

# The importance of being financially literate

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## Changing landscape for financial security

### Changes in pension systems

- More individual and private accounts

### Changes in financial markets

- Greater complexity
- More opportunities to borrow and in large amounts

### Changes in labor markets and education

- Workers change job very often
- Rising cost of education
- Other reasons to plan and save for the future



## Some questions given the current and future economic environment

- 1. How financially literate are people?**
- 2. Does financial literacy matter?**
- 3. Which policies and programs can affect financial literacy?**

**How financially literate are people around the world?**

## A simple measure of financial literacy

### The Big Three

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?”

- More than \$102
- Exactly \$102
- Less than \$102
- Don't know
- Refuse to answer

2. “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...”

- More than today
- Exactly the same as today
- Less than today
- Don't know
- Refuse to answer

3. “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.*”

- True
- False
- Don't know
- Refuse to answer

## Financial Literacy around the World (FLat World)

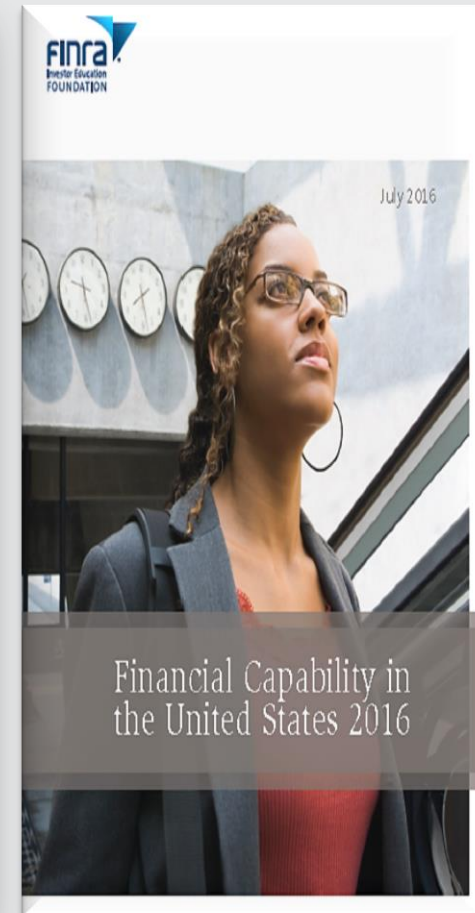
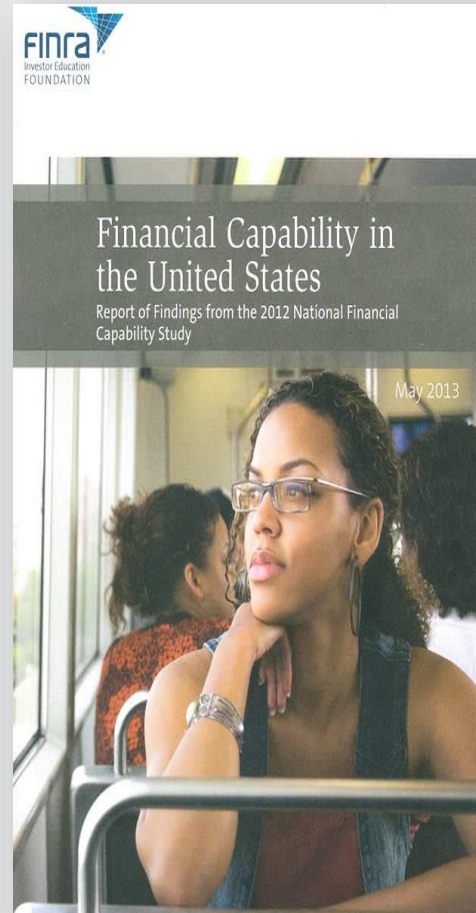
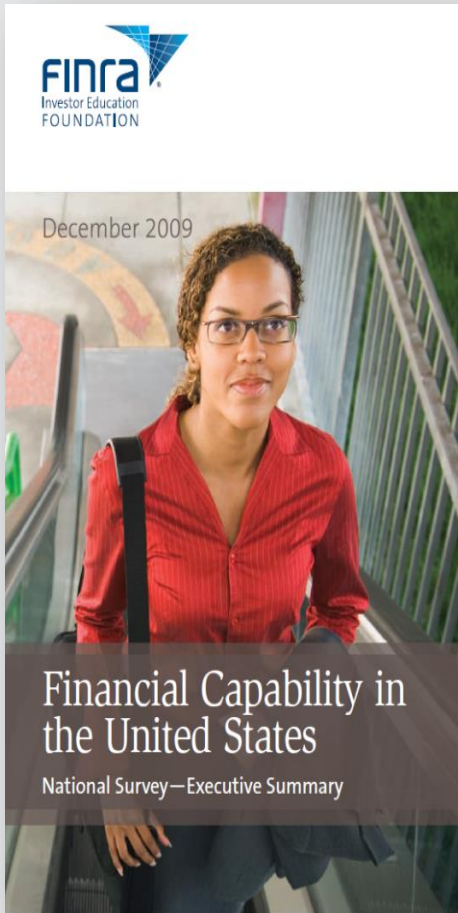
Evidence from 15 countries:

- ❖ USA
- ❖ The Netherlands
- ❖ Germany
- ❖ Italy
- ❖ Russia
- ❖ Sweden
- ❖ New Zealand
- ❖ Japan
- ❖ Australia
- ❖ France
- ❖ Switzerland
- ❖ Romania
- ❖ Chile
- ❖ Canada
- ❖ Finland



These 3 questions are now in the 2016 US Survey of Consumer Finances

# Collecting data : The US National Financial Capability Study (NFCFS)



## How much do Americans know?

Distribution of responses across the U.S. population  
(2009 National 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; less than half (46%) got the first two questions right.



## How much do the Dutch know?

Distribution of responses across the Dutch population  
(2010 Dutch Central Bank Household Survey)

**Distribution of Responses to Financial Literacy Questions (%)**

|                | Responses      |                  |           |
|----------------|----------------|------------------|-----------|
|                | <i>Correct</i> | <i>Incorrect</i> | <i>DK</i> |
| Interest rate  | 85%            | 5%               | 9%        |
| Inflation      | 77%            | 8%               | 14%       |
| Risk diversif. | 52%            | 13%              | 33%       |

NB: Only 45% correctly answer all 3 questions; more than half (73%) got the first two questions right.

## How much do Japanese know?

Distribution of responses in the Japanese population  
(2010 Survey of Living Preferences and Satisfaction)

**Distribution of Responses to Financial Literacy Questions (%)**

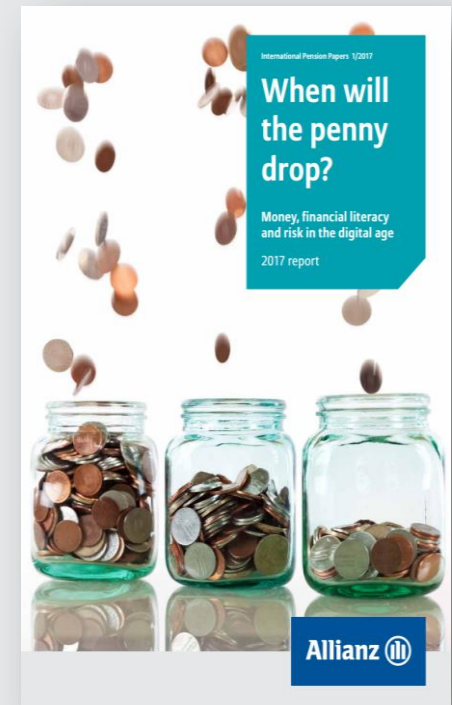
|                | Responses      |                  |           |
|----------------|----------------|------------------|-----------|
|                | <i>Correct</i> | <i>Incorrect</i> | <i>DK</i> |
| Interest rate  | 71%            | 15%              | 13%       |
| Inflation      | 59%            | 11%              | 28%       |
| Risk diversif. | 40%            | 3%               | 56%       |

NB: Only 27% correctly answered all three questions; less than half (49%) got the first two questions right.

