Financial literacy: An epic fail in America

By **Greg Iacurci** — March 2, 2019 (article has been shortened)

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For as long as he can remember, Zachary Beneda dreamed of joining the Air Force.

But the 23-year-old senior at Texas A&M University, who will be headed to Japan after graduation for his first active-duty assignment as an Air Force support officer, got a rude awakening when he realized he'll also have to begin paying back $90,000 in college loans.

Zachary Beneda regrets not paying more attention to taking out $90,000 in college loans. He's headed to the Air Force after graduation, and the loans will cost him $1,000 a month to pay back — about half his starting salary.

Mr. Beneda will be required to pay $1,000 a month — about half his monthly salary as a second lieutenant.

"I was floored," he said. "I thought the military was going to take care of me and the burden wouldn't be as bad. I wasn't worrying about the loans as much as I should have."

Mr. Beneda is hardly the first to underestimate the weight of college loans, and he won't be the last.

But it's not just college cost confusion — financial mistakes are made every minute of every day. The consequences of those mistakes run the gamut, from being an annoyance (inadvertently choosing a high-interest credit card) to being financially ruinous (investing a retirement nest egg in what turns out to be a Ponzi scheme).

We teach our children to wear seat belts. Schools invest in programs aimed at helping kids practice smart internet habits. But few are talking about the dangers of too much debt or the blessing that is compound interest.

As a result, Americans are saddled with exorbitant loans and save too little for retirement. As the gap between rich and poor widens, it's clear that financial literacy is one of the factors that separate the haves from the have nots.
Financial advisers recognize the problem: 78% strongly agree financial literacy is a concern in the U.S., according to a survey of advisers by *InvestmentNews*.
But there's a disconnect — only 4 in 10 advisers are doing anything to address the problem, meaning the majority are ignoring the issue.

Americans fall short

But when it comes to being financially literate, Americans fall woefully short. Although the U.S. is the world's largest economy, the **Standard & Poor's Global Financial Literacy Survey** ranks it No. 14 (tied with Switzerland) when measuring the proportion of adults in the country who are financially literate. To put that into perspective: the U.S. adult financial literacy level, at 57%, is only slightly higher than that of Botswana, whose economy is 1,127% smaller.

U.S. ranks only slightly higher than Botswana in adult financial literacy

Source: Standard & Poor's Global Financial Literacy Survey

In another study, researchers found in 2015 that only 30% of Americans were able to answer three simple financial questions about inflation, interest compounding and risk diversification. The academics who conducted the study, Annamaria Lusardi of George Washington University and Olivia Mitchell of the University of Pennsylvania, called that success rate "discouragingly low" in light of the complex financial decisions Americans face.

Yet another study shows a downward trend in financial literacy. In 2015, 37% of individuals correctly answered four out of five financial questions, down from 42% in 2009, according to the Financial Industry Regulatory Authority Inc.'s Investor Education Foundation's most **recent study of financial capability in the U.S**.

"Americans are struggling and at times they're clueless — and that's a disaster recipe right there," said George Barany, director of the America Saves initiative at the Consumer Federation of America.

More responsibility

> The financial literacy crisis comes at a time when Americans are being asked to take responsibility for their own financial security.
> Perhaps the first serious financial decision many Americans have to make is how much debt they are willing to take on to go to college. Unfortunately, like Mr. Beneda, many students don’t consider the ramifications of that debt until it’s too late — when they have to start paying off their loans. The result: Average college debt per student **more than doubled over the decade** through 2016, to nearly $30,000.
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> “My parents really didn’t tell me anything,” said Mr. Beneda, who is the oldest of three children. “I feel like I was the test dummy.”
> Student loans are now the second-highest household liability, after home mortgages, and student debt is the most common form of consumer debt to become delinquent.
> “It’s something we should worry about,” said Brigitte Madrian, dean of Brigham Young University’s business school. “It could have a ton of spillovers on other economic behaviors that are important to the economy overall.”

consumer credit

Even before they get out of college, students are faced with another important decision, one which can have consequences throughout their lives: how to handle consumer credit.
“When you get to college, there are literally people from different credit card companies on campus giving you a coupon for free pizza if you sign up for a credit card with them,” said Courtney Allen, a 22-year-old senior at Flagler College. “All you see is free pizza if you give them information.”

