

## **“Leveraging Admissions Tests to Increase Financial Savvy”**

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Annotated Version with Data Sources

Most Americans cannot perform basic financial calculations.<sup>1</sup> This ignorance is costly: research shows that people who are not “debt literate” use high cost credit and are over indebted.<sup>2</sup> This is a particular concern for young adults, who have no experience managing debt yet make major borrowing decisions.<sup>3</sup> In 2008, two-thirds of graduates from four-year colleges had student loans averaging \$23,200.<sup>4</sup> Over 75% of college students have at least one credit card<sup>5</sup> and median credit card debt for college students is \$1,645, a 74% increase since 2004.<sup>6</sup> While the new CARD Act limits credit card marketing on campuses and makes it harder for students to get cards, it will not eliminate young adults’ indebtedness.<sup>7</sup>

For young people, financial mistakes can quickly snowball, marking them as subprime borrowers. Low credit scores would drive up their costs of borrowing,<sup>8</sup> make it difficult to borrow, and even affect some insurance rates and job prospects.<sup>9</sup>

Many observers call for financial education in the schools to arm young adults with necessary financial skills.<sup>10</sup> While such standards now exist in 44 states, and while some cities and states are demonstrating successful programs, delivering this material nationally and effectively is a challenge.<sup>11</sup> Teachers, already stretched thin, have to be trained in the subject.<sup>12</sup> Space must be carved out of existing school days. And all of this must be coordinated over nearly 20,000 public high schools across America and over 3000 private secondary schools.<sup>13</sup>

There are three simple lessons from the business world that might direct more attention to this important topic. First, we manage what we measure. Second, self interest is extraordinarily powerful. Third, small steps can sometimes lead to bigger outcomes.

This fall, millions of frenzied high schoolers will apply to colleges. By leveraging their energy and self interest, college admissions testing can play a new role in advancing financial capabilities. Gaston Caperton, the president of the College Board, which oversees the SAT and PSAT, has identified “the urgent need... to provide better guidance and improved financial literacy for students before they take out loans that will get them into trouble down the road.”<sup>14</sup> This need could partly be met by including financially-related questions on the SAT, PSAT and ACT exams that over 5 million high school students take each year.<sup>15</sup> Doing so would not require adding more *content-based* questions, but rather reframing the *context* for existing questions in the critical reading and mathematics sections.

For example, in the critical reading section of the SAT, test-takers are given passages—about the theater or population control—and asked what they mean. These passages could be

set about credit cards or insurance. In the math section, students solve word problems. Reframing some questions around key financial principles, such as interest compounding, would be straightforward. Testing services already have experience with this material, which is included in the GMAT taken by MBA applicants.

If changes to these exams were publicly announced, test prep organizations, along with students, parents, and schools, would have incentives to upgrade teens' financial capabilities.<sup>16</sup> If financial numeracy gave students even a slight edge, self-interest could be quite powerful. While this small change would be neither universal nor complete, it would reach the more than 50% of all high school seniors who take these tests each year<sup>17</sup> and who will soon have the highest debt loads. It would signal that financial skills are important even for top academic achievers, moving these topics from remedial subjects to core priorities. It might even have broader ripple effects: studies of civics and public health education programs show that student participation can improve *parents'* knowledge and behavior.<sup>18</sup>

More broadly, there are even bigger other opportunities to embed financial matters as the context for testing quantitative reasoning. Initiatives to develop new common curricular standards for secondary school students, such as CommonCore.org or P21.org, may create platforms to bring personal finance education into schools nationwide.<sup>19</sup> Teaching and testing math and reasoning using financial problems might enhance skills while making the underlying subjects more accessible.<sup>20</sup> Another alternative would be to require college students to pass a financial literacy course before taking out student loans.<sup>21</sup>

Sometimes system-wide changes emanate from unlikely sources. Teaching to the test is often criticized, but in this instance, harnessing self-interest may not only increase financial capabilities directly, but also stimulate bigger interventions to arm our youth to handle their complex financial lives.

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<sup>1</sup> FINRA, Financial Capability in the US, National Survey—Executive Summary, 2010, available at <http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p120535.pdf>; See also Ana Lusardi and Olivia Mitchell, 2009, "How Ordinary Consumers Make Complex Economic Decisions: Financial Literacy and Retirement Readiness," NBER Working Paper No. 15350 available at <http://www.dartmouth.edu/~alusardi/Papers/LusardiMitchellOrdinaryConsumers.pdf>. See also a review of studies in Wendy Way and Karen Holden, "Teachers' Background and Capacity to Teach Personal Finance: Results of a National Study," Final Report. March, 2009, available at <http://www.nefe.org/LinkClick.aspx?fileticket=q9Ahp7m5Cbg%3d&tabid=246>. Also, a recent Federal Reserve Report shows how limitations in numerical ability are strongly related to delinquency and default rates among subprime mortgage borrowers. Kristopher Gerardi, Lorenz Goette, and Stephan Meier, 2010, "Financial Literacy and Subprime Mortgage Delinquency: Evidence from a Survey Matched to Administrative Data", available at <http://www.frbatlanta.org/documents/pubs/wp/wp1010.pdf>.

