

**Statement for the
House Ways and Means Committee
Subcommittee on Social Security**

***Protecting Social Security Beneficiaries from Predatory Lending and
Other Harmful Financial Institution Practices***

**June 24, 2008
B-318 Rayburn HOB, Washington, DC**

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T-153**

“Financial Literacy and Financial Education”



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“Financial Literacy and Financial Education”

By Dallas Salisbury, EBRI

Chairman McNulty, and members of the Subcommittee on Social Security of the Committee on Ways and Means, I thank you for the opportunity to provide testimony on this important topic. Since first working on related issues at the U.S Department of Labor in 1975, I regret that in spite of dramatic advances in technology, education delivery, and financial services, issues related to the financial literacy of our population have grown greater, not declined. I am pleased to comment on the specific questions sent to me by the Committee.

- **Why do people make bad choices when it comes to their money?**

An entire field of psychology and behavioral finance has developed in an effort to answer this question (see http://en.wikipedia.org/wiki/Behavioral_finance). Put it its simplest form, people prefer immediate gain and gratification, focus most readily on the short term, and are highly subject to messages and the way they are framed. Individuals prefer to be “sold.”

When these factors are taken into consideration against the substantial documentation of low financial literacy among all age groups, it makes bad decision-making understandable. Thus, individuals become victims of predatory lending practices, choose to pay high check cashing or lending fees when they have other choices, or make bad choices when they have choices in terms of financial management. They frequently make choices from among what they think they know or are presented with, rather than undertaking a search on their own. Behavioral research also finds that they prefer making choices from a narrow set of options, as opposed to a wider set.

Many individuals at lower income levels may not have a choice in cases where they have little or no income and/or face emergencies. These individuals face desperation and make choices that allow them to survive today, regardless of the longer-term consequences.

- **Your overall assessment of the financial literacy of our nation and whether there are significant variations between certain demographic groups.**

It has been well-documented that financial literacy in the population is quite low. This is essentially true across all demographics, even though we do find higher rates as education and income increase. As a result of the termination of most “home economics” courses in our public schools, we provide a lower rate of mandatory financial education today than in the 1970s and earlier. Nearly 80% of our young are offered elective opportunities for financial education, but our surveys indicate that fewer than 8% choose to take the courses.

The 31-question Jump\$tart Coalition’s biennial survey of youth financial literacy survey revealed that high school seniors have a lot to learn about important financial concepts. Among the findings in the survey:

- Forty-eight percent correctly said that a credit card holder who only pays the minimum amount on monthly card balances will pay more in annual finance charges than a card holder who pays their balance in full.
- Seventeen percent correctly answered that stocks are likely to yield higher returns than savings bonds, savings accounts and checking accounts over the next 18 years, even though there has never been an 18-year period where this wasn't true.
- Forty percent correctly answered that they could lose their health insurance if their parents become unemployed.
- Thirty-six percent think a house financed with a fixed-rate mortgage is a good hedge against a sudden increase in inflation, compared with 45 percent in 2006.

An amazingly low percentage of the total population actually understands the concept of “compound interest,” and this includes not understanding it when it applies to the interest you will have to pay on a loan or your credit card.

- **The financial literacy of “seniors,” including what we know about how they make their decisions, is also not encouraging.**

A recent survey by AARP found among those over 50 that:

- Americans are befuddled by financial jargon.
- Confusion results in doubt, missteps and lost opportunities.
- Americans believe the financial services industry does a poor job of communicating.

The AARP Bulletin recently commissioned a nationwide poll to explore financial literacy on important consumer subjects among people ages 40 and older. Fifty percent of the poll respondents “failed” the financial literacy quiz, meaning they could not get at least half the questions right.

Additional findings include the following:

- **Medicare coverage.** Less than one-third (31%) of the respondents correctly identified all of the items that Medicare does not cover.
- **Car buying regrets.** Nearly two-thirds (63%) of the respondents incorrectly stated that federal law allows one to cancel a car purchase within three days if it was bought at a car dealership.
- **Bankruptcy.** Roughly one-third (32%) of the poll respondents correctly reported that bankruptcy is growing faster amongst Americans age 65 and older than any other age group.
- **Social Security benefits.** Only 32% of the respondents correctly reported that a person of full retirement age or older may keep 100% of his Social Security benefits even if he is currently employed, regardless of how much he earns at his current job.

