

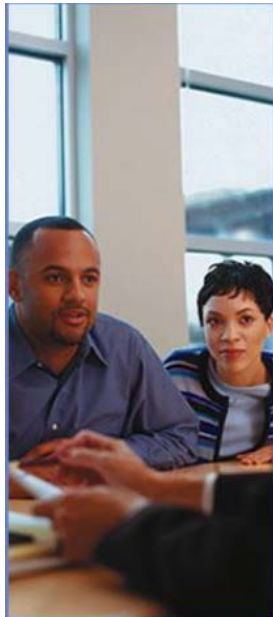


# Financial Literacy and Your Financial Security

Academic Staff Institute  
April 1, 2014

# **What Does Financial Security Mean For You?**

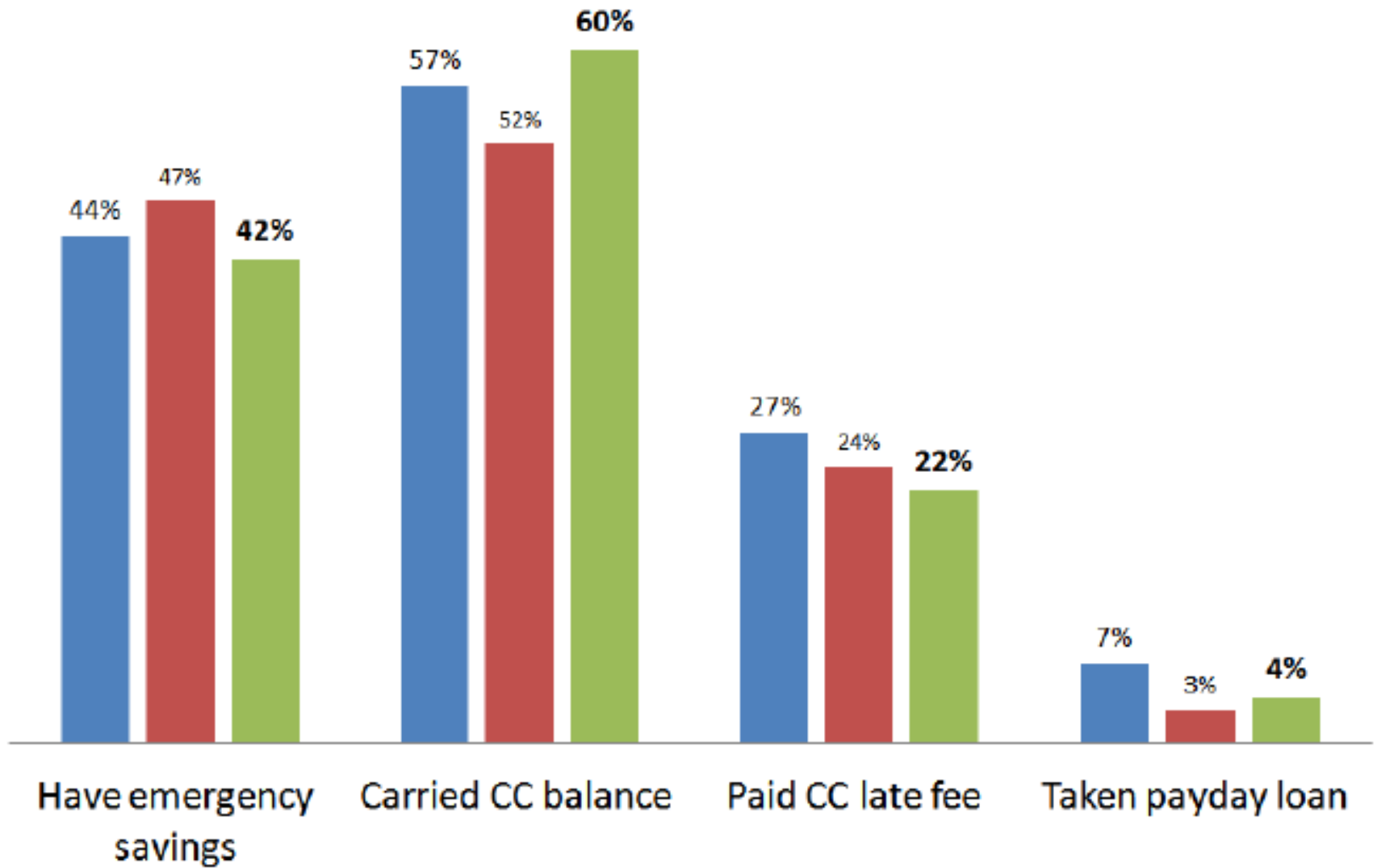
# What makes for Financial Security?