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<sup>2</sup> Lusardi and Tufano, "Debt Literacy, Financial Experiences and Overindebtedness," 2009, available at [http://www.dartmouth.edu/~alusardi/Papers/Lusardi\\_Tufano.pdf](http://www.dartmouth.edu/~alusardi/Papers/Lusardi_Tufano.pdf)

<sup>3</sup> Jump\$tart 2008 Survey, <http://www.jumpstart.org/assets/files/2008SurveyBook.pdf>; Teens and Personal Finance Survey by Junior Achievement, 2010, <http://www.ja.org/files/surveys/2010-Teen-Personal-Finance-Survey.pdf> A recent study reported that only 27% of 23-28 year olds could correctly answer three questions related to interest rates, inflation and risk diversification. Lusardi, Mitchell and Curto, "Financial Literacy Among the Young: Evidence and Implications for Consumer Policy", 2010, available at [http://www.dartmouth.edu/~alusardi/Papers/Financial\\_literacy\\_young.pdf](http://www.dartmouth.edu/~alusardi/Papers/Financial_literacy_young.pdf); See also a discussion in *CQ Researcher*, "Financial Literacy: Should Courses Be Mandatory in Schools?" Volume 19: 30, page 717-740.

According to a 2008 Demos Report, income for college graduates has declined, while student loan debt and credit card debt has increased. Two-thirds of college students borrow money to attend college and have an average student loan debt of \$19,500. Debt loads for young people are the highest of any demographic category. 94% of those with education debt do not have enough saved to sustain them for three months, and 19% of 18-24 year olds have a debt-to-income ratio of over 40%. Tamara Draut, *Economic State of Young America*, Demos, Spring 2008, available at [http://www.demos.org/pubs/esya\\_web.pdf](http://www.demos.org/pubs/esya_web.pdf). Some avoid attending college due to concerns over debt. 36% of 18-29 year olds who are not in college and don't have a degree say it is because college is too expensive (Pew Research Center, February Study: <http://pewsocialtrends.org/assets/pdf/millennials-confident-connected-open-to-change.pdf>) and 22% of 22-29 year olds polled in 2006 reported that they are not pursuing education due to the amount of debt they already carried, 2006 USA Today Young Adults Finances Poll, [http://www.nefe.org/Portals/0/NEFE\\_Files/USATodaySurvey.pdf](http://www.nefe.org/Portals/0/NEFE_Files/USATodaySurvey.pdf)). Exacerbated by high college costs and over-eager student loan providers (<http://www.nytimes.com/2010/05/29/your-money/student-loans/29money.html?pagewanted=2&sq=student%20loan&st=cse&scp=3>), a stronger grasp of financial management tools and concepts is necessary for both students and their parents to make informed decisions about taking on student debt.

Some related tidbits:

- 77% of adults under 30 worry that they aren't saving enough (Pew Research, February 2010)
- A 2006 Key Bank poll reported that 32% of college students were "not at all" or "not very well prepared" for managing their money on campus (Packaged Facts, p. 17).
- 49% of teens aged 12-17 report that they are good at saving money, but 29% say they spend money without thinking (Packaged Facts, p. 87).

<sup>4</sup> Draut, *Economic State of Young America*, 2008; Project on Student Debt, <http://projectonstudentdebt.org/files/pub/classof2008.pdf>

<sup>5</sup> Furthermore, 15% of freshmen carry more than three cards and 21% pay them off each month, 11% make less than the minimum payment each month. (Packaged Facts, p. 111)

<sup>6</sup> How Undergraduates Students Use Credit Cards, Sallie Mae 2009, available at <http://www.salliemae.com/NR/rdonlyres/OBD600F1-9377-46EA-AB1F-6061FC763246/10744/SLMCreditCardUsageStudy41309FINAL2.pdf>. It appears that much of this is a result of overspending or failing to pay down card balances. A 2006 Key Bank poll reports that 75% of college students admit to having made money mistakes when getting to college, including overspending on food (21%), entertainment (19%) and charging too much to credit cards (16%) (Packaged Facts p. 149).