Sometimes teenagers are opening credit card accounts even before they get to college. Pat Curran, a high school teacher in Jacksonville, Fla., who has been teaching economics for nearly four decades, remembers one student who obtained a credit card with a $1,500 credit limit. She didn’t have a job or understand that she’d have to pay back the expenses charged to the account — with interest, no less.
“It was a wild moment,” Mr. Curran said. Shortly afterward, he wrote a credit-card lesson into his curriculum.

Given the climate of easy credit, it's not surprising that the average household credit card debt rose to $8,284 in 2018, a 25% increase from $6,642 in 2011, and is now the **highest it has been in nearly a decade**.
Americans are called on to make many other important financial decisions in their lives: leasing versus buying a car, renting versus owning a home, taking out a fixed-rate mortgage versus an adjustable rate, and the best type of life and health insurance to purchase.

Saving for retirement

But perhaps one of the biggest financial decisions they have to make is how to save for retirement. Over time, pensions have all but disappeared for U.S. workers, unless they are in a union or work for a government entity. This shift means workers have to save the majority of money on their own in a 401(k) plan or individual retirement account. In addition to deciding how much they want to save, they have to decide how to invest it.
Americans are not doing a very good job of it. The median retirement savings for Americans between ages 55 and 64 is $104,000, according to a 2015 study — an amount that would translate into only $310 a month if invested in an inflation-adjusted annuity.

Compounding the problem is the fact that Americans are living longer, which means they will more likely need to pay for things like long-term health care and stretch their savings over a longer period than previous generations.
All of this long-term planning is on Americans' shoulders, although studies show even managing one's money day-to-day seems like a challenge for most. Roughly four in 10 working U.S. adults would not be able to scrape together enough money in a month to cover the cost of a midsize budget emergency — a car or home repair, medical bill or legal expense — according to a 2017 report from the **Global Financial Literacy Excellence Center**.

Lack of education

Part of the problem is that few schools incorporate financial education into their curriculum.
Only a third of states require high school students to take a course in personal finance, according to the **Council for Economic Education**.
Most teach the subject as one portion of another course of study, such as math, economics or social studies, while only five states require a semester-long, stand-alone personal finance course.

17 states require a personal finance course to graduate high school

Source: Council for Economic Education

The relative unimportance policymakers and educators place on personal-finance courses is a primary contributor to the nation's dismal financial literacy. Early education around the effect of high versus low interest rates, short- versus long-term payments, credit scores and budgeting, for example, would prepare consumers for big financial decisions such as financing college, buying a home or saving for retirement. Early mistakes can set people up for years — if not a life — of financial struggle.

It's kind of sad, to use a more pejorative term, that you graduate from high school — or more importantly, you graduate from college — and you don't have an appreciation for these basic concepts that are going to be important to your own lifestyle," Jay Clayton, chairman of the Securities and Exchange Commission, said at an investor roundtable last summer.

The financial services industry bears some of the responsibility, too. Institutions have erected barriers of entry for Americans to participate in important parts of the financial system. Banks, for example, have moved out of poorer rural areas. And banks requiring large account-opening deposits and minimum balances, and high overdraft fees — primarily affecting low-income minorities — keep many from even opening bank accounts. That's despite evidence that bank account ownership correlates with improved levels of financial literacy.

According to a **2017 report published by the Organization for Economic Cooperation and Development**, 15-year-old American students who hold a bank account scored 40 points higher in financial literacy than students without one.

But unfortunately some financial firms, including some corners of the financial advice industry, see more opportunity to profit when dealing with non-savvy consumers.

Marketing to ignorance

The financial services industry engages in consumer education efforts — but that's dwarfed by the resources devoted to marketing its products. The industry spends roughly $17 billion annually to market products and services to consumers, but only $670 million on financial education, according to a 2013 report published by the **Consumer Financial Protection Bureau**.

That translates to $25 spent on financial marketing for every $1 put toward financial education — meaning the public has little access to unbiased information.

While there are ethical financial advisers who recognize investors' vulnerabilities and aim to protect them, a significant portion of the industry is "designed to take advantage of that lack of sophistication," said Barbara Roper, director of investor protection at the Consumer Federation of America.

Conflicts of interest, for example, are pervasive in the advice industry. Current rules allow brokers to put their financial interests ahead of a customer's when selling a financial product. In other words, they may choose the mutual fund or annuity earning them the highest sales commission, even if it's not in the customer's best interest. Brokers are allowed to do this under the guise of being a "financial adviser."

These sorts of conflicts are disclosed, but are often too complex for investors to understand. Important concepts like investment cost, risk and liquidity are beyond the reach of those lacking basic financial literacy.

"Investors are left to just trust and hope for the best," Ms. Roper said.