The Retirement Confidence Survey[®] includes results for the population over age 65. Over the 18 years that this survey has collected data, confidence in having enough money to live comfortable throughout retirement has changed very little overall. Confidence in Medicare and Social Security continuing to provide benefits of equal value in the future has risen. Savings among

those over 65 have remained well below the value of Social Security benefits for the vast majority, with declines in recent years. Forty-four percent reported this year that they are more concerned about their financial future than before they retired. While these measures do not speak to financial literacy per se, they do speak to the reliance seniors place on continuation of public programs at current levels. This also suggests the education challenges facing the public sector in the future.

- **Any information you can provide about what efforts are being tried in both the public and private sector and what works.**

Numerous campaigns are underway that specifically relate to our nation's seniors, with resources at web sites such as these:

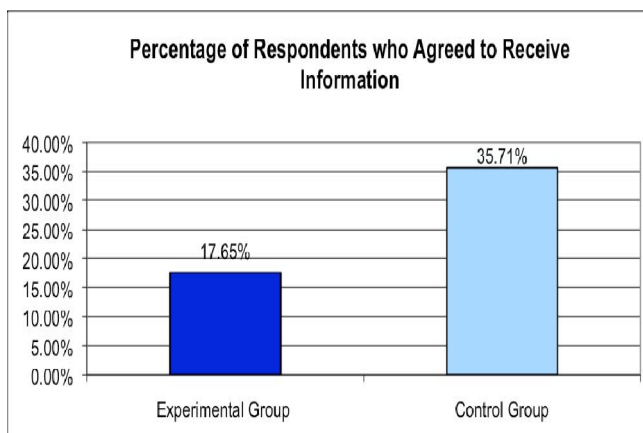
- Financial Literacy Public-Private Partnership (FLPPP) <http://www.dfi.wa.gov/flPPP/seniors.htm>
- Financial Literacy for Older Adults <http://www.albany.edu/aging/fl/resources/pres-financialliteracy.pdf>
- Seniors Protecting Themselves from Securities Fraud <http://www.asc.state.al.us/InvestorED/8-3-04SeniorsTakeControlPortrait.pdf>

Overall, research finds that individuals seek the path of least resistance, and respond to sales efforts. As a result, many people become victims of predatory lending practices, choose to pay high check cashing or lending fees when they have other choices, and make bad choices when they have choices in terms of financial management.

For many, the 2007 National Risk Behavior Study found that fraud was most common when individuals:

1. Rely on friends, family and co-workers for advice.
2. Are open to 'new' investment information and attending free seminars.
3. Fail to check on the background of the person doing the selling.
4. Are unable to spot persuasion tactics used by con men and women.

One program that I have been involved with as a member of the Board of the FINRA Investor Education Foundation provides information at www.SaveAndInvest.org



Working with the SEC, the State of Washington, and the AARP, a pilot investor protection campaign for older investors has just been completed. This work has found that *Direct education on fraud risk behaviors, social influence tactics and prevention strategies—such as asking questions and checking registration status of the professional and the investment—can reduce investment fraud susceptibility.*

- Interviews of con-artist criminals reveal that they do not like to be questioned.
- Call center research found that providing fraud targets with questions they could ask produced the largest reduction in victimization rates.
- Older investors who received a workshop on outsmarting investment fraud and influence tactics were 50% less likely to “open the door” to a fraudulent investment pitch by accepting additional communications.

Conclusion

The nation needs to continue to focus on increasing financial knowledge, providing meaningful consumer protections, and finding ways to protect vulnerable populations from fraud. Many good programs exist, but the absence of requirements for financial education in public schools underlines that the nation is missing opportunities—if financial literacy is an objective—even when it has “captive” populations.

As the FINRA coalition research found in 2007, high income and extensive education do not alone protect seniors from fraud. These are issues for the entire U.S. population.

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