## Findings: The world is *flat*

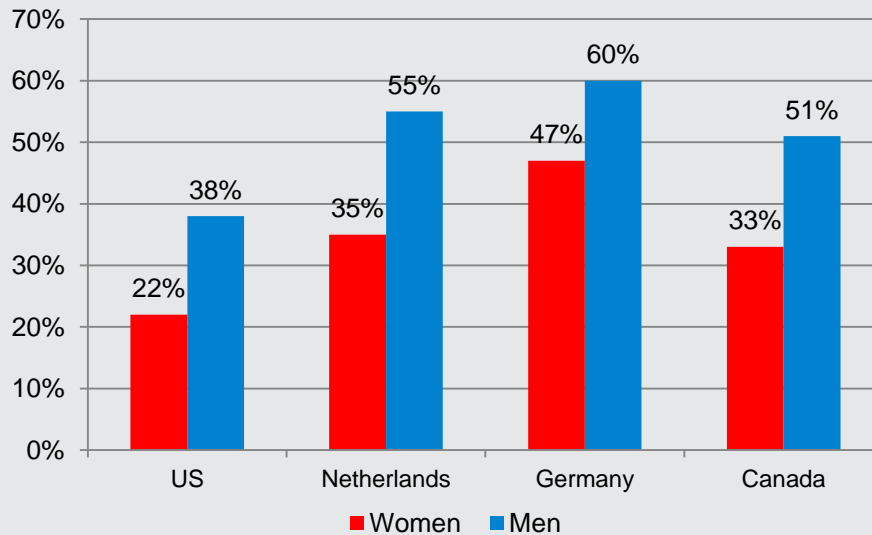
- **Financial illiteracy is widespread in the population**
  - Less than half of the population can answer three basic questions
  - People lack knowledge of fundamental financial concepts (even among «investors»)
- **Risk diversification is most difficult concept to grasp**
  - Similar pattern of response across countries
  - Prevalence of “don’t know” answers
- **These findings are robust**
  - Evidence from bigger surveys and different questions
    - 2014 Global FinLit Survey
    - 2016 Allianz Survey in 10 European countries

