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Financial Wellness.
HOUSEHOLD FINANCIAL CAPABILITY.

November 2016

Annamaria Lusardi, Ph.D., is the founder and academic director of the Global Financial Literacy Excellence Center (GFLEC) at the George Washington University School of Business.

T. Rowe Price recently sat down with Professor Lusardi to discuss some of the research findings in the 2015 National Financial Capability Study (NFCS) and implications for defined contribution plans as they think about financial wellness programs for their employees.

Q. The National Financial Capability Study shows that some segments have low levels of financial literacy. Why is financial literacy so important for financial wellness, and how are different participant segments doing from a financial wellness perspective?

Professor Lusardi: The NFCS is an online survey of more than 25,000 respondents and offers unique information on financial literacy and capability. The data provides a comprehensive view of household finances. We have enjoyed the collaboration with the FINRA Investor Education Foundation, which commissioned the study in consultation with the U.S. Department of Treasury and other federal agencies. Our team at GFLEC has used the data for new research, including research on financial wellness.

As you have mentioned in your question, in the 2015 study, we found that the level of financial literacy in the population is very low. Although individuals have made many financial decisions over their lifetime, even those who are age 50 and over still show low levels of financial literacy. Financial literacy is also low among the young, women, and those with low educational attainment. This matters because financial literacy can be linked to several indicators of financial wellness, including:

- Financial security in the short term, as measured by the ability to deal with short-term "shocks"
- Planning for retirement
- Level of debt and ability to manage debt

When looking at financial wellness, one size does not fit all. Certain segments, such as millennials and women, are particularly vulnerable. These two groups can be targeted with financial wellness programs suitable for their needs.

"Research is important to finding a long-term sustainable solution."

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Q. You mentioned that millennials and women are particularly vulnerable. Can you talk a bit more about demographic differences in financial fragility, and how this impacts retirement savings?

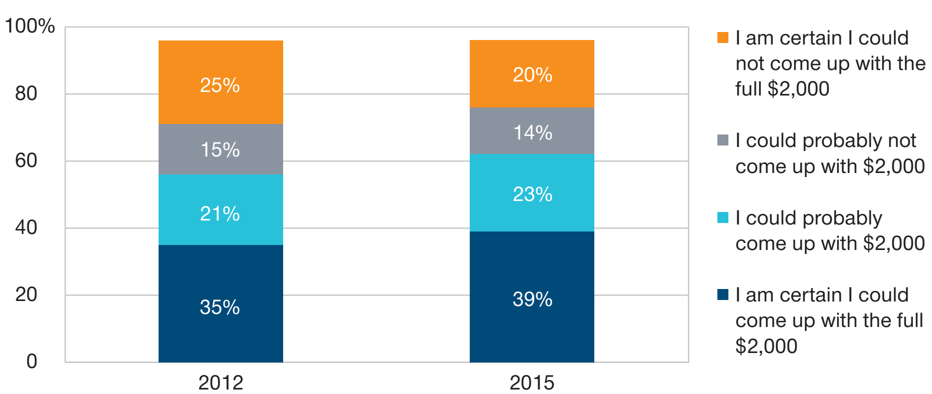
Lusardi: Financial fragility is a measure that was added to the survey in 2012, and it turned out to be such a good indicator that it was used again in 2015.

This measure assesses the confidence that people have in coming up with $2,000 in 30 days. This question assesses whether people can face a mid-size “shock”—the car breaking down, a child needing braces, unemployment, etc. The question does not ask whether the individual has the money to deal with the shocks, rather it asks about the *confidence* in coming up with money.

The results are remarkable and speaks of the need for financial wellness programs: 40% of the population was unable to come up with $2,000 in 30 days in 2012, and now a third cannot come up with $2,000 in 30 days. (See Figure 1, below.)

FIGURE 1: Financial Fragility

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



Note: Percentages may not add up due to rounding.
Source: Financial Capability in the United States 2016, FINRA Investor Education Foundation, July 2016.

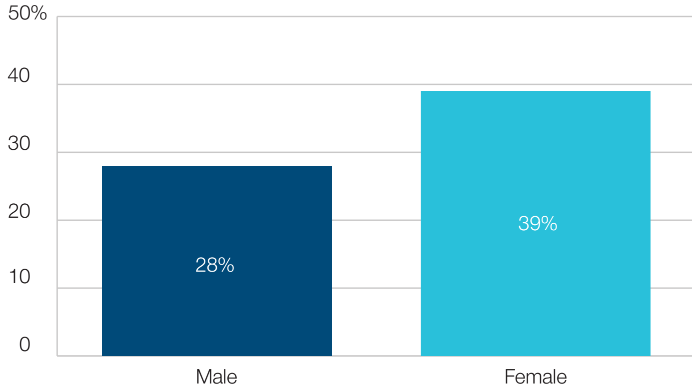
Professor Annamaria Lusardi

Annamaria Lusardi is the Denit Trust Chair of Economics and Accountancy at the George Washington University School of Business (GWSB). Previously, she was the Joel Z. and Susan Hyatt Professor of Economics at Dartmouth College, where she taught for 20 years. She has also taught at Princeton University, the University of Chicago Harris School of Public Policy, the University of Chicago Booth School of Business, and Columbia Business School.

