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America Fails RICP® Retirement Literacy Quiz

Advisors should take a proactive approach to improving Americans’ retirement literacy.

By David A. Littell, JD, ChFC®, CFP®

Retirement income literacy for those moving into retirement is critical. There are many important decisions to make about when to retire, claiming Social Security benefits, addressing medical insurance, investing a retirement portfolio and choosing strategies to convert assets into income. Most decisions have significant financial implications, and good decisions can mean more income in retirement as well as more protection against the uncertainties and risks retirees face.

Even though many surveys have tested financial literacy, little work has focused specifically on retirement income knowledge. To fill this gap, the New York Life Center for Retirement Income (NYLCRI) at The American College asked Matt Greenwald and Associates to conduct a comprehensive survey testing retirement income literacy. The survey included 38 quiz questions in 11 relevant topic areas. The survey also asked respondents about their attitudes and amount of planning activity. Online interviews were conducted with 1,019 Americans ages 60-75 with at least $100,000 in household assets (not including their primary residence). The participant parameters were selected to ensure the group would only include those who really had a stake in knowing about retirement income planning.

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The lack of retirement income literacy poses many obstacles for the advisor.

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KEY FINDINGS

The survey results showed a general lack of retirement income literacy. The average percentage correct score on the quiz portion of the survey was 42 percent. Only 19 percent received a passing grade (60 percent or higher). No one scored an A (90 percent and above), and only 1 percent scored a B (80 percent to 90 percent). More than 20 percent of the participants scored lower than 30 percent correct.

This makes good headlines (“America fails retirement income quiz”) and USA Today (http://ow.ly/Jp6CN), AARP (http://ow.ly/Jp6Fw), and the Washington Post (http://ow.ly/Jp6Jf) all featured stories and portions of the quiz for consumer consumption. This coverage put a spotlight on retirement income planning — which may be the most important result of the survey.

The survey results also suggest specific areas where the obvious lack of knowledge could have consequences on the decisions older Americans make. Respondents showed a lack of knowledge when it comes to understanding how to preserve assets in retirement.

- Only 31 percent know that $4,000 is the most they can afford to “safely” withdraw per year from a $100,000 retirement account (the 4-percent safe withdrawal rule), despite the enormous amount of press this rule has received.
- Only 35 percent know that maintaining a portfolio of 50-60 percent in equities is likely to yield a higher sustainable withdrawal rate than a much higher equity allocation (90-100 percent) or a much lower (20-30 percent) allocation.
- Only 43 percent know that using a portion of the portfolio to purchase a life annuity can protect against the uncertainty of life expectancy.
- Over half underestimate the life expectancy of a 65-year-old man, suggesting they may not realize how long their assets have to last.

Respondents also lack knowledge of the best strategies to consider as they approach retirement to improve retirement security.

- Only 30 percent understand that it is more effective to work two years longer or defer Social Security for two years than to increase contributions by 3 percent for five years just prior to retirement.
- Only 37 percent know that a person planning to retire at age 65 should take the least amount of investment risk at age 65, rather than earlier or later.

Respondents show a lack of knowledge when it comes to understanding basic investment considerations.

- Only 39 percent understand that when interest rates rise significantly, the value of bond funds will decrease significantly.
- Less than 1 in 10 understand that small company stock funds have a higher return over time than large company stock funds, dividend-paying stock funds or high-yield bond funds.

While long-term care is an issue many will face in the future, Americans have limited knowledge of long-term care and the challenge it may pose.

- Only 17 percent know that Medicaid pays for most long-term care today, and only 25 percent know that 70 percent of the population is going to need assistance in the activities of daily living at some point.
- Only 35 percent realize that family members end up paying most long-term care costs.

- As approximately two-thirds of retirees receive more than half their income from Social Security, the Social Security claiming decision is one of the most important decisions that retirees face. There has been a lot of discussion of this topic, which is reflected in somewhat better results on the quiz than in other areas, but still too many Americans do not understand key elements of Social Security.
- Perhaps most critically, only a little more than half (53 percent) know it is best to wait until age 70 to claim Social Security if one is going to live to age 90.
- Only a little more than half (54 percent) realize that benefits increase each year one delays up to age 70.

