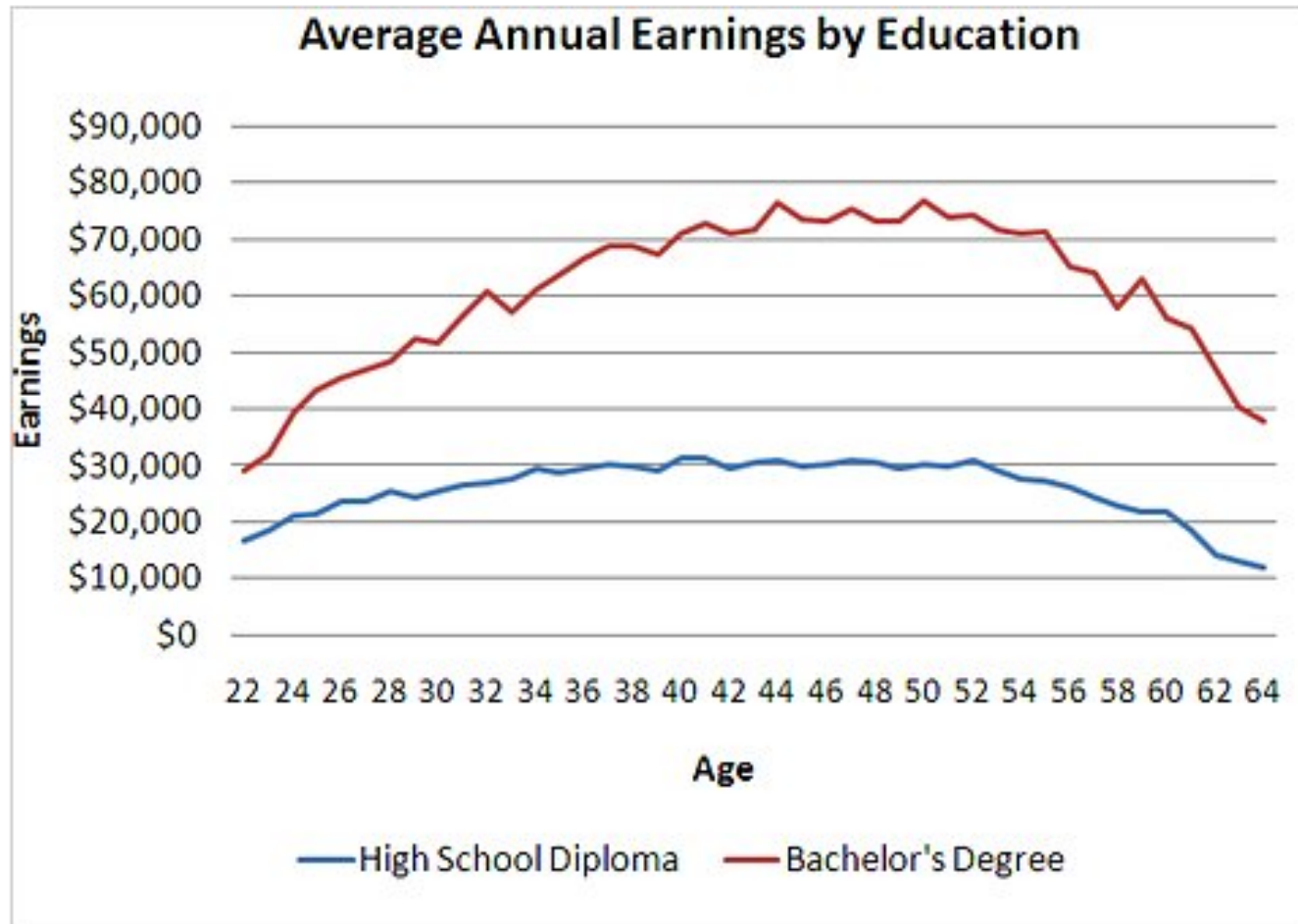
3 The average age-income profile is hump-shaped. Workers reach their peak of earnings at around age 50