**Most countries get an F in financial literacy**

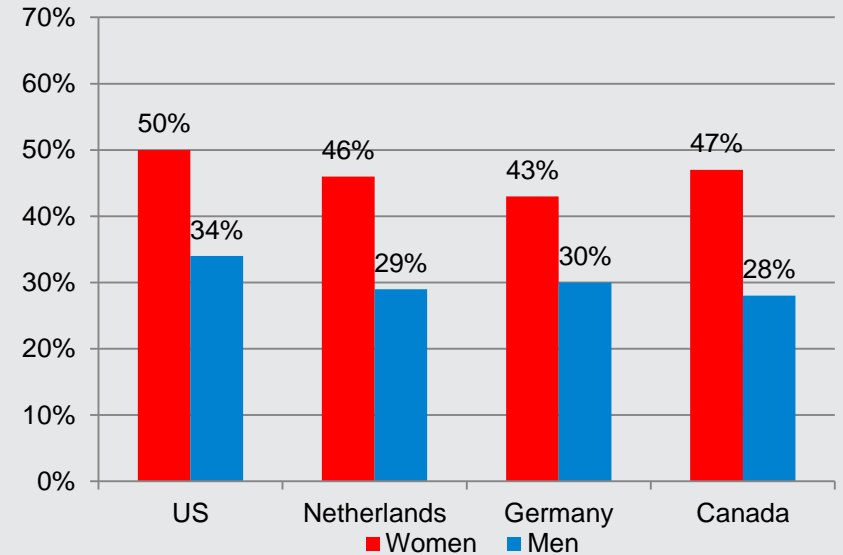


# Gender differences in financial literacy

**Financial knowledge by gender  
(% answering 3 Qs correctly)**

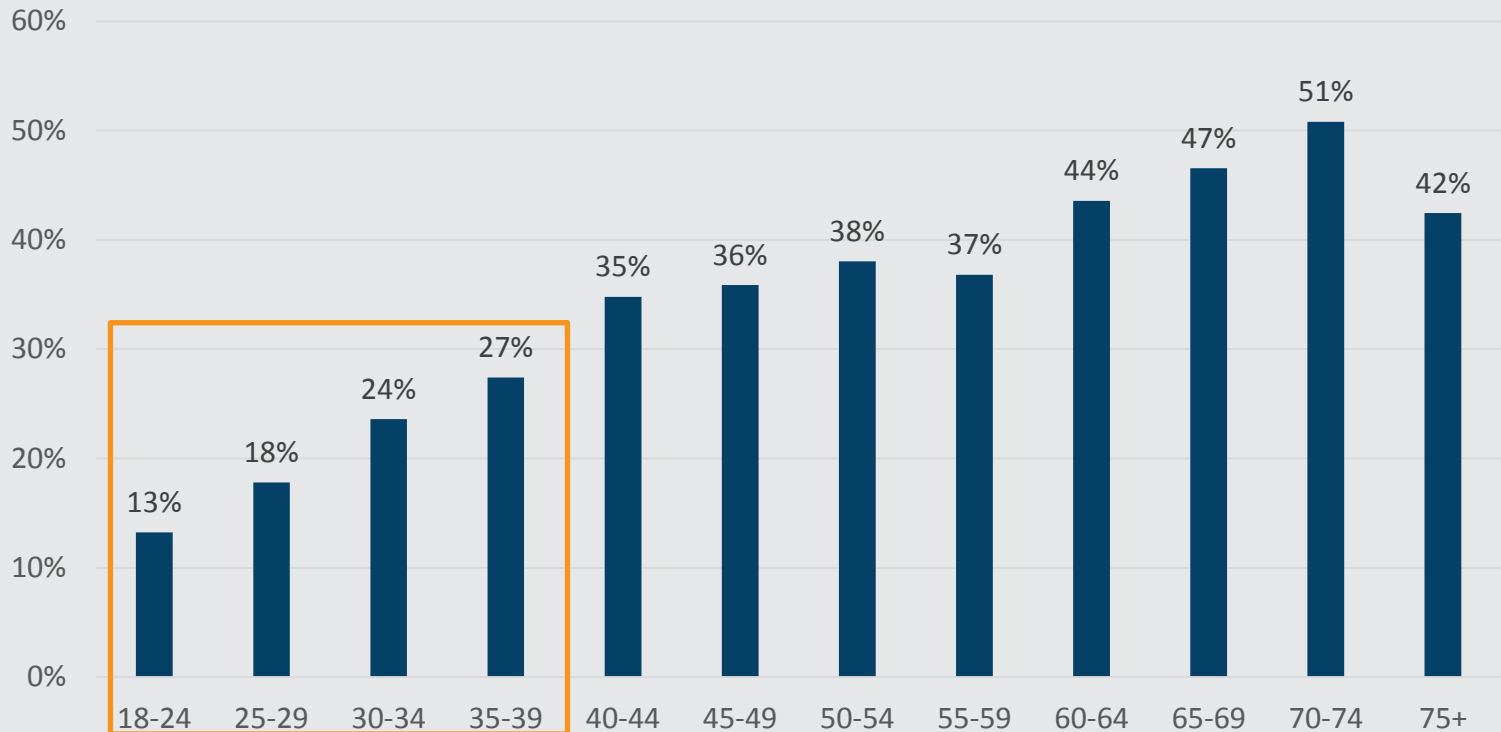


**At least one "don't know" answer, by  
gender**



- Very robust findings of large gender differences in financial knowledge
- Women are much more likely to say “I do not know”

## Financial literacy across age: 2015 NFCS



Source: 2015 NFCS

- Financial knowledge increases very slowly with age/cohort
- Less than 30% know these 3 basic concepts by age 40 even though many financial decisions are made well before that age

## The S&P Global Finlit Survey

- *The S&P Global Financial Literacy Survey* is the largest, most comprehensive measure of financial literacy
- Interviewed more than 150,000 adults age 15+ in 143 countries in 2014
- The survey provides key information to policy makers, regulators, the private sector, and academics



## The S&P Global Finlit Survey



The survey covers four topics:

