Financial Education in the Workplace: The Impact on Employers & Employees

Federal Reserve Bank of Kansas City
Denver Branch

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THE NEED FOR FINANCIAL EDUCATION
Consumption Smoothing

- **Youth:** borrowing
- **Peak earning years:** saving
- **Retirement:** dissaving

The graph illustrates the concept of consumption smoothing over time. The curve shows how consumption is smoothed over the life cycle, with peaks and troughs corresponding to different stages of life.
U.S. Personal Savings Rate

Retirement Savings Outlook is Grim

• Median value of holdings in retirement accounts is $48,000 (2009 SCF)

• 45 percent of workers elect to cash-out 401(k)’s upon leaving (Hewitt Associates)
Estimated Social Security Benefits

- Pre-Retirement Income, 2008 ($000)
  - Benefits Share (%)

Maximum benefits = $2,057 (income = $102,000)
Credit and Debt

• Median outstanding debt for families holding debt increased by 27 percent from 2004 to 2007
• Credit card delinquencies (30 days = 3.5%) and charge-offs were 5.6% (Federal Reserve)
• Bankruptcies, after declining significantly between 2006 and 2008 (due to rules changes) have picked up 58 percent hence (uscourts.gov)
• Foreclosure rates are barely off all time highs
Conceptual Framework/Hypotheses

- lack of knowledge → bad decisions
- personal finance education → better knowledge
- more knowledge → better financial outcomes
- better financial outcome → better workers

- Providing financial education at the workplace is good for the bottom line
How Personal Financial Problems Translate into Workplace Problems

• Potential Costs (examples)
  – Absenteeism/Tardiness/Turnover
  – Garnishment
  – Increased Use of Employee Assistance Programs
  – Failure to Meet 401(K) Nondiscrimination Tests
  – Fiduciary Liabilities (ERISA)
  – Theft/Embezzlement
  – Accidents
  – Workplace Violence
  – Stress leads to lower productivity
Financial Knowledge and Behavior

STUDY EVIDENCE
<table>
<thead>
<tr>
<th>Do you follow a monthly budget?</th>
<th>TEST SCORE</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Low 28</td>
<td>Intermediate 28</td>
<td>High 36</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Do you generally pay off your credit card balances every month?</th>
<th>TEST SCORE</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Low 38</td>
<td>Intermediate 40</td>
<td>High 58</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Credit card balances relative to credit limits</th>
<th>TEST SCORE</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>Low 17</td>
<td>Intermediate 26</td>
<td>High 49</td>
</tr>
<tr>
<td>0% - 10%</td>
<td>Low 39</td>
<td>Intermediate 31</td>
<td>High 24</td>
</tr>
<tr>
<td>10% - 25%</td>
<td>Low 8</td>
<td>Intermediate 11</td>
<td>High 8</td>
</tr>
<tr>
<td>25% - 50%</td>
<td>Low 12</td>
<td>Intermediate 16</td>
<td>High 7</td>
</tr>
<tr>
<td>&gt; 50%</td>
<td>Low 24</td>
<td>Intermediate 17</td>
<td>High 13</td>
</tr>
<tr>
<td>&lt; 10%</td>
<td>Low 56</td>
<td>Intermediate 57</td>
<td>High 72</td>
</tr>
<tr>
<td>&lt; 25%</td>
<td>Low 64</td>
<td>Intermediate 68</td>
<td>High 81</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Credit card balances relative to income</th>
<th>TEST SCORE</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 10%</td>
<td>Low 84</td>
<td>Intermediate 79</td>
<td>High 92</td>
</tr>
<tr>
<td>10% - 25%</td>
<td>Low 7</td>
<td>Intermediate 14</td>
<td>High 6</td>
</tr>
<tr>
<td>25% - 50%</td>
<td>Low 6</td>
<td>Intermediate 4</td>
<td>High 2</td>
</tr>
<tr>
<td>&gt; 50%</td>
<td>Low 3</td>
<td>Intermediate 3</td>
<td>High 0</td>
</tr>
<tr>
<td>&lt; 25%</td>
<td>Low 91</td>
<td>Intermediate 93</td>
<td>High 98</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Emergency fund adequacy (at least three months of expenses saved outside of retirement accounts)</th>
<th>TEST SCORE</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>Low 37</td>
<td>Intermediate 37</td>
<td>High 16</td>
</tr>
<tr>
<td>Insufficient</td>
<td>Low 58</td>
<td>Intermediate 59</td>
<td>High 71</td>
</tr>
<tr>
<td>Sufficient</td>
<td>Low 5</td>
<td>Intermediate 4</td>
<td>High 12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Retirement savings relative to age and income (see formula in text)</th>
<th>TEST SCORE</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Low 69</td>
<td>Intermediate 52</td>
<td>High 33</td>
</tr>
<tr>
<td>Moderate</td>
<td>Low 13</td>
<td>Intermediate 17</td>
<td>High 19</td>
</tr>
<tr>
<td>High</td>
<td>Low 18</td>
<td>Intermediate 31</td>
<td>High 48</td>
</tr>
</tbody>
</table>

All values expressed in percentage of total in test score cohort
Financial Knowledge and Sophistication

Test Score:
- Low
- Intermediate
- High

Financial instruments and their corresponding test scores include:
- Checking:
- Savings:
- Credit Card:
- Money Market:
- CD:
- Mutual Fund:
- Stocks:
- Savings Bond:
- Real Estate:
Cohort Study

STUDY EVIDENCE
Details of Cohort Study

• Increase in use of budgets*
• Substantial reduction in number paying bills late
• Share paying off cards every month increased by 50%
• Most credit card balances declined, compared to 11.2% increase nationally over same period
• Significant reduction in 401(k) loans at retail site
• Some large debt pay-offs
Details of Cohort Study

• Modest increase in numbers holding mutual funds and certificates of deposit (lower holding stocks)
• Many reported that they “had more money than they thought”
• Increases for most in savings outside of retirement
• Retirement planning
  – Most reported more retirement planning
  – Share of income saved for retirement increased 13%
  – Money balances in 401(k)s increased by 70%
  – In one company, 401(k) enrollment increased from 65% to 100%
  – Increased contributions for many who had previously enrolled in a 401(k)
Details of Cohort Study

• Many reported less stress in their lives
  – after getting financial house in order
  – improved relationship with spouse because of reduced money concerns
  – Large increase in satisfaction with financial situation

• Some reduction in garnishments

• Enrollment in health care FSA increased from 45% to 70%

• Fewer payday advances and 401(k) loans
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