

## **“Financial Education and Consumer Behavior”**

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I’m very pleased to be here today to talk about financial education and its impact on individuals’ behavior with regards to retirement planning and saving. Before discussing my research in this area, I would like to provide a very brief overview of my company and the financial condition of U.S. retirees.

TIAA-CREF’s history stems from a dramatic \$10 million gift by the philanthropist, Andrew Carnegie in 1905 for a foundation that would provide a free pension for teachers in higher education. As a significant contributor of charitable funds to institutions of higher education, Carnegie became aware of the plight of its faculty who, in order to further their careers, often moved from school to school, losing any pension benefits built up during their employment upon leaving, and retiring destitute. Carnegie hoped that the fund would grow sufficiently so that it would provide an adequate retirement for all eligible educators. Well, \$10 million was a lot of money back then, but it wasn’t enough to provide continuing support to all professors then or in the future. Today, TIAA-CREF includes among its participants not just those faculty members who were the reason for the original gift, but all types of employees at colleges and universities, as well as other non-profit institutions involved in education or research.

After it became clear that ongoing contributions would be required, the Teachers Insurance and Annuity Association, or TIAA, was founded in 1918 to serve as the pension system for participating colleges and universities. For many years, the fixed annuity – called TIAA Traditional – was the only investment vehicle in the

pension plan. In 1952, TIAA formed a companion organization, called CREF, to offer the first variable annuity, which provided participants the opportunity to invest in the stock market.

Today, TIAA-CREF is the largest provider of retirement plans to colleges and universities in the United States. Working with 15,000 institutions, we currently manage about \$280 billion in assets for 2.9 million participants. In addition to advising institutions about their retirement plans and counseling their employees about financial security issues, our job is to accept premiums, manage the investments, and pay out benefits when participants retire. The vast majority of our business consists of annuity contracts in defined contribution plans. Over the past several years, TIAA-CREF has become a full service financial services organization, expanding its menu of available financial products to include Long Term Care Insurance, Life Insurance, Mutual Funds, Single Premium Immediate and Deferred Annuities, IRAs, Tuition Savings Plans and even Trust Services for our wealthier clients.

TIAA-CREF is a big believer in the value of financial education. We believe that as a result of the tremendous growth in defined contribution plans, individuals increasingly need to make informed decisions about saving and investing in order to achieve a comfortable retirement. Most individuals seem to have extremely limited knowledge of financial markets, the level of risks associated with specific assets, and how much they need to save to reach their income goal in retirement.

Despite the enormous wealth in the U.S., the unfortunate truth is that millions of people who have worked hard throughout their adult lives are not financially prepared for retirement. According to the 2001 Survey of Consumer Finances, the median net worth of families nearing retirement, which refers to those having heads of households between the ages of 55 and 65, is \$181,500, including the value of their homes. Families who have to stretch these assets without any

supplemental income over 25 or more years do not have a very comfortable retirement.

Most elderly people in the United States rely heavily on Social Security for a significant portion of their income. For roughly two-thirds of the elderly, Social Security accounts for 50% or more of their income. For approximately a third of the elderly, Social Security accounts for 90% or more of their income; and for 20% of the elderly population, Social Security accounts for all of their income. (Source: Social Security Administration)

Skeptical of the adequacy of Social Security funds in the future, especially once the 77 million Baby Boomers retire, many retirement experts are emphasizing the need for increased private saving through employer retirement plans and through individual saving.

There's a growing body of research indicating that financial education and planning help individuals achieve a more financially secure retirement. Workers who attend company-sponsored financial education programs tend to have higher participation and contribution rates than workers whose employers do not offer them. And, in general, individuals who engage in financial planning tend to have higher net worth at retirement. Interestingly, research is indicating that while written communications about the company's retirement plan is helpful to employees, the most effective form of financial education is seminars.

TIAA-CREF is widely recognized as offering extensive and high-quality financial education to participants. We have developed more than 20 financial education seminars to help participants with various aspects of saving, investing, understanding account statements, rebalancing portfolios, and choosing among distribution options at retirement. Some of the seminars are targeted to specific audiences such as those nearing retirement, those with different income levels, and women. In 2002, TIAA-CREF consultants delivered nearly 4500 financial

education seminars, attracting more than 122,000 people. We expect those numbers will be even higher for 2003.