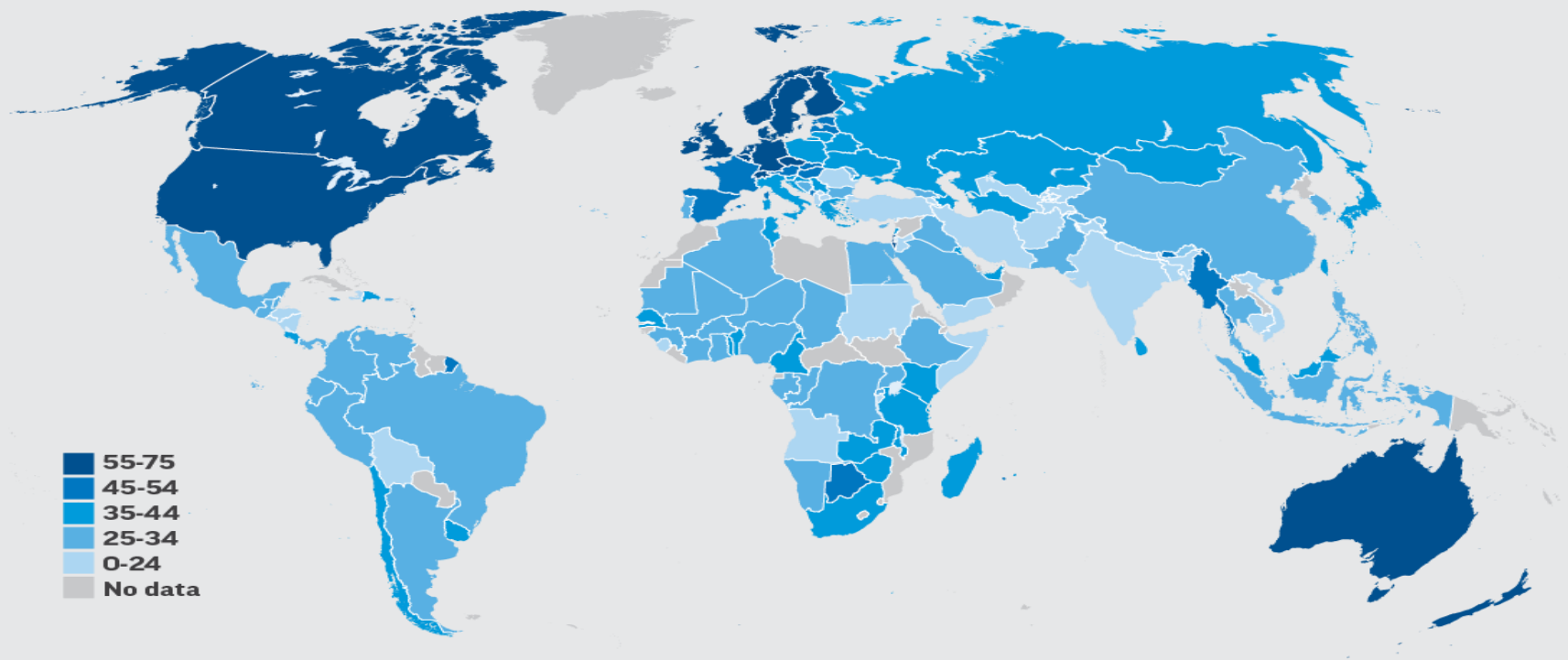
- Numeracy
- Interest compounding
- Inflation
- Risk diversification

*Being financially literate:*

How many can answer 3 out of these 4 topics correctly

## Financial literacy globally

% of adults who are financially literate



Only 1 in 3 adults worldwide responded correctly to three out of four topics.



## Financial literacy across economies

**% of adults who are financially literate**

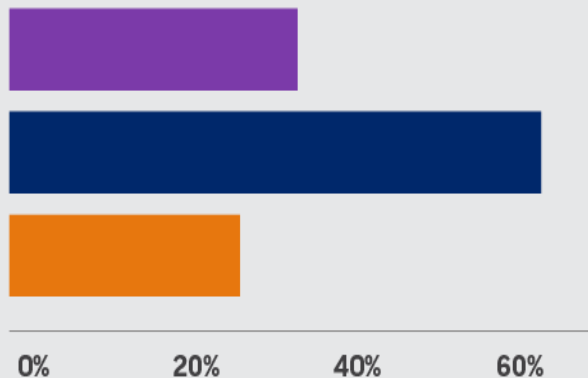


- Financial literacy is low even in advanced countries (G7)
- Financial literacy is low among BRICS countries