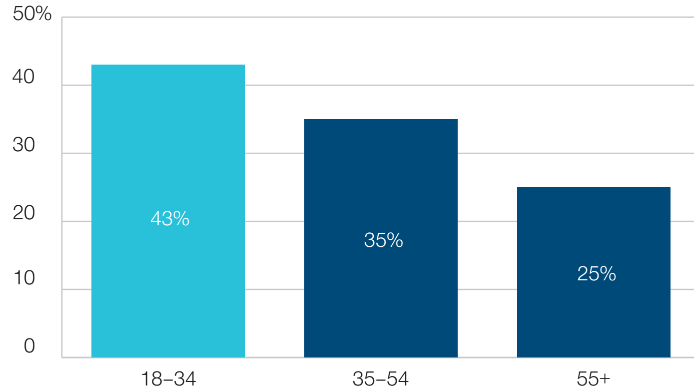
From January to June 2008, she was a visiting scholar at Harvard Business School. Moreover, she is the founder and academic director of GWSB’s Global Financial Literacy Excellence Center. She holds a Ph.D. in economics from Princeton University and a B.A. in economics from Bocconi University.

FIGURE 2: **Financial Fragility—by Gender and Age**

Percentage who probably/certainly could not come up with $2,000 in 30 days—by gender



Percentage who probably/certainly could not come up with $2,000 in 30 days—by age



Note: Percentages may not add up due to rounding.
Source: Financial Capability in the United States 2016, FINRA Investor Education Foundation, July 2016.

As mentioned earlier, there are certain segments of the population that are especially vulnerable. For example, women and millennials are more financially fragile than the general population. (See Figure 2, above.)

These findings are important because if individuals are not financially secure in the short term, it will be unlikely they will even think about saving for retirement.

Moreover, if people do not have the capacity to deal with shocks, they may tap in to their retirement accounts, as many millennials seem to be doing (see Figure 3, page 4). It is very important to think about financial wellness holistically when thinking about retirement security.

GLOBAL FINANCIAL LITERACY EXCELLENCE CENTER

Founded in 2011 at the George Washington University School of Business, the Global Financial Literacy Excellence Center has positioned itself to be the world's leading center for financial literacy research and policy.

Through rigorous scholarship and research, wide-reaching education, and global policy and services, the Center works with partners in Washington, D.C., throughout the United States, and across the globe to raise the level of financial knowledge. The GFLEC builds on more than 15 years of academic research by Professor Annamaria Lusardi, an early contributor to financial literacy as a field of study. By virtue of its location in the heart of Washington, D.C., the Center is positioned to directly influence policymakers.

Q. How are the challenges millennials face different from preretirees, and why is this important for plan sponsors?

Lusardi: With millennials, the main issue is student loan debt.

According to the 2015 NFCS, about half of those with student loans are worried about not being able to repay them.

Moreover, a striking 53% of those with student loans say they would make a change to their decision if they could do it all over again. Low financial literacy and the burden of student loan debt are two important reasons why millennials need advice and guidance.

Preretirees carry debt too, and debt and debt management are becoming a common feature even later in the life cycle. For many preretirees, often half of the mortgage on their house still needs to be paid off. Plan sponsors need to understand that everyone carries debt—that is a feature of the balance sheet for households today.

Q. So at this point, let's discuss actions and steps that plan sponsors can take. Can you talk about the importance of the role of the plan sponsor in integrating financial wellness into their defined contribution plan oversight?

Lusardi: It is important to consider the many financial decisions that an individual makes, not just retirement savings. Long-term objectives can be achieved through small steps that help people build retirement security. A simple way to think about this is to think about the building blocks for retirement security. These building blocks include not only increasing retirement savings but also having precautionary savings and having strategies for debt management.

Using the building blocks approach is an easy way to help people achieve financial security. In the case of millennials, consider providing education on how to build a good credit score. Millennials are in danger of having a poor credit score, and this could impact their ability to rent an apartment or get a mortgage for a new home and to save. Building a good credit score, a precautionary savings account, and starting to contribute to a retirement savings account are good steps for young people.

"It is very important to think about financial wellness holistically when thinking about retirement security."

Planning for a child's education is important too, because education has become so expensive. Sometimes families focus too much on saving for their child's education, at the expense of their own retirement savings. It is important to balance college savings along with saving for retirement and help employees meet both needs.