# Financial Capability Survey for Wisconsin

- [www.usfinancialcapability.org](http://www.usfinancialcapability.org) - clickable map
- 55 percent of Wisconsinites are living paycheck-to-paycheck (same as US average)
- 57 percent of Wisconsinites do not have a rainy day fund to cover three months of unanticipated financial emergencies. (60 percent nationwide).
- 19 percent used payday loan or similar (24 percent nationwide).
- Average 3/5 financial literacy questions correctly (about average)

■ US ■ MN ■ WI



# Common Survey Question

**Let's say you have 200 dollars in a savings account. The account earns 10 percent interest per year.**

**How much would you have in the account at the end of two (2) years if you did not deposit or withdraw any money during this time?**

*Click the answer below that is closest to the amount you estimate in the account.*

- \$200
- \$210
- \$220
- \$221
- \$240
- \$242
- Answer cannot be determined

40% Correct  
30% Neglected Compounding

<u>Answer</u>	<u>Percent</u>
\$200	3%
\$210	3%
\$220	10%
\$221	13%
\$240	30%
<b>\$242</b>	40%

# Potential Building Blocks of Financial Security





# Taking Charge

1. **Set goals.** Make concrete/specific
2. **Can be simple.** (cocktail napkins are ok) Just start
3. **Have a clear next steps.** This week...
4. **Review the plan on a regular schedule**

# Spending Plan

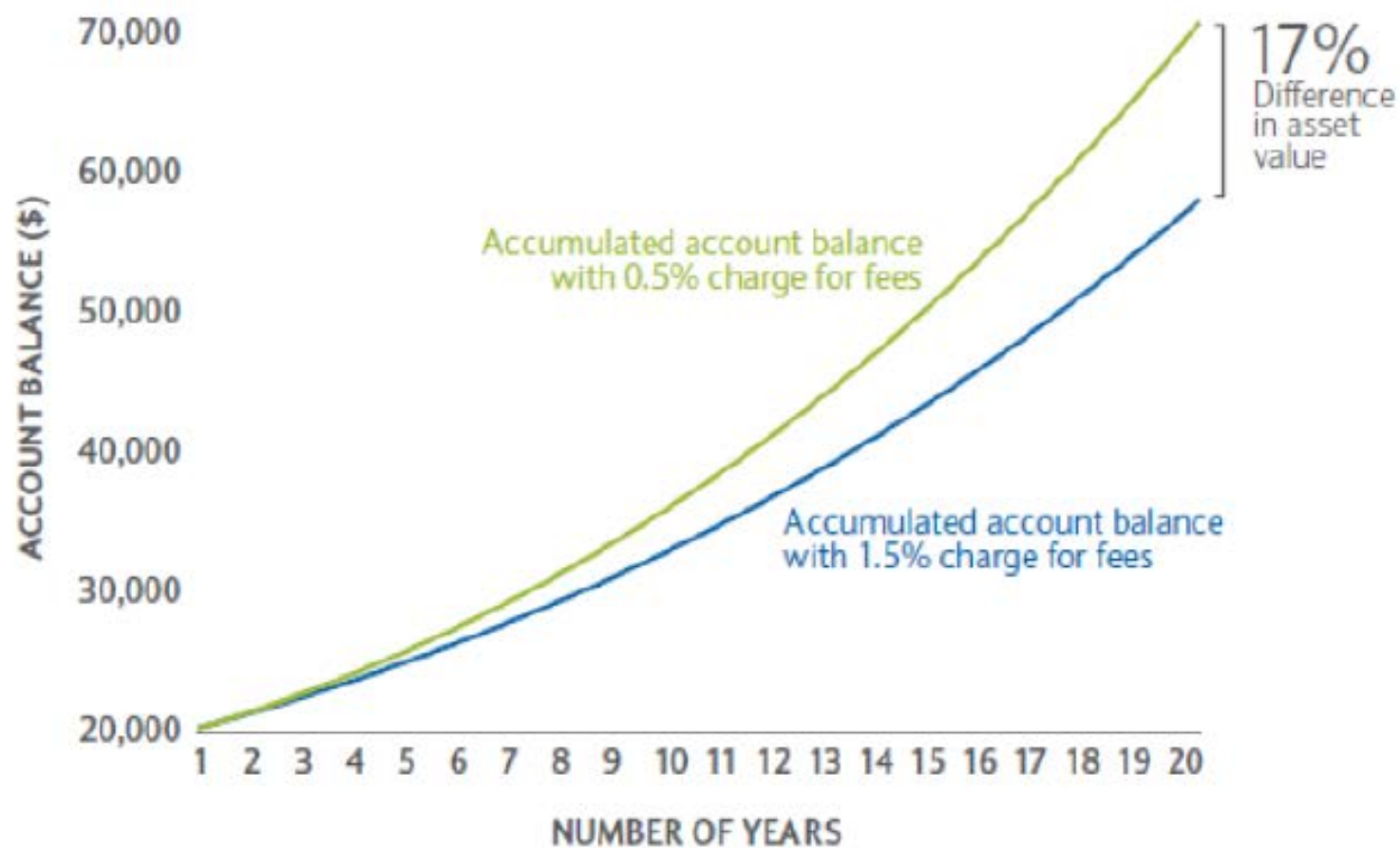
- Pay attention
  - Review actual expenditures
  - Due dates
  - Have a system
- Expect the Unexpected
  - Be realistic about presumed windfalls
  - Don't underestimate 'emergency' expenses
- “Pay yourself first” – save off the top
  - Commit – direct deposit

