Key Takeaways

• By and large, individual investor financial literacy is poor, with average scores on literacy quizzes near failing.

• Financial advisors play a critical role in educating their clients to set them up for success and ensuring the next generation of clients has a solid grasp on financial issues as well.

• By assessing your clients’ literacy, and then adopting key tactics to improve it, you and your clients can see great payoffs.
Although most individual investors consider themselves financially savvy, the reality is that they have a lot to learn. The awareness of sound financial practices, combined with an understanding of the connection between lifestyle and finances, can help them set realistic expectations for what’s possible. To that end, financial advisors must have at their disposal the strategies and tools to effectively educate their clients. The following steps can help lay the groundwork for a successful learning process.

**Start with a Basic Diagnostic**

Financial literacy occurs along a spectrum and what makes financial education effective is being able to deliver content specific to each client’s literacy level. As a starting point, you should assess each client’s particular level of financial knowledge. While much of this information will naturally flow out of client conversations, a short diagnostic test can also be a highly effective tool.

To test financial knowledge, consider using surveys that distill big issues into simple questions, while covering off three key areas:

- Interest rates and compounding
- Inflation and risk
- Diversification

Once a diagnostic has been completed, you can then support your client’s needs by using communications tailored to that individual's specific literacy level.

**Teach the Real Definition of Success**

Investors suffer from a disconnect between their reasons for investing and their definition of success. Only 29% of investors define success as reaching long-term goals. Instead, they choose impossible or irrelevant metrics such as making gains and no losses, outperforming the market and achieving short-term investment goals. Investors take false comfort in these short-term benchmarks of success because they are easier to measure than progress toward a long-term goal. They need help from you to understand what a meaningful, goal-related strategy looks like.

**Use Rules of Thumb**

One way to empower clients is to give them information they can readily act on. Rules of thumb, used judiciously, can be an effective tool for accomplishing that. For example, the so-called “4 percent rule” (in which retirees withdraw 4% of their initial retirement savings balance and then adjust that amount for inflation each year thereafter) can be used as a starting point for educating clients about retirement income strategies. Although rules of thumb lack precision, in the absence of providing one, many people will likely devise their own shortcuts, which could be far less desirable.

**Don’t Attack Misguided Beliefs**

Beliefs, however misguided, powerfully influence behaviors. Investors have largely unconscious tendencies to perceive and interpret things in terms that confirm their prior expectations. This makes them far more likely to notice and remember experiences that confirm what they expect and to ignore advice that goes against their expectations. Focus instead on laying out all the facts and helping investors draw their own conclusions. Educate them and help them recognize the range of possible outcomes.

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1. Only 29% of investors define success as reaching long-term goals.
**Focus on Pressing Decisions**

To make financial education most effective, you have to relate abstract concepts to something practical in your client’s life. And the closer you can get to an actual decision that clients are immediately confronting, the more effective financial literacy becomes.

Advisors can also use these pressing decisions as a launching pad to provide education on future issues (such as retirement) that clients should be paying attention to, but tend to put off. For instance, that might involve assessing the impact of each mortgage payment on the client’s ability to save for retirement.

**Be Willing to Bend a Little**

Behavioral science shows that loss-aversion and emotions can cause even well-educated investors to act irrationally.

Seventy-eight percent of women and 50% of men would consider moving to a more conservative investment strategy if their portfolio declined by more than 20% in a year. And a whopping 90% of those investors would make the change in less than three months.²

With that in mind, you need to accept that even the most financially sophisticated clients may be better served with a less-than-optimal portfolio if they are susceptible to panic-selling, in order to prevent them from doing something extreme.

“If you give me a lecture on whether I’d be better off having a fixed rate mortgage or an adjustable one, and I’m shopping for a house right now, I will remember what you told me,” says Brigitte Madrian, a professor of public policy and corporate management at Harvard University. “If you give that same lecture to a 20-year-old in a college classroom, it will be completely forgotten two months later because it isn’t relevant.”

**Speak in Plain English**

Drop the jargon and speak to clients in plain English—not because clients lack intelligence, but because they are managing busy lives and don’t have time to become instant experts at complex financial issues. What people need are straightforward explanations.

By actively embracing the role of educator, you can set up your clients and their families for success, demonstrate your value proposition, and be better positioned to retain assets across generations.

For more materials and information from our Family Education and Financial Literacy program, contact your Regional Consultant or the SSGA Sales Desk at +1 866 787 2257.

¹ State Street Center for Applied Research, The Folklore of Finance, 2014
² State Street Center for Applied Research, Addressing Gender Folklore, 2015
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