The research that I've been conducting – along with Robert Clark and his colleagues at North Carolina State University – examines how financial education affects individuals' choice of retirement goals, their level of retirement saving, and their investment allocations in retirement accounts.

Our study consisted of analyzing the extent to which employees at colleges and universities have altered their retirement goals and/or their saving behavior as a result of attending a one-hour financial education seminar by TIAA-CREF consultants. The seminar presented information about their employer's retirement plan, and provided guidelines for setting retirement goals, establishing sufficient saving levels, and understanding risk-return characteristics of different types of investments. Participants were asked to complete survey questions before the seminar regarding their saving levels, retirement income goals and expected retirement date, along with providing demographic and economic data.

After the seminar, participants were asked to indicate whether they had changed their goals for retirement age or retirement income as a result of the information provided in the seminar. If respondents had a supplemental retirement plan, there were asked if they were planning to increase their contributions; if they did *not* have a supplemental plan, they were asked if they planned to establish one. In addition, they were asked whether they intended to change their asset allocations as a result of the seminar.

The research project consisted of 60 seminars occurring from March 2001 to May 2002 at various colleges, universities and community locations. Participants consisted of a wide range of employees: faculty, administration, support staff, maintenance, etc. A total of 633 usable responses were obtained from participants who completed the surveys both immediately before and after the

seminar. Three months later, attendees were surveyed again to determine whether they had implemented their intended changes in saving behavior and investment allocations. The number of participants who answered the third survey was considerably smaller.

Before describing the results, let's take a quick look at some of the characteristics of participants. The mean age was 54 and the gender composition was 54% female and 46% male. On average, participants had worked 15 years at their institution and had an average of nearly two children. Average household income was approximately \$103,000 and the average account balance in participants' defined contribution plan was about \$358,000. Equity allocations in the basic retirement plan averaged 64%. Employer contribution rates averaged about 9% and employee contribution rates averaged about 8%.

Outside of the basic retirement plans, about 50% of participants were contributing to supplemental pension plans and they had accumulated, on average, about \$109,330 in those accounts.

In the first survey – before the seminar – the average participant set a retirement age goal of 64 and a retirement income goal of replacing 80% of pre-retirement income. However, the goals varied considerably among participants according to gender, education, occupation, marital status, presence of children in the family, and other variables.

In general, women planned to retire at earlier ages than men. Also, younger participants and married participants tended to indicate earlier retirement dates than older participants and single individuals. Those with children tended to set older retirement ages than those without children.

Respondents' education and work experience also accounted for differences in retirement age goals. Employees *without* graduate and professional degrees reported younger desired retirement ages than did those who had them. Similarly, secretarial, clerical and maintenance personnel were more likely to set younger retirement ages than teaching and professional employees.

Following the seminar, participants were asked about the quality of the information. In general, participants thought they had been part of a high quality financial education program, with 36% rating the seminar excellent and 54%, good. Respondents indicated that the seminar had improved their understanding of the need for retirement savings and had improved their chances of achieving their retirement goals.

As I mentioned earlier, two of the main aspects of the study were to determine whether the seminar affected participants' retirement goals – including both age and income – and whether it affected their saving behavior. Overall, only a small percentage of respondents indicated they would change their expected retirement date. However, more than a quarter of respondents indicated they were changing their retirement income goals, mostly upward. And, most significantly, 91 percent of respondents indicated their intentions of making changes to their retirement saving plans such as raising their contributions or changing their investment allocations. Participants indicated intent to change allocations in both basic and supplemental plans. In short, participants who realized that their retirement plans were not on track to meet their goals indicated a preference for increasing annual saving rather than retiring at older ages.

As for retirement income goals, about 20% of respondents increased this goal and about 8 percent decreased it. More than one-third of participants who before the seminar had set a goal of retiring with only about 65% of their pre-retirement income raised their retirement income goal by an average of 19 percentage points. This suggests that, as a result of the seminar, these individuals

determined that their goal was too low and that they should attempt to achieve a higher standard of retirement consumption. In general, individuals with lower goals for retirement income were more likely to raise their goals than those with higher goals, and those with higher income goals were more likely to lower them than those with lower income goals.

