

Most Americans Fail Financial Fluency Investing Quiz; Consumers Who Are Confused Over Competing Definitions of “Passive Investing” Save Less, Use Fewer Investment Products

Self-Directed Investors, Plan Participants, Women Score Lower

(Nov. 17, 2020, Rye, NY) – Most Americans fail a financial fluency quiz of key investment selection terms, and confusion over a term like “passive investing” can translate into saving less and lower use of investment products, according to a new report by [Hearts & Wallets](#), the research and benchmarking firm that specializes in how consumers save, invest and seek financial advice.

This new report, **Financial Fluency: What Consumer Understanding of the Language of Finance Means for Advice, Retirement and Asset Management**, examines consumer understanding of the language of investing, the connection to financial needs and behaviors, and the implications for advice, workplace retirement and asset management businesses. The analysis covers consumer groups by asset level, gender, generation, marital status, investing experience, participation in workplace retirement plans, and the positive impact of advice on fluency, identifying opportunities for solution improvements and high value-added advice, such as tax optimization. The report draws from the Hearts & Wallets Investor Quantitative™ Database, recognized as the largest single dataset with over 100 million data points on consumer buying patterns from 60,000 U.S. households, and the Explore Qualitative™ Database, which includes over 8,000 curated consumer stories on future trends.

Overall Scores and Implications for Retirement Plan Design

Most Americans (81%) lack fluency, choosing the best answer for 4 or fewer of 7 key investment selection terms that were presented to participants in a national survey of nearly 6,000 U.S. households. Only 19% of Americans achieved a passing grade, selecting the best answer for 5 or more terms. The terms were divided into 4 basic investment selection terms and 3 more advanced terms (see methodology of all 7 terms at end of this release).

One in 3 potential participants in workplace retirement plans did not know any definitions for the 4 basic investment selection terms fundamental to their ability to select investments within plan.

“Many surveys assess consumer financial literacy,” Laura Varas, CEO and founder of Hearts & Wallets said. “Our goal was to extend the conversation into investing. Lack of understanding of the words that plan participants need to make decisions has implications for our national retirement system and improving plan design.”

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Lack of Financial Fluency/2

Who Speaks the Language

Fluency is much higher for consumers with higher education levels. Being a consumer of advice also helps. Consumers who use paid investment professionals as their “go-to/primary” or usual sources of investing information and advice are more likely to know the best definitions for 5-plus terms. Conversely, 3 in 10 consumers (30%) who identify as self-directed investors did not know the best definition for even 1 term. Men have a better understanding than women across all asset levels.

Confusion over “Passive Investing” and Negative Impacts

Consumer confusion with language can correlate with negative household financial impacts. For the term “passive investing,” half (51%) of all consumers selected “don’t know” rather than one of the two definitions.

Adding to the confusion, among consumers who chose a definition, more consumers selected the definition that differs from the one touted by large financial services firms. Nearly one third (29%) of consumers picked “buying and holding without being influenced by short term market fluctuations” while 20% selected “investing in an index, often weighted to market capitalization.” A Hearts & Wallets analysis finds most established investing companies, including market share leaders in index fund management Vanguard, Fidelity and BlackRock, tend to use the technical “indexing” definition of passive investing vs. the more intuitive definition of “buy and hold” preferred by consumers.

Consumers who “don’t know” the definition of “passive investing” save less and use fewer investment products. They are less likely to own mutual funds, lack exposure to the stock market and are less likely to allocate any savings to IRAs. They have high cash allocations with 44% having 90% to 100% of assets devoted to cash vs. 26% of “buy and hold” and 15% of “index.”

“Consumers, financial services firms and advisors should speak the same language,” Beth Krettecoc, Hearts & Wallets Subject Matter Expert, said. “An intuitive definition will often take on a life of its own, as shown with the term, ‘passive investing.’ Firms may want to use a more descriptive term, like ‘indexing,’ to avoid misunderstanding. Where complex choices require technical language for explanation, firms may want to consider introducing new, more intuitive concepts to help consumers become more confident about investing. Advice also plays a role in helping consumers succeed in saving and investing.”

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Methodology – 7 Key Investment Selection Terms

Participants in the national survey were presented with a “best” and an alternative definition for 7 investing terms. The alternative was sometimes outright false and other times just not as good as the “best” choice. Participants were told to choose “don’t know” rather than guess. Some terms surfaced in Hearts & Wallets Explore Qualitative™ about 5 years ago, including “passive investing,” where consumers use the term “passive investing” to mean “buy and hold” with positive connotations. Tax-related terms are included as tax optimization for withdrawal during retirement and saving allocation during accumulation becomes more competitively important in Inside Advice® Benchmarking, as well as an opportunity for premium-priced high value-add advice. Other terms are from the areas where Investor Quantitative™ Database suggests consumer decisions may be sub-optimal.

Best Definition	Inaccurate/not “best” definition
Basic Investment Selection Terms	
mutual fund	
“an investment product with multiple stocks or bonds overseen by a portfolio manager”	“an investment product that is an option in a 401(k) or 403(b) retirement account”
asset allocation	
“a strategy for spreading money across stocks, bonds, cash”	“a strategy for spreading money across investment companies”
exchange traded fund	
“an investment that holds a variety of securities but is traded like a stock”	“a fund of investments in private companies”
cost basis	
“the amount of money originally invested in a stock, above/upon which capital gains taxes are paid”	“the price of an investment product, usually expressed in basis points”
Advanced Terms	
passive investing	
“investing in an index, often weighted to market capitalization	“buying and holding without being influenced by short term market fluctuations”
key difference between ROTH & traditional retirement account	
“withdrawals from a ROTH retirement account are not subject to income taxes”	“withdrawals from a ROTH retirement account are not subject to capital gains taxes”
taxable brokerage account	
“an account for holding or trading stocks using money on which all income taxes have already been paid”	“an account for holding or trading stocks using money on which income taxes have not been paid yet”

Methodology – Report

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About Hearts & Wallets

Hearts & Wallets is the research and benchmarking firm that specializes in how consumers save, invest and seek financial advice. Leading firms use Hearts & Wallets thought-leadership reports, software and benchmarking to make their saving, investing and advice solutions more consumer-centric. For more information visit www.heartsandwallets.com.

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