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<sup>7</sup> Credit CARD Act of 2009, Title 111, Sections 301-304 available with explanation, at <http://www.creditcards.com/credit-card-news/credit-card-law-interactive-1282.php>

<sup>8</sup> A few financial missteps can mark them as subprime borrowers for years. Research shows that credit scores typically reflect a consumer's credit risk accurately, with the exception of those under age 30. Younger individuals, therefore, have lower scores than may be justified. (Robert Avery, Kenneth Brevoort and Glenn Canner, "Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit." Board of Governors of the Federal Reserve System, submitted to Congress pursuant to section 215 of the Fair and Accurate Credit Transactions Act of 2003, August 2007.) Given this, it is perhaps even more important to ensure that younger people have the skills they need to manage money, as their credit score will determine the type of loans they can get. If they have limited numerical ability and make poor money-management choices, thereby ending up in "subprime" loans (typically for those with credit scores under 620), they will pay higher rates and fees for mortgages, and may also be disproportionately less satisfied with their borrowing experience (Howard Lax, Michael Manti, Paul Raca, Peter Zorn, 2004, "Subprime Lending": An Investigation of Economic Efficiency," *Housing Policy Debate*, Volume 15:3.) They also are more likely to face default (Gerardi et al 2010). While it is not impossible for a borrower to move from the subprime market into the prime market, it may be more difficult that it would otherwise be. Marsha Courchane, Brian Surette, Peter Zorn, 2004, Subprime Borrowers: Mortgage Transitions and Outcomes, *Journal of Real Estate Finance and Economics*, 29:4, 365-392. As of the end of 2007, credit card companies were actively seeking subprime customers as well. With low credit limits and high fee structures, the card companies take little risk relative to the fees they are likely to collect on consumers who may not be financially savvy. Changes to bankruptcy laws in 2005 also made it more likely that companies would be able to recover their losses, even if the cardholder went into bankruptcy. Margo Anderson, "From Subprime Mortgages to Subprime Credit Cards," *Communities and Banking*, Federal Reserve Bank of Boston, Fall 2008, available at [http://www.bos.frb.org/commdev/c&b/2008/fall/Anderson\\_subprime\\_credit\\_cards.pdf](http://www.bos.frb.org/commdev/c&b/2008/fall/Anderson_subprime_credit_cards.pdf).

<sup>9</sup> Credit reports are often used for their "predictive value" Robert B. Avery, Paul S. Calem & Glenn B. Canner, *Credit Report Accuracy and Access to Credit*, FED. RESERVE BULLETIN, Summer 2004, available at [https://www.chase.com/cm/chf/miscellaneous/file/document/Canner\\_FRB.pdf](https://www.chase.com/cm/chf/miscellaneous/file/document/Canner_FRB.pdf). (last visited December 2009). In 2009, For example, 16% of employers consistently used credit reports to screen job applicants. <http://blogs.wsj.com/wallet/2009/03/11/one-in-six-employers-looking-at-your-credit-report-study-finds/tab/article/> (last visited April 2010). And credit reports were often used to determine insurance and utility rates. <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre24.shtm> (last visited April 2010).

<sup>10</sup> These include the President's Advisory Council on Financial Literacy, established in 2008 under President Bush ([http://www.ustreas.gov/offices/domestic-finance/financial-institution/fin-education/council/exec\\_sum.pdf](http://www.ustreas.gov/offices/domestic-finance/financial-institution/fin-education/council/exec_sum.pdf)), and Common Core, a state-led and driven initiative to develop and implement consistent curricular standards. Their goal is to "provide a consistent, clear understanding of what students are expected to learn, so teachers and parents know what they need to do to help them. The standards are designed to be robust and relevant to the real world, reflecting the knowledge and skills that our young people need for success in college and careers." As part of the federal "Race to the Top" Funding, states who are making substantive changes according to specific guidelines can secure new grants of between \$20 million and \$700 million dollars, depending on the number of school aged children in their state. English and math are the main subjects of focus now, but other content areas are being considered. In addition, research-based strategies have been put forward by academics, non-profit organizations and financial services providers including National Endowment for Financial Education, Jump\$tart, Demos, OECD Visa, Inc., Charles Schwab, Fidelity and others. See "Financial Literacy: Should Courses be Mandatory in Schools?" CQ Researcher, September 4, 2009, Volume 19 for a full discussion.

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<sup>11</sup> In 2009, 44 states have personal finance included in education standards, 13 states require a personal finance course be taken (or inclusion in econ course), 9 states require testing student knowledge in personal finance, (NCEE survey of States 2009, p. 12-14). See CQ Researcher, September 4, 2009, Volume 19 and Networks Financial Institute at Indiana University, “National K-12 Financial Literacy: Qualitative and Quantitative Research”, March/April 2007 at <http://www.networksfinancialinstitute.org/SiteCollectionDocuments/NationalK12FinancialLiteracyStudy.pdf> for some discussion of challenges to implementing these programs.

<sup>12</sup> Michelle Singletary, “We’re flunking personal finance,” The Washington Post, May 9, 2010. According to surveys, most teachers and teacher education students agree that personal finance education is important, yet many say they don’t feel prepared to teach it. In general, there has been a call for more clearly defined goals and curricular guidance, coupled with specific content-area training to ensure that teachers are properly prepared. While some studies show that financial education classes have no significant effect on students’ financial knowledge or behavior (Mandell, Jump\$tart Survey 2008), a recent, more tightly controlled study suggests otherwise. A forthcoming article in the *Journal of Consumer Affairs* by