Later in the life cycle, it is important for preretirees to plan the transition from working to retirement, perhaps a phased retirement, while continuing to build assets and manage debt. So thinking about the building blocks helps provide a broader view and helps equip people with better financial security.

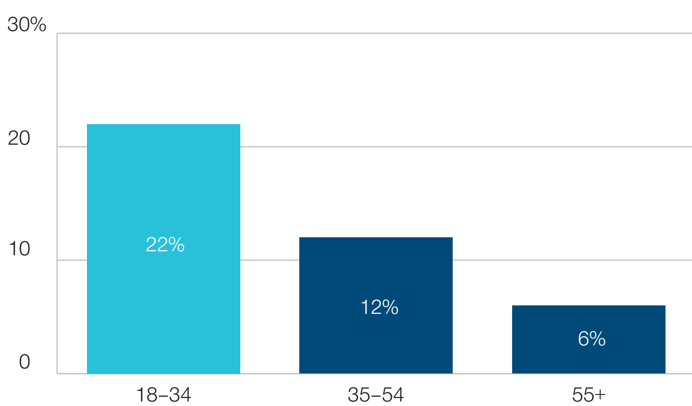
How do we measure effectiveness? Again, looking at retirement savings is not enough. There is a need for a more complex measure. We should think about measurements similar to how we think about doctor check-ups. Normally, we cannot assess good health by looking at only one test or a diagnostic. Moreover, it is not just how well individuals are doing now, but also about taking preventive steps. It is important to have a dynamic view and to see if people are showing any signs of financial distress or anything "lurking" around that could cause future problems. Many things can go undetected if we do not ask about debt, credit scores, or whether they have precautionary savings. The building blocks mentioned earlier can help assess how people are doing, and they can be an indicator of whether financial wellness programs have created better outcomes for individuals.

Q. As we think about women, the research found that women have lower levels of confidence with their financial capabilities and are also vulnerable. Is there anything plan sponsors should do as they think about financial wellness programs for women?

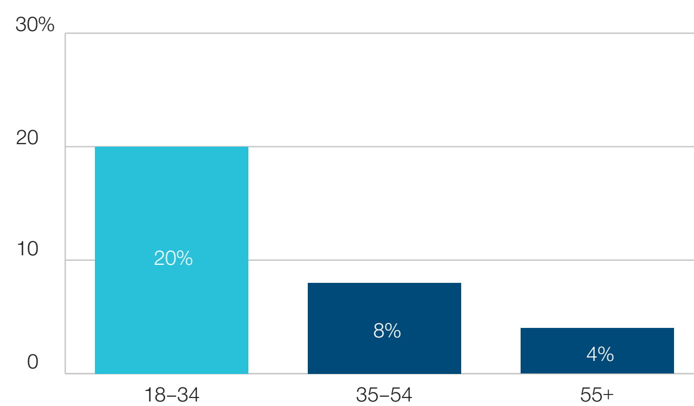
Lusardi: Our research, including using the 2015 NFCS, has several important findings regarding women. First, women

FIGURE 3: **Financial Stress—by Age**

Percentage who have taken a loan from their retirement account—by age



Percentage who have taken a hardship withdrawal from their retirement account—by age



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"So thinking about the building blocks helps provide a broader view and helps equip people with better financial security."

not only have lower knowledge, but they also have lower confidence. Therefore, plan sponsors need to design a different program for women.

Second, the research also found that women are more likely to attend financial wellness programs and are more likely to change their behavior. Women are eager to learn and are willing to change their behavior.

Moreover, women have a "multiplier effect" because they have multiple responsibilities (e.g., caring for children, caring for aging parents) and so women impact other groups as well. However, because women have so many responsibilities, sometimes they do not think about their own needs. So they are less likely to plan for retirement, less likely to be prepared for retirement, and more likely to be worried they will run out of money in retirement.

Thus, the message to engage women should be different; for example, it should be about helping them achieve financial security for themselves and their family.Moreover, empowering women to make financial decisions can help them to help others meet their objectives.

Q. Looking to the future, what do you think financial wellness programs will look like 10 years from now?

Lusardi: In 10 years, we will use more technology to inform financial decision-making. How that technology will work will depend on whether people are educated enough. Financial technology will not replace financial education. Financial technology will not replace our capacity to make decisions. Rather, financial technology will complement financial education; therefore, people will still need a basic level of financial knowledge in order to use the tools well.

If we are visionary enough, we'll have financial literacy taught in schools so that people have the basic knowledge to make financial decisions and to use the proper tools to make the best decisions for themselves.

Q. This has been a great conversation and very informative. Do you have any final thoughts to share today?

Lusardi: Financial wellness is a very important topic, and I want to reiterate the importance of research. We need data to design the best programs, and we need data to see how people are doing so that programs can be continuously improved. Research is important to finding a long-term sustainable solution.

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