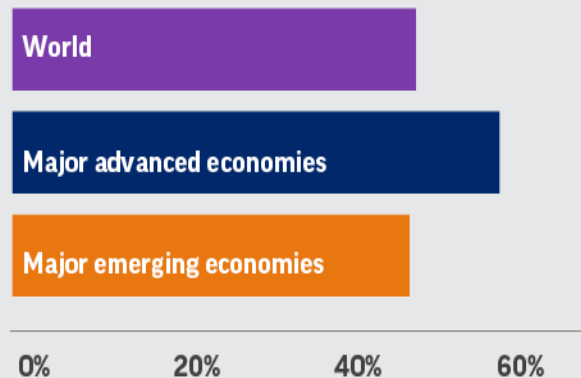
# Financial literacy by topic

% of adults answering correctly

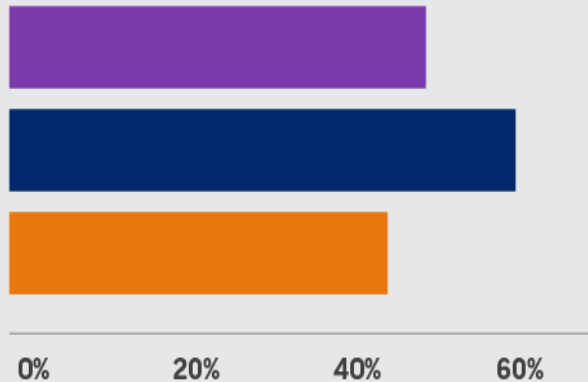
## RISK DIVERSIFICATION



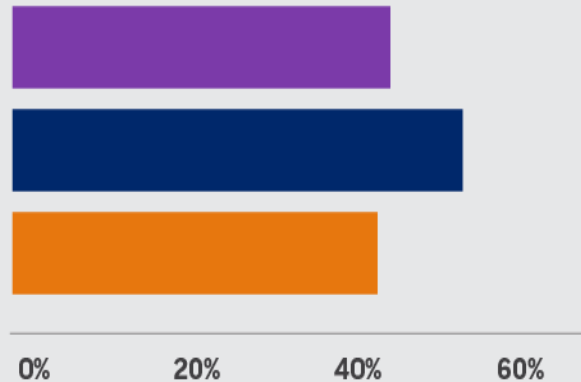
## NUMERACY (INTEREST)



## INFLATION



## COMPOUND INTEREST



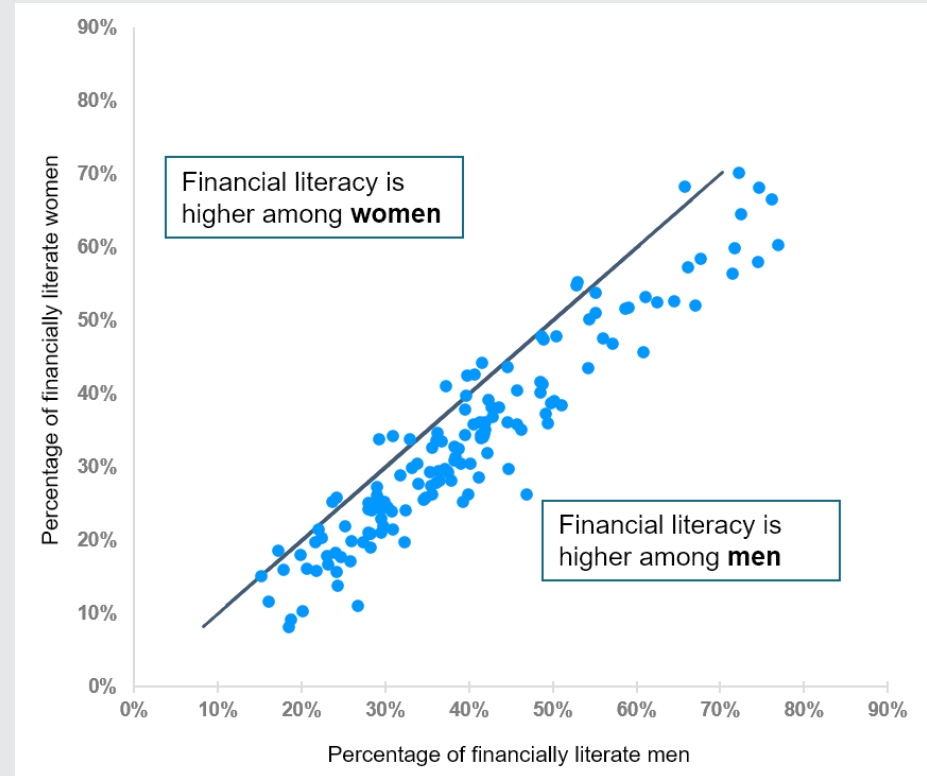
Inflation and simple interest/numeracy is what people know most across countries.

Risk diversification is what people know the least.