# Investing for the Future

- Contribute every paycheck
  - dollar cost averaging
- Chase low fees not 'hot' returns
  - Most 'pros' who devote massive resources cannot beat the market average consistently (and fees often eat up gains)

## Focus on Fees

EFFECT OF A 1% DIFFERENCE IN HIGHER ANNUAL FEES ON  
A \$20,000 401(k) BALANCE INVESTED OVER 20 YEARS.



Source: Government Accountability Office.

# Credit Reports

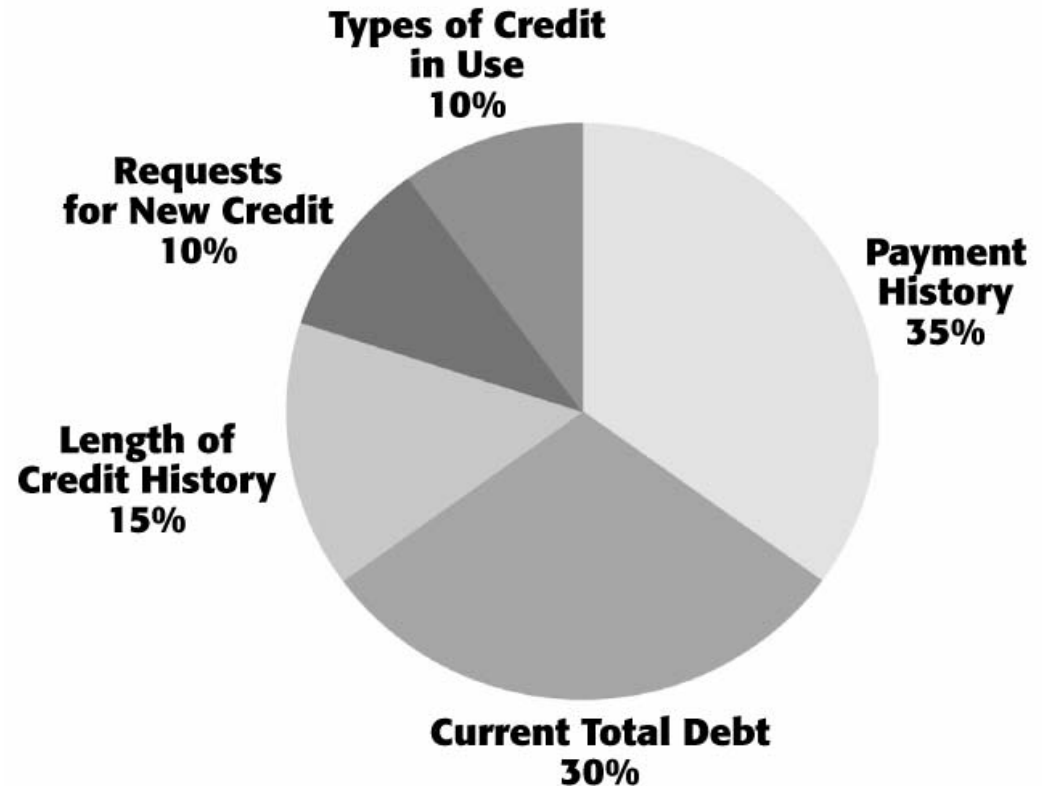
Watch for changes in existing credit / loans

Pay bills on time.