The income profile of an athlete is reversed, very high earnings are achieved when young



Earnings Over the Life-cycle

How earnings change with age

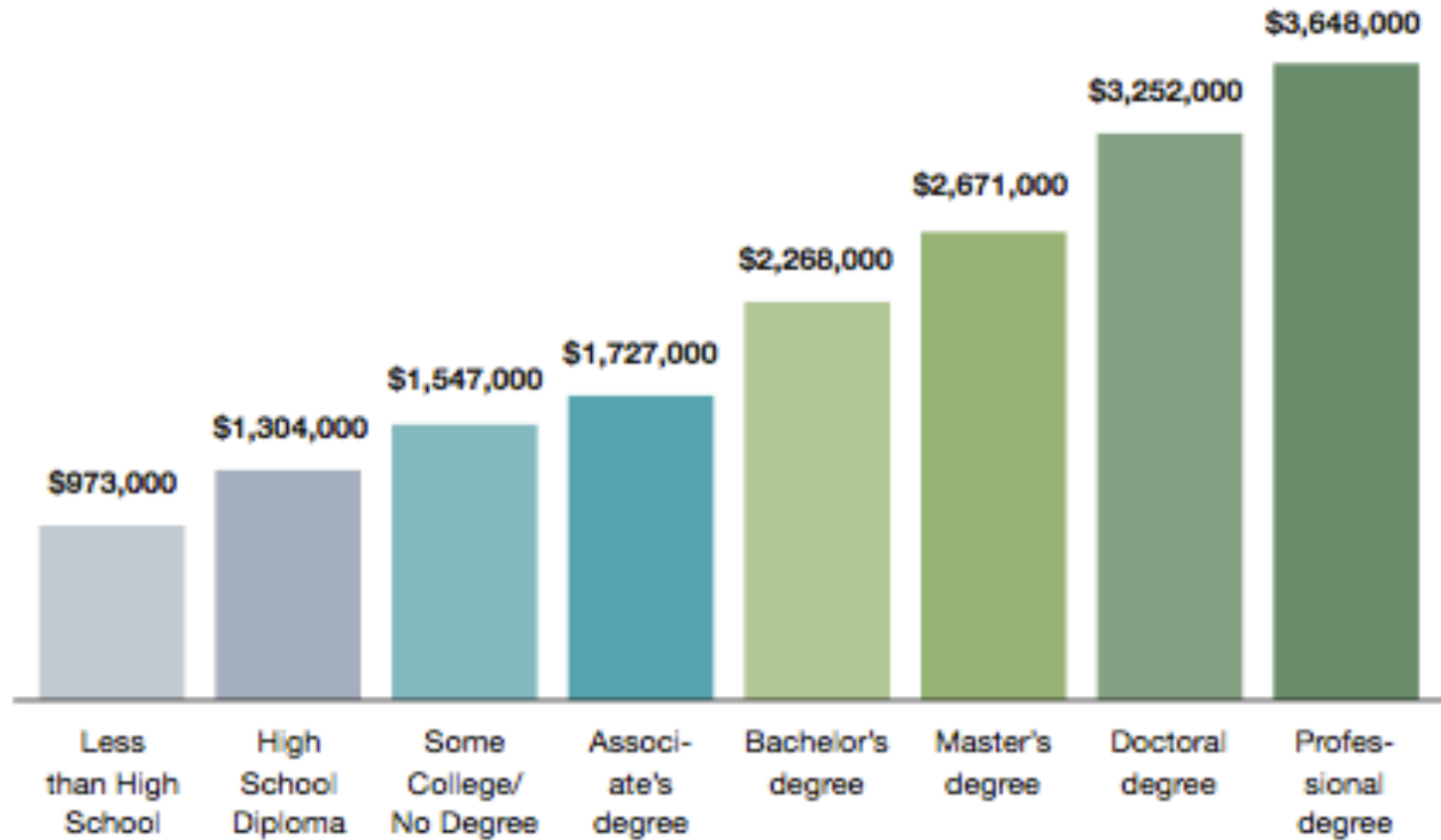


Source: The Hamilton Project: 2010

The Hamilton Project

Earnings Over a Lifetime

Figure 1: Lifetime Earnings by Educational Attainment.