In addition to making revisions to their basic retirement plan, participants also indicated intentions to increase participation in supplemental plans. Forty-one percent of those who did not have a supplemental pension plan said that they planned to establish one following the seminar. And among respondents who already had a supplemental plan, 37% stated they would increase their contributions to them. About 29% of participants indicated after the seminar that they planned to open an individual retirement account or increase their contributions to an existing IRA.

Results of the second survey revealed significant differences in the reactions to the seminar content based on demographic and other characteristics of respondents. For example, younger workers were more likely to indicate that they planned changes in their retirement saving than older workers. Perhaps the seminar showed them the power of compounding returns and the payoff to saving earlier in life. Women and individuals employed in secretarial and maintenance positions were also more responsive to the information provided. This may reflect a greater gain in knowledge concerning saving and financial markets among these individuals or simply a different reaction to the same gain in knowledge.

Regarding gender differences in responses after the seminar, women were twice as likely to increase their expected retirement age rather than to lower it. Men, on the other hand, were split almost equally between those who increased their expected retirement age and those who lowered it.

In response to the new information, women were also much more likely than men to alter their retirement income goal. Approximately 35% of the women changed their income target compared to only 20% of the men. Of the women who changed their retirement income goal, nearly three-quarters of them raised it.

Perhaps partly because their investment accumulations were significantly lower than those of men, women realized with the seminar input that they should be saving more. As a result, they were much more likely than men to increase their retirement saving and to alter their investment choices. Among persons without a supplemental retirement plan, 48% of the women – but only 33% of the men – indicated that they would establish such a plan in the future. Among persons who already had a supplemental plan, 53% of women – compared to only 33% of men – indicated they would increase their annual contributions.

So, now that we know what participants *intended* to do following the seminar, let's review what they *actually did* as of three months after the seminar. Recall that 41% of respondents indicated in Survey Two that they planned to establish a supplemental retirement plan. Of those, only 25% indicated three months later in Survey Three that they had actually established a new plan, but 63% stated that they still intended to do so. Interestingly, 22% of those who indicated in Survey 2 that they did not intend to open a supplemental plan had changed their minds by three months later in Survey 3, stating that they now intended to do so.

Among those who already had supplemental plans and indicated in Survey 2 that they would increase future contributions following the seminar, 42% had actually taken the necessary steps to increase their contributions by the time of Survey 3. Interestingly again, 30% of those who stated in Survey 2 that they would *not* be increasing their contributions to supplemental plans actually did so by the time of Survey 3.

Only about 40% of individuals who said in Survey 2 that they were going to use automated telephone services or the Internet to monitor retirement accounts reported they had actually done so in Survey 3.

In general, responses to Survey 3 indicated a substantial disconnect between the stated intent to change saving behavior immediately following the seminar and the actual actions taken in the next three months. Individuals who had stated in Survey 2 that they intended to increase retirement saving but who had not done so in the following three months were asked why. About 20% said the money was needed to pay off existing debts, 16% said their income was lower than expected following the seminar, and another 16% said they had changed their minds and no longer were planning to increase their saving. About one-third reported that they had simply failed to take the necessary steps to increase their retirement saving.

These findings imply that financial education programs would be more effective if they included methods that would make it very easy for employees to act on their intentions, such as the ability to open up a supplemental plan or change contribution rates at the conclusion of the seminar. The ability to make on-site changes in their saving plans at the end of a seminar would tend to reduce the forces of inertia and procrastination. In addition, it would be beneficial for employers to provide follow-up actions such as reminders, refreshers, and new programs. As noted, our research indicates the effectiveness of seminars targeted for special groups such as women and lower-income employees, who have demonstrated considerable responsiveness to the seminars.

In conclusion, our research has shown that financial education can produce significant changes in how individuals think about and plan for retirement. The results have direct policy implications for plan sponsors and workers around the world, including both public and private retirement plans. Many countries are adopting individual accounts as part of their national plans. These new plans

may require additional saving and investment decisions by workers who will need quality educational programs to help them prepare adequately for retirement. Similarly, employer pensions in other countries are also moving in this direction. In addition, aging populations may result in lower benefits from certain national social security programs. In sum, the trends are headed toward increased responsibilities of individuals to make saving and investing decisions that have lasting implications for their financial well-being. All of these trends underscore the importance of our research and the need for financial education. When it comes to retirement planning, ignorance is not bliss, and employees deserve quality education to help them achieve financial security in retirement.