Don't open a lot of new accounts

Correct mistakes.

Keep balances low on revolving credit.



Source: Fair Isaac and Consumer Federation of America

## Check Your Credit Report Campaign

**“5 minutes 3 times per year”**

**2/2, 6/6, 10/10**

<http://fyi.uwex.edu/creditreport/>

- 15.9 out of 200+ million consumers use [AnnualCreditReport.com](http://AnnualCreditReport.com) annually (CFPB, 2012)
  - 5% of records have errors that could have negative consequence (FTC, 2013)
- 
- February 2<sup>nd</sup> (2/2): (Experian)
  - June 6<sup>th</sup> (6/6): (Equifax)
  - October 10<sup>th</sup> (10/10): (TransUnion)





# Avoid Fraud

- “Too good to be true?”
  - Probably is not true.
- Always stay in charge of your money
  - Don’t be fooled by appearances
  - Watch out for salespeople who prey on fears
- Monitor
  - Be wary of solicitations

# Get Help

- Credit Counseling: <http://www.debtadvice.org/>
- Mortgage Counseling: [www.995hope.org/](http://www.995hope.org/) 888-995-HOPE
- UW Extension: [www.uwex.edu/](http://www.uwex.edu/)
- Wisconsin Department of Financial Institutions <http://www.wdfi.org/> (800) 452-3328
- Federal Deposit Insurance Corporation (FDIC) — (877) ASK-FDIC (925-4618); [www.fdic.gov](http://www.fdic.gov).
- Federal Trade Commission (877) FTC-HELP(382-4357); [www.ftc.gov](http://www.ftc.gov).



<http://www.consumerfinance.gov/>



# Goal: Financial Capability

- “Financial literacy” has Limits
  - Still may not engage in positive behavior
- The Promise:
  - Focus attention
  - Exercise self-control
  - Build adaptable skills
  - Empowered consumers in marketplace—not about “a product” or one decision

# Expectation of life as you age: U.S. Non-Hispanic Whites (2009)

	<u>males</u>	<u>females</u>
<b>Expectations of life @ 65</b>	<b>17.6yrs</b>	<b>20.3yrs</b>
Percent alive at 80	62 <sup>0</sup> %	72 <sup>0</sup> %
<b>Expectations of life @ 80</b>	<b>8.2yrs</b>	<b>9.7yrs</b>
Percent alive at 90	35 <sup>0</sup> %	46 <sup>0</sup> %
<b>Expectation of life @ 90</b>	<b>4.2yrs</b>	<b>4.8yrs</b>
Half of 65 year olds alive at	age 83	age 86

# Cohort life expectancy

Birth Year	<u>MEN</u>			<u>WOMEN</u>		
	<u>65</u>	<u>70</u>	<u>100</u>	<u>65</u>	<u>70</u>	<u>100</u>
1955	17.9	14.5	2.5	20.6	16.8	2.9
1965	18.5	15.0	2.7	21.2	17.4	3.0
1970	18.8	15.3	2.7	21.4	17.6	3.1
1980	19.4	15.8	2.9	22.0	18.1	3.3
<b>Current @ 65</b>	<b>17.6yrs</b>			<b>20.3yrs</b>		



# Using an on-line calculator —my result

- “Your Life Expectancy is 97”
  - The lucky 35% from the 1950 birth cohort estimated life table?
  - Or the U.S. life table the 9% who will live to 97, 26% of whom will die that year?
    - 97 year olds in 2009 born in 1912
    - Will my experience reflect 1944 cohort (unknown) or the 1912 – 1943 birth cohorts?

# Expectation of life as you age: U.S. Non-Hispanic Whites (2009)

	<u>males</u>	<u>females</u>
<b>Expectations of life @ 65</b>	<b>17.6yrs</b>	<b>20.3yrs</b>
Percent alive at 80	62 <sup>0</sup> %	72 <sup>0</sup> %
<b>Expectations of life @ 80</b>	<b>8.2yrs</b>	<b>9.7yrs</b>
Percent alive at 90	35 <sup>0</sup> %	46 <sup>0</sup> %
<b>Expectation of life @ 90</b>	<b>4.2yrs</b>	<b>4.8yrs</b>
Half of 65 year olds alive at	age 83	age 86

# Importance of understanding probability of living

- *Annuitizing wealth of \$500,000*

Monthly (gross) payments. Real return = .03/year

20 years          \$2,766/month    (annual w/draw 6.6%)

30 years          \$2,103/month    (annual w/draw 5.0%)

35 years          \$1,919/month    (annual w/draw 4.6%)

70.5 minimum in 2014 = **\$18,248.18 (\$1,520/mo)**

Issues: Your replacement rate?