Source: *The College Payoff*, Georgetown Center on Education and the Workforce, August 2011

Financial Literacy for Athletes

Important Concerns:

- The importance of planning
- The importance of insurance
- The importance of wealth management since athletes are rich at the beginning of life

The Importance of Planning

Planning is critical

Do you plan to work for pay after you stop playing?

You have a choice.

Suppose you have accumulated \$5 million by the time you retire. At an interest rate of 5%, you can consume each year \$250,000 without decreasing your capital

The Importance of Planning

Planning includes:

- Tax planning
 - Given high earnings, taxes can take away a sizeable fraction of income
- Estate planning
 - Prenuptial agreement
 - Trusts
 - Wills
- Children's education
- Non-profit activities



The Importance of Insurance

Protect yourself and your family

- Disability insurance
- Life insurance
- Car Insurance. The need for an umbrella insurance policy
- Prenuptial agreement: Protect your assets

The Importance of Wealth Management

Some basic principles

- Risk diversification
 - Entrepreneurship
 - Real estate
- Inflation
- Fees
 - They are opaque and hidden but cut away wealth
- Avoid scams



3. Implications for Non-Profits

How you can make a difference by promoting financial literacy



Peers and Rookies

Some suggestions for fellow athletes

- The power of peers
 - We learn from others around us
- Mentor the rookies
 - The young are less financially literate



The Power of Peers: Four Stories

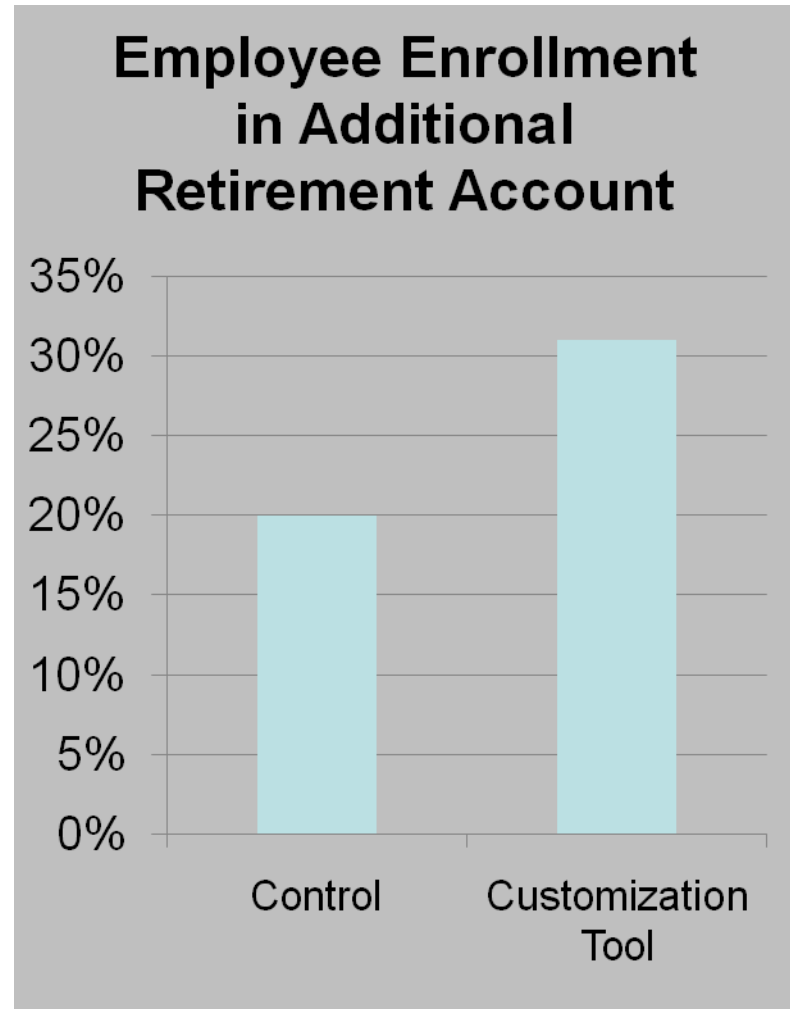


Topics discussed:

- Hopes for Retirement
 - Why they Save
 - How they Save
- Planning for the Future
- Their Recommendations

Effects of Videos

- Increase of 56% in additional retirement accounts by showing videos
- Possibility to test because videos were not shown on some days



The Implications for Non-Profits

Invest in the high return initiatives

- Which project has a high ROI?
- There is an asset with a high return, well above the stock market
- It is called “education”



Some Evidence:

The Importance of a College Education

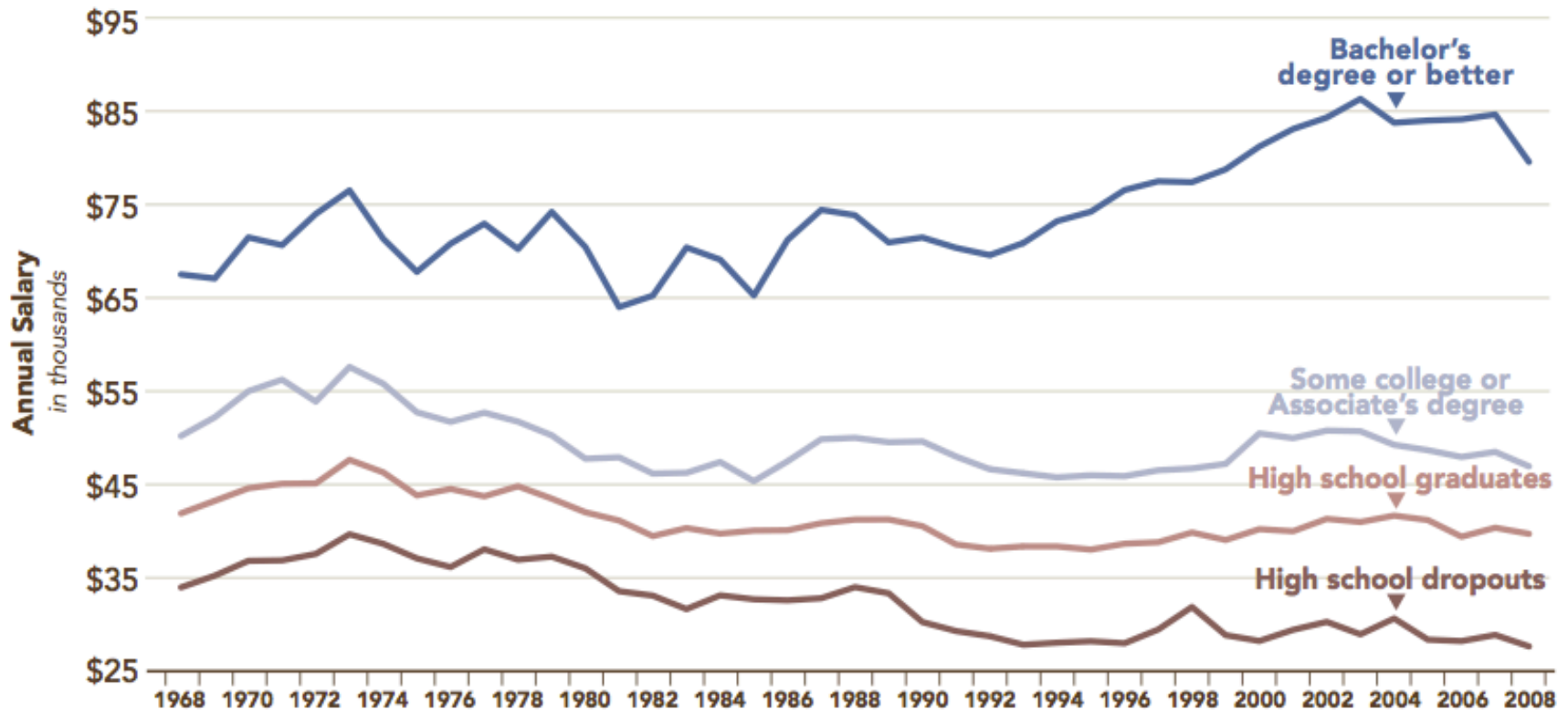


The Wage Premium Over Time

FIGURE IV

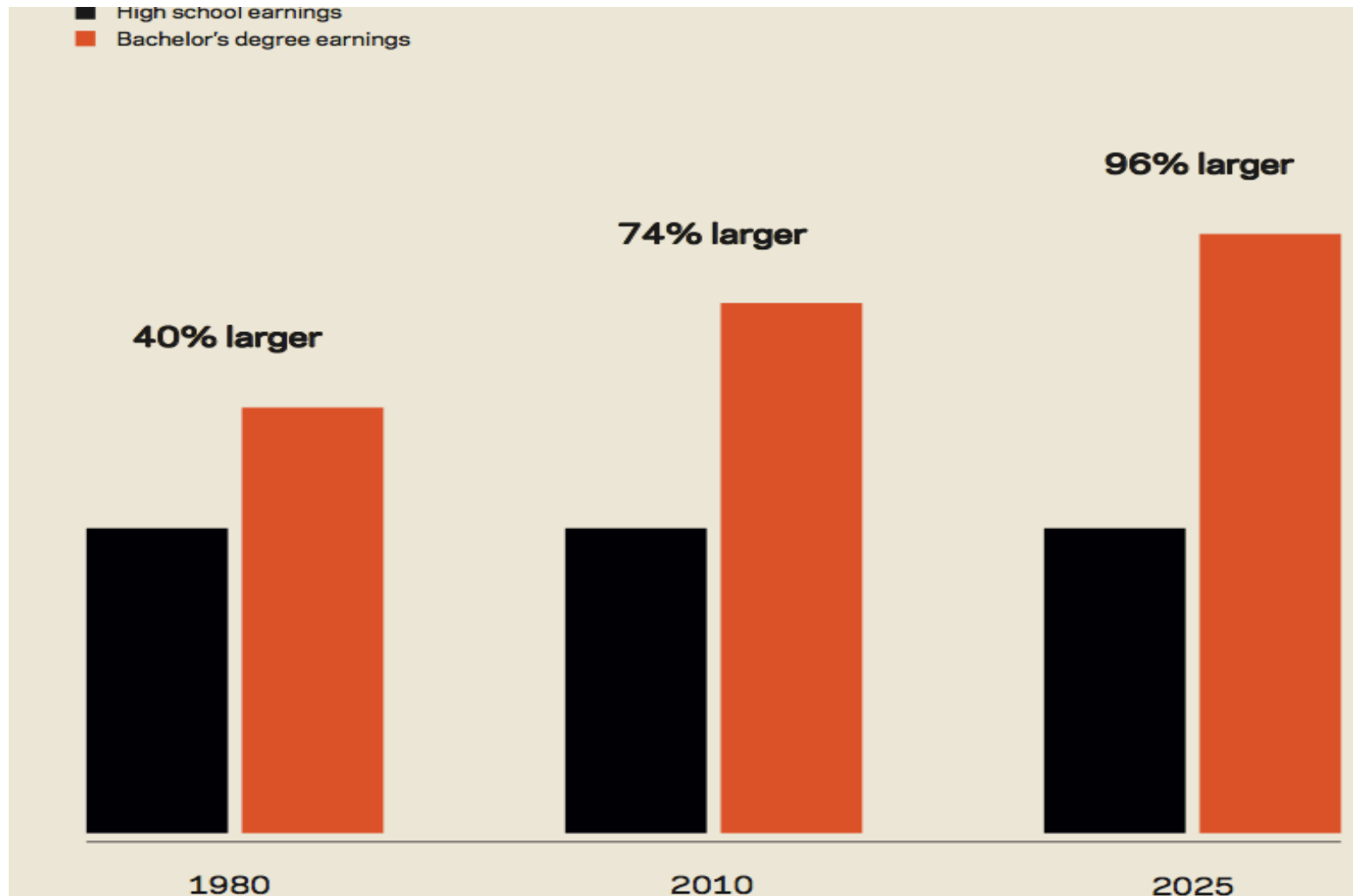
Wage premium by education. Compared to high school graduates, holders of Bachelor's degrees and better have earned a substantial wage premium since the 1990s. (makes no control for full-time or full-year status of workers)