Findings are similar in other surveys

## Gender gap in financial literacy around the world

In most economies around the world, men have a better understanding of basic financial concepts than women



Source: Global FinLit Survey

# Does financial literacy matter? Linking financial literacy to financial behavior


## Financial literacy and personal finance outcomes

Individuals who are financially literate are also more likely to:

- Cope with emergency expenses/less likely to be financially fragile
  - Can come up with \$2,000 in 30 days
- Manage their debt well
  - Less likely to have “too much debt.”
- Have long-term savings:
  - More likely to plan for retirement
  - More likely to have financial investments, aside from retirement accounts.




New research released Monday April 16, 2018



**Financial Fragility  
Fact Sheet**

**EVIDENCE AND IMPLICATIONS**



*Financial fragility is the inability to cope with emergency expenses, such as a car or house repair, a medical bill, or a small legal expense, in a short time period.*

**OUR MEASURE OF FINANCIAL FRAGILITY**

How confident are you that you could come up with \$2,000 if an unexpected need arose within the next month?

|   |                  |                     |
|---|------------------|---------------------|
| Percentage of Working-Age Americans (25- to 60-year-olds) | Confidence Level | Financially Fragile |
| I am certain I could come up with the full \$2,000        | 36.15%           | No                  |
| I could probably come up with \$2,000                     | 24.06%           | No                  |
| I could probably not come up with \$2,000                 | 13.92%           | Yes                 |
| I am certain I could not come up with \$2,000             | 21.78%           | Yes                 |
| Don't know/Prefer not to say                              | 4.08%            | Refuse to answer    |

**36% 2015**  
In 2015, despite a recovering economy, almost 30% of working-age Americans were considered financially fragile.

**50% 2009**  
In the aftermath of the 2007-09 financial crisis, nearly 50% of Americans of working age were considered financially fragile.


This question, posed to the respondents of the 2015 National Financial Capability Study (NFCS), evaluates how individuals assess their own capacity to cope with a mid-size financial emergency over a 30-day timeframe.

Source: 2015 NFCS


**While financial fragility is most prevalent among those with low income or low education, the data show that a broad cross-section of the American population is financially fragile:**

- Nearly 30% of middle-income households are financially fragile
- Almost 40% of those without a college degree are financially fragile, compared to only 23% of those who have at least a bachelor's degree
- 42% of working-age women are financially fragile, compared to 29% of men
- A similar fraction of individuals across all ages are financially fragile

Please visit [gflec.org](http://gflec.org) for additional information regarding our work and research. Research support was provided by the National Endowment for Financial Education (NEFE).



**Business**



**THE UNDERLYING FACTORS**

Data from the 2015 NFCS, the 2015 Survey of Household Economics and Decisionmaking (SHED), and observations from focus groups show that financial fragility can be attributed to three factors:

- + Lack of assets
- + High indebtedness
- + Lack of financial literacy

**FINANCIAL LITERACY**

Financially literate: 79.16%  
Not financially literate: 19.47%  
Don't know/Refuse to answer: 1.37%

Not financially literate: 53.87%  
Financially literate: 40.77%  
Refuse to answer: 5.35%

Source: 2015 NFCS

**ASSETS**

|                       |            |           |
|-----------------------|------------|-----------|
| HOME OWNERSHIP        | YES: 69.68 | NO: 30.32 |
| CAR OWNERSHIP         | YES: 66.79 | NO: 33.21 |
| RETIREMENT SAVINGS    | YES: 74.09 | NO: 25.91 |
| INSURANCE COVER       | YES: 62.38 | NO: 37.62 |
| INDENTEDNESS          | YES: 64.69 | NO: 35.31 |
| AUTO LOAN             | YES: 68.79 | NO: 31.21 |
| STUDENT LOAN          | YES: 50.07 | NO: 49.93 |
| MEDICAL BILLS OVERDUE | YES: 39.76 | NO: 60.24 |
|                       | YES: 64.67 | NO: 35.33 |

Source: 2015 SHED

Financial fragility goes beyond assessing lack of precautionary savings. It is a multifaceted measure of high debt, low asset levels, and low financial literacy.

**THE LONG-TERM CONSEQUENCES**

The data show that individuals who are financially fragile not only suffer from short-term financial setbacks in the face of an emergency, but may also be more financially vulnerable in the long term. Financially fragile people are less likely to think about how much to save for their retirement. Moreover, the focus group discussions show that among the financially fragile respondents who do plan for their retirement, many have withdrawn or taken loans from their retirement accounts. Thus, financial fragility can have severe short and long-term implications for households' financial resilience.