Reduction in savings? Expenses? Lifestyle?

Unexpected expenses?

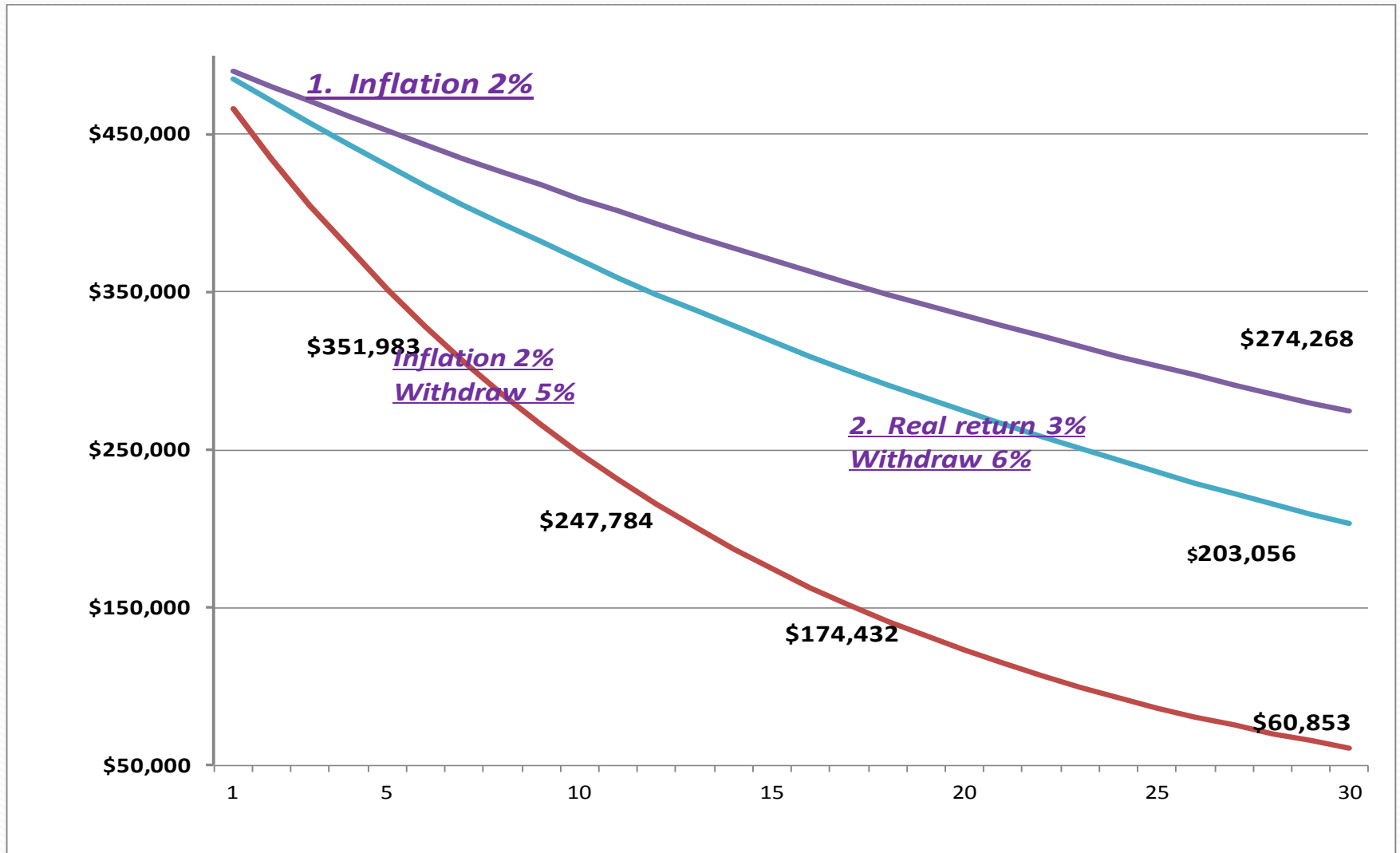
Children? Parents? Health shocks?