Source: Authors' analysis of March CPS data, various years



Source: *Help Wanted: Projections of Jobs and Education Requirements Through 2018*, Georgetown Center on Education and the Workforce, June 2010

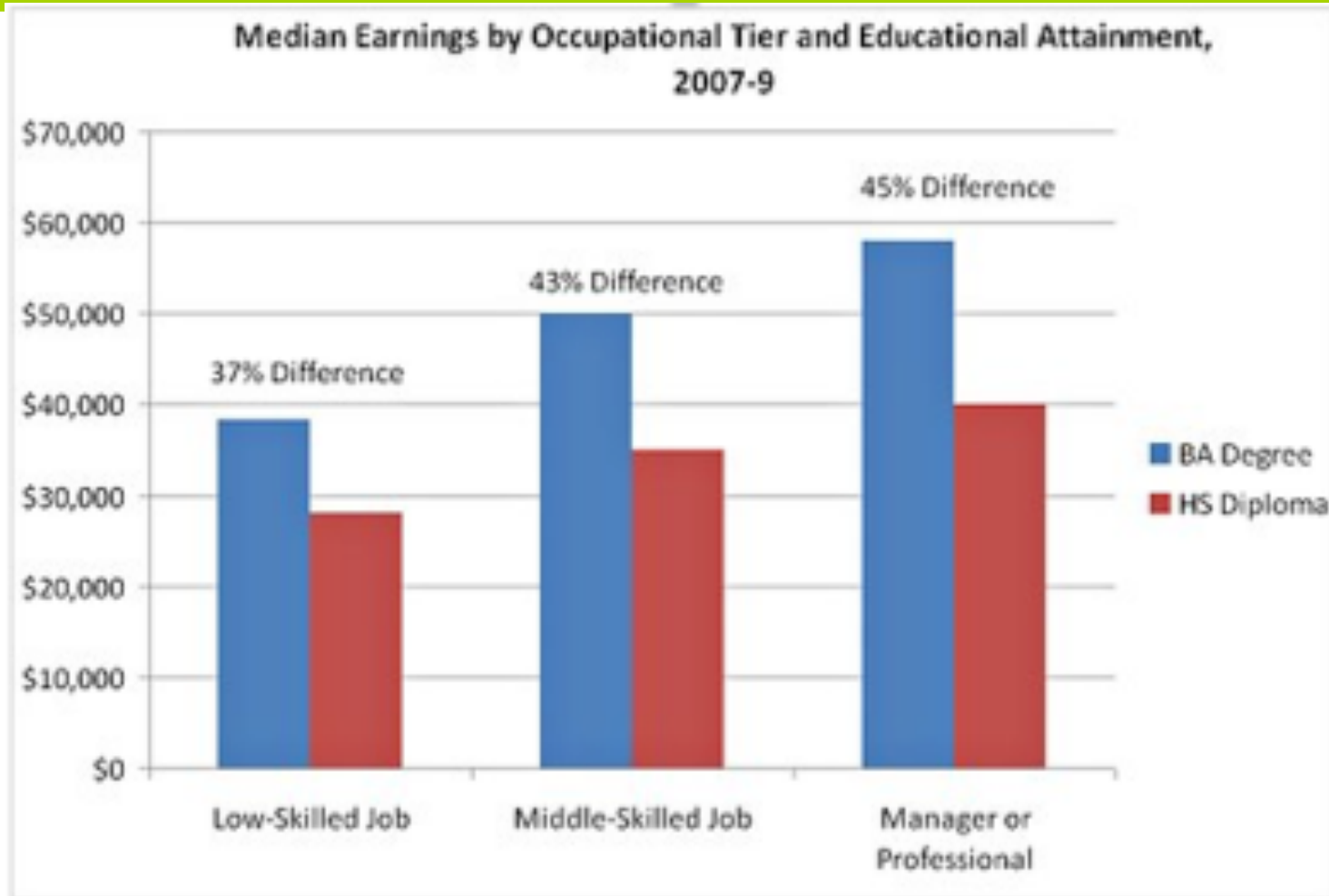
The Income Inequality Will Keep Growing