Sign up at [gflec@psu.edu](mailto:gflec@psu.edu) if you would like to be added to our mailing list.




**FINAL REPORT**

**Financial Fragility in the US: Evidence and Implications**

**Authors:**  
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Andrea Hasler  
Annamaria Lusardi  
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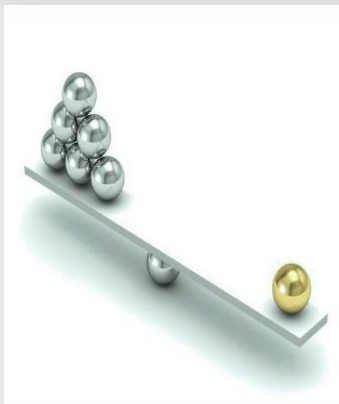
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# Financial literacy and wealth inequality



- Consider a life cycle model of saving with financial literacy
- Financial literacy affects the return on savings
- Financial literacy is an important determinant of wealth and wealth inequality
- Important finding: **30-40%** of U.S. retirement wealth inequality can be attributed to difference in financial knowledge



**Which policies and programs  
can affect financial literacy?**



## What we learn from research

- **Need to improve levels of financial literacy**
  - Levels of knowledge are critically low globally
  - This happens in rich countries too
  - We are at a crisis level
  
- **Some topics are particularly complex**
  - Risk and risk diversification
  
- **Two groups are useful targets for financial education**
  - The young
  - Women
  
- **One size does not fit all**
  - Need tailored programs



## Given widespread financial illiteracy

### Need for large and scalable programs

- Financial education in school
- Financial education in the workplace
- Financial education in the community (libraries, museums, other places where people go to learn)



## Financial literacy among the young

We need initiatives at the national and local level

- We need financial literacy in school (mandated or not)
- Need to improve knowledge of the ABCs of personal finance
  - Everyone needs basic financial literacy
- The young are an important target and can use time in their favor
- The pension and financial industry should connect with the Department of Education



## **Personal finance courses for college students**

- Use a rigorous quantitative approach
- Cover the basics, in particular risk and risk diversification
- Cover personal finance topics, such as saving and investing, retirement planning, insurance, etc.
- Material available for free on our website
- We have some special students (NFL football players)



## Significance and prevalence of the gender gap

- Unique challenges for women relative to men
  - Longer life expectancies
  - Lower lifetime income
  - Career interruptions due to child rearing
- Need for tailored programs
  - Greater need to plan for old age
  - Different savings needs
- Captive audience
  - More aware of lack of knowledge
  - Multiplier effect



## Financial education in the workplace: A simple example

### Set-up:

- Design of a low-cost, easily-replicable financial education program called «Five Steps»
- Covering five basic financial planning concepts, including risk
- Delivery models: written narratives and online videos (3min)
- Field experiment to evaluate the overall impact
- Follow-up tests 8 months after the intervention

### Program:

- Targeted to Millennials
- Kept the message free of economic/ finance jargon
- Covered concepts that people know the least (risk diversification) in a simple story



## Results from Five steps to planning success

- After being exposed to videos, the performance on financial literacy improved
- While Millennials were targeted, the videos affected all age groups
- 25-33% of the knowledge gain is still observable 8 months after the intervention
- Simple program has effects both in the short and medium run

## New Financial Education Committee in Italy



### *Annamaria Lusardi Appointed Director of Italy's New Financial Education Committee*

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This appointment supports GFLEC's vision of promoting the development of a financially literate world.

In July 2017, I was appointed by Italy's Minister of Economy and Finance, Pier Carlo Padoan, as director of the Financial Education Committee

The Committee designed a national strategy for financial literacy

First initiative: a portal of financial education



## Concluding remarks

Financial literacy is like reading and writing

- It is an essential skill for the 21st century
- Everyone deals with finance, and finance is sufficiently complex that we cannot leave it to the individual to learn by himself/herself
- It is very important to be financially literate as early as possible
- Financial literacy is a stepping stone for financial security

# Definition of financial literacy: *A vision for the future*

## Which future do we want to build?



**Thank you!**

Questions? Contact us at [\*\*gfilec@gwu.edu\*\*](mailto:gfilec@gwu.edu)

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