# Later Life Risks

- Financial
  - Inflation (adjustments?)
  - Market risks (general conditions and responsible fiduciaries)
- Personal risks
  - Involuntary early retirement
  - Health conditions (physical and cognitive)
    - Health care costs
    - Accommodation costs
    - Long-term care coverage (by whom or what insurance?)
  - Spouse/partner's death (understanding bequest laws and documents)
  - Own death and post-death process (end of life documents)

# Effect of Inflation on Portfolio







# Savings Vehicles

- Work Longer-save more

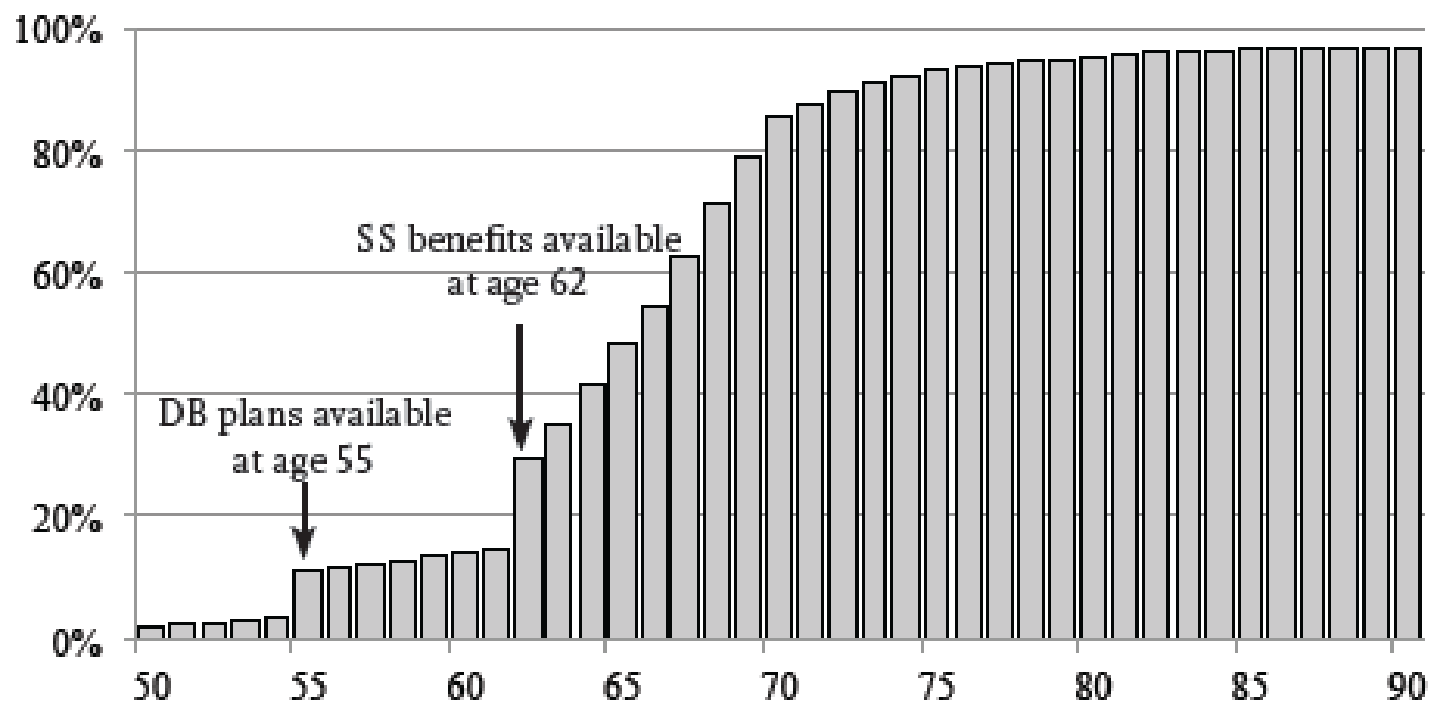
“Half of today’s households are ready to retire at age 65, but more than 85 percent would be prepared by age 70. Thus, five years of additional work would solve the problem for the bulk of the population.”