Source: *The Undereducated American*, Georgetown Center on Education and the Workforce, June 2011

Education Pays in Many Occupations

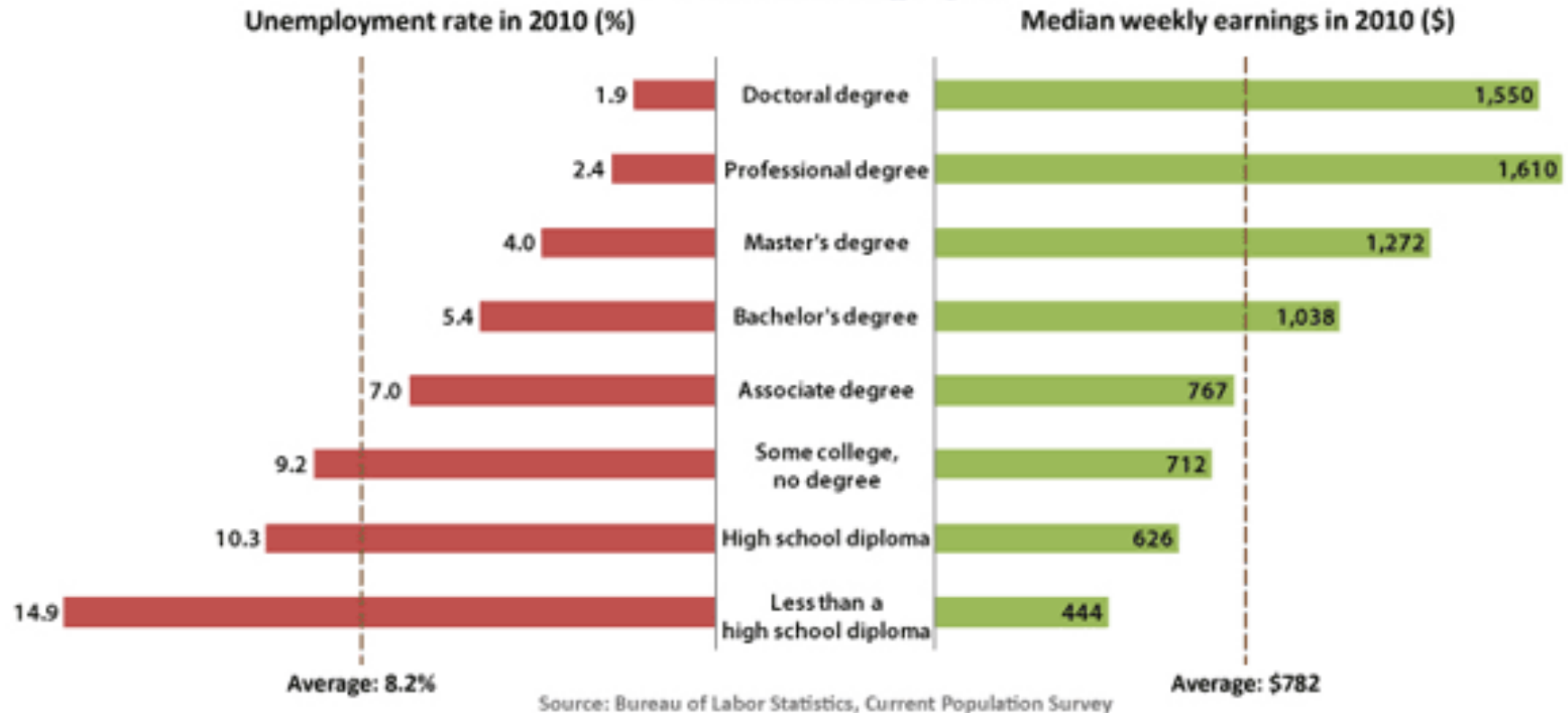
Wage premium of a college degree



Source: Center on Education and the Workforce, Georgetown University (2009)