Respondents know very little about using annuities as a retirement income strategy. Unlike many other areas of knowledge, 65 percent admitted having very little knowledge of immediate annuities, and 57 percent admitted having very little knowledge of deferred income annuities.

- Only 26 percent know that buying a $1,000 a month income with an immediate annuity will be more expensive for a younger person than an older one.
- Less than half (48 percent) realize that a life annuity is a better choice than a lump sum if one is concerned about having enough money to meet basic expenses in retirement.
- Only 13 percent know that a deferred annuity with a guaranteed lifetime withdrawal benefit can pay income even if the investment account goes to zero.
IMPLICATIONS FOR FINANCIAL ADVISORS
The results of the survey are somewhat surprising given the ages and wealth of the respondents. The group also performed very well on two questions often used to test basic financial literacy. In addition, they indicated significant engagement with their finances. Two-thirds indicated taking the time to figure out a savings goal for retirement, and a majority indicated checking the status of their investments at least four times a year. Also, nearly two in three have an ongoing relationship with a professional financial advisor, and nearly half of those with an advisor rely heavily on that advisor to manage their finances and investments.

However, if you take a closer look at engagement, you wonder if Americans are taking enough time to consider these complex issues. First, only one in four report having a formal, written retirement plan. Second, less than one-third of respondents reported spending a great deal of time planning for complex issues such as determining the retirement budget, how to address the risks faced in retirement, where to live in retirement and how to replace meaning provided by work.

Financial advisors may also be interested in knowing some of the factors that are related to success on the quiz. First, men passed at a much higher rate than women did (29 percent for men and 11 percent for women); the average score was 49 percent correct for men and 41 percent for women. This is consistent with other research on financial literacy. Wealth also had a strong correlation to the respondents’ knowledge as scores increased from each asset level range.

It is interesting that the existence of an advisor relationship corresponded with a lower knowledge score on the quiz. For instance, those individuals with a financial advisor scored on average 43 percent, while those without a financial advisor scored on average 48 percent. The fact that do-it-yourselfers know more than those with advisors is not that surprising, but the lack of knowledge by those with advisors is disconcerting. Also of interest was those who had a formal financial plan (whether or not they had an advisor) performed better on the quiz, implying there is an educational value to going through a planning process. The survey additionally indicated that retirees are somewhat more motivated than pre-retirees to take action, as retirees were more likely to have an advisor (65 percent for retirees and 59 percent for pre-retirees) and were somewhat more inclined to have a written plan than pre-retirees (30 percent for retirees and 20 percent for pre-retirees).

The survey results have many implications for financial advisors and the advisor relationship. The lack of retirement income literacy poses many obstacles for the advisor.

- It is difficult for clients to appreciate the urgency of the issues they face.
- They cannot make fully informed decisions from the options offered.
- They are less likely to take ownership in the plan, which can mean failing to execute the plan.
- It is more likely that clients (or their families) will be dissatisfied with the results.

CONCLUSIONS
All of these are reasons for financial advisors to take a proactive stance in improving retirement literacy. In some cases, it may mean that advisors need more education themselves. The American College offers the Retirement Income Certified Professional Designation® (RICP®), which provides the advisor a stronger foundation and a specialization in retirement income planning (http://ow.ly/Jp6MY). The NYLCRI website (http://ow.ly/Jp6OF) has a tremendous amount of content in this area that can be freely accessed. As for your clients, you may want them to take the quiz. It is available (with answers and explanations) online at The American College. The NYLCRI also has a series of “Retirement Income 101” videos (http://ow.ly/Jp6R0) that provides a great introduction for clients new to retirement income planning.

This knowledge is also a call for The American College, the NYLCRI, financial firms and industry organizations to continue to provide education and reduce the knowledge gap. To answer this call, the NYLCRI will build more consumer education that can be used independently or by advisors to help educate their clients. We have since learned that everyone likes a quiz — expect more tests to come!