(Center for Retirement Research, Brief 12-12)

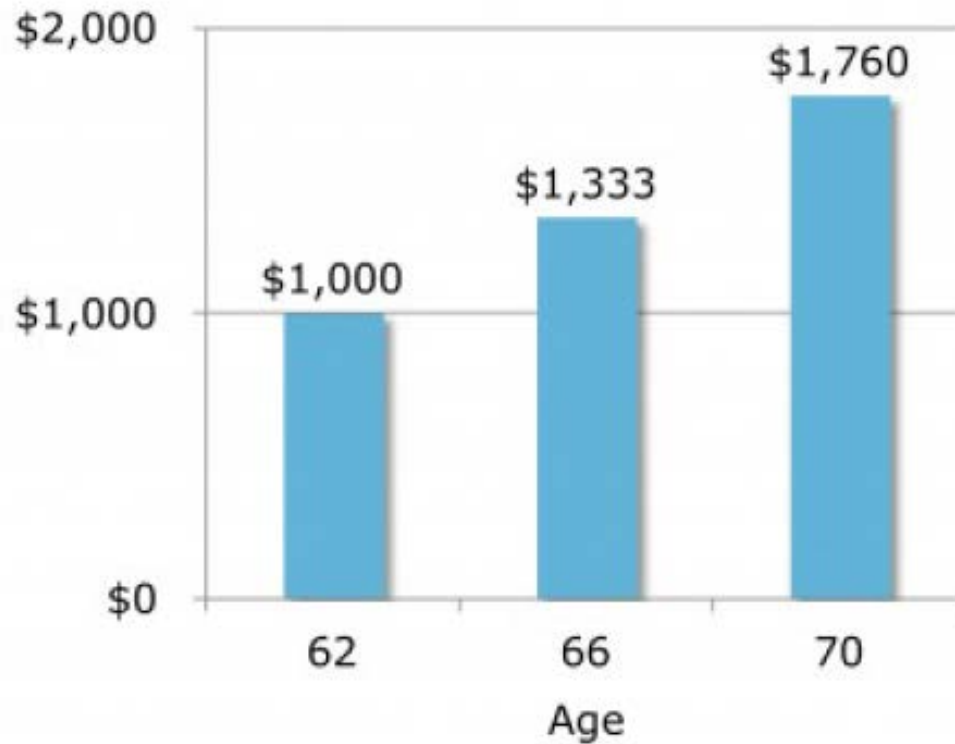
- Social Security

- “Full Retirement age” formally 66 or 67
- In fact: actuarial gains from postponing receipt
  - At 62 receive 25% or 30% smaller benefit than at FRA
  - Better return to waiting than most investments
    - 8% per year increase waiting after FRA
  - Receive 32% or 24% more at 70 than at FRA;
  - Receive 76% more at age 70 than at age 62

FIGURE 2. CUMULATIVE PERCENTAGE OF HOUSEHOLDS READY FOR RETIREMENT BY AGE



## Social Security Benefits: The Longer You Wait, The More You Get



*Source:* Center for Retirement Research at Boston College.

<http://squaredawayblog.bc.edu/>



# Social security and risks

- Earnings based
  - Wage indexed earnings take account of average wage growth (capturing one piece of market gains)
  - Progressive benefit formula favors low earners—e.g., earnings lost through unemployment
    - Low earners not expected to have other options (noncovered offset)
- Post-retirement risks
  - Inflation adjusted.
  - Spousal and survivor benefits
  - Early retirement of one spouse disadvantages lower earning surviving spouse.



# Savings Vehicles

- Employer Provided Pensions (market, inflation, longevity risks?)
  - Defined Benefit (system bears risks)
  - Defined Contributions (participant bears risks)
  - WRS—hybrid plan
    - DC-DB comparison at retirement with DB floor
- Voluntary Tax Deferred Options
  - UW employee has access to both WDC and UW allowed options (can contribute maximum to both)
- Post-tax options
  - Roth IRA
- Coordinate the different income/tax implications
  - Age 70.5 withdrawal requirements for tax deferred
  - Tax brackets over retirement



# Income decline upon partner's death

Social security benefits fall by

one-third: if spouse + worker → worker

one-half: if two worker → worker

Loss in pension income

Out of pocket medical expenses

Health insurance coverage

Medicare?

Employer provided

Long term care issues

# WRS Payout options

Annuitant's age	57	60	65
Survivor's age	53	59	65
Single life	\$1,000	\$1,000	\$1,000
60 payments	\$997	\$996	\$995
180 payments	\$975	\$967	\$959
75% survivor	\$908	\$911	\$926
100% survivor	\$880	\$885	\$904
-25% either death	\$924	\$935	\$964



# Cognitive impairment (HRS)

Estimate a person reaching age 70 with a life expectancy of 14 years will spend 1.5 of those years with moderate or severe cognitive impairment.