The Unemployment Disparity

Education pays:



Source: Bureau of Labor Statistics, Current Population Survey, 2010

How We Can Change This:

Living in a world of individual responsibility

- **Need to equip people for the new changed world**
 - Financial literacy is what *reading and writing* was in the past
- **Need to add financial literacy in school**
 - Everyone has an opportunity to learn
 - We need to be financially literate *before* we make financial decisions

The Importance of Financial Literacy in school

Living in a world of individual responsibility

Need to add financial literacy in school

- 1. Everyone has an opportunity to learn**
- 2. We need to be financially literate *before* we make financial decisions**
- 3. We need to teach students about the “return on education” so they can invest in this asset**

How to Be a Millionaire?

It requires knowledge and practice

- **Save steadily**
- **Invest wisely**

An example:

Save \$10,000 each year for 35 years

After 35 years, at an interest rate of 0%, you have \$350,000

After 35 years, at an interest rate of 7%, you have \$1,479,000

Financial decisions in addition to income will create disparities in society: knowledge matters!



Workplace Financial Fitness Toolkit



The Employer Checklist

Ten key steps to financial fitness, divided into three stages and designed to help employees meet their financial goals.

[LEARN MORE](#)

The recent financial crisis has taught us many things. Chief among the lessons learned is that each of us needs to be responsible for our own financial welfare. Decisions about how much to save to secure a comfortable retirement, how to invest, and how to protect wealth are overly complex. It is incumbent on employers to assist their employees in becoming more financially fit. Without employer guidance, employees may end up without the financial fitness necessary to meet short- and long-term goals.

WORKPLACE FINANCIAL FITNESS KIT



Employer Resources

Make the financial fitness kit your own by tailoring our resources to fit your employee needs. [MORE](#)



For Your Employees

This toolkit provides Human Resources with resources to market financial fitness to employees. [MORE](#)

ABOUT THE PROGRAM



The Experts

Annamaria Lusardi and Punam Anand Keller can help boost your team's financial fitness. [MORE](#)



About the Program

Our toolkits help you empower employees to meet their financial goals. [MORE](#)

Follow Us



Facebook



Twitter



LinkedIn



Did You Know?



Bells were introduced on the NYSE when continuous trading was instituted in the 1870s. Originally a Chinese Gong was used, but brass bells

have been used since the Exchange moved to its current location in 1903. Visit our history page to learn more fascinating facts. [MORE](#)



Ask Our Experts a Question

Name : *

Financial Literacy Games

- Bite Nightclub



Video Game: Celebrity Calamity

- *Project with Doorways to Dreams*



What Ordinary People Can Do

The story of Ethel Percy Andrus

- A school principal who retired to take care of her ailing mother, she was shocked to discover how many retired teachers did not have health insurance
- She contacted many insurance companies to offer health group insurance to retired educators
- She was turned down by more than a dozen insurance companies but she persisted until she found a company willing to develop a health plan for retired educators
- The plan became so popular that other retired non-educators wanted to purchase it
- In 1958, Ethel established the American Association of Retired Persons (AARP)

What Extraordinary People (STAR) Can Do

The power of your voice and knowledge

- Your power in influencing the young
- Your power among fellow athletes
- Your power in your communities

On a Personal Note...

**Some
Simple
Suggestions**

1 Talk to your daughters about finance



2

***Support* financial literacy in your school district.**
***Demand* that they offer financial literacy courses.**



3

***Help* underprivileged
children get an
education**



4

Be an ambassador for financial literacy



Good catch, yes?

I hope you feel the same about your advanced education