Prevalence increases with advanced age.

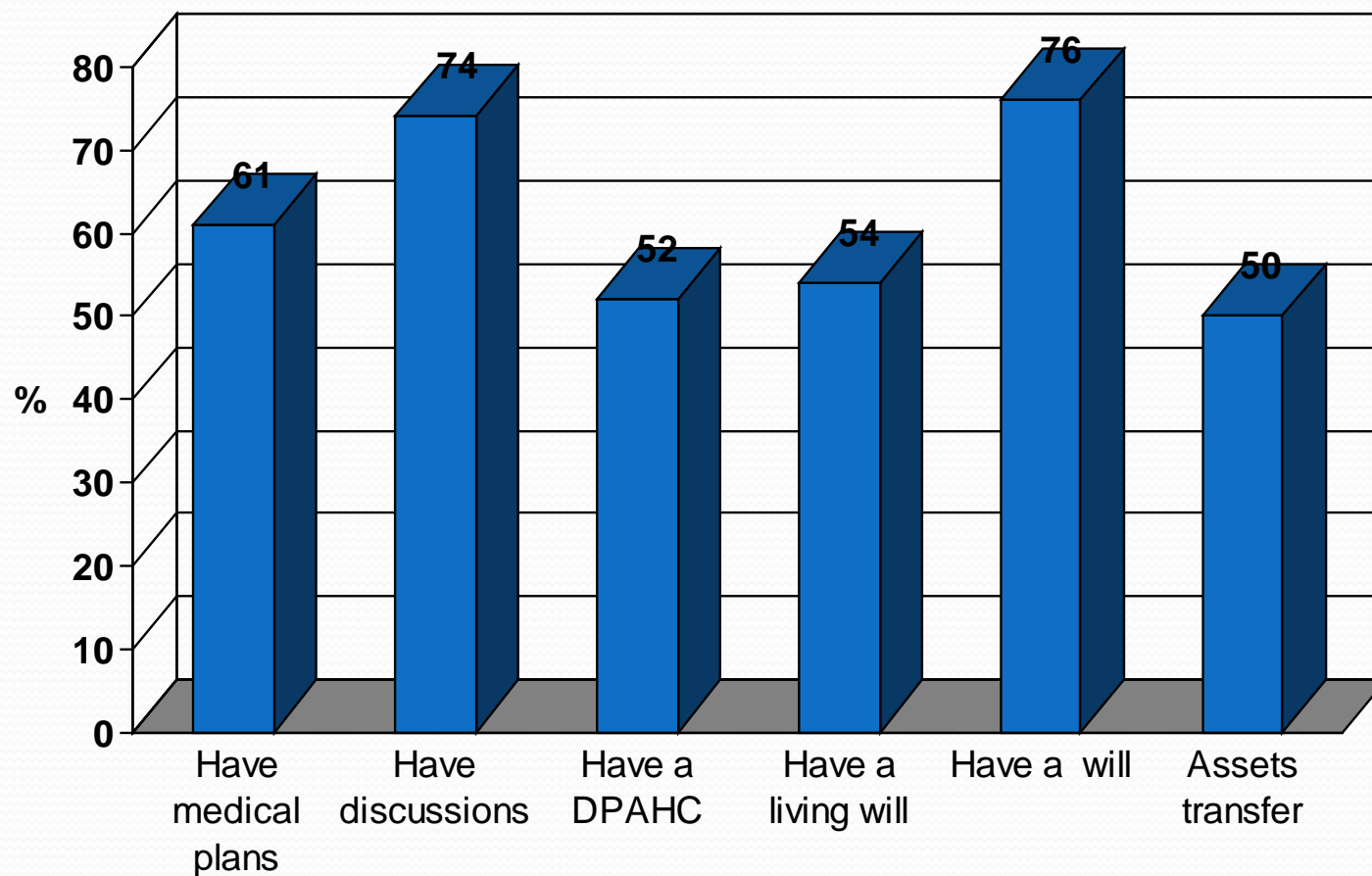
ages 75 to 79 < 5 percent

85 + approaching 20 percent

(Suthers et al.2003).



## Percentage of EOL Planning Completion by Older Wisconsinites (N=3152)



**Karen Holden**

kcholden@wisc.edu

**J. Michael Collins**

jmcollins@wisc.edu

**For More Information: [cfs.wisc.edu](http://cfs.wisc.edu)**

Follow CFS on  and  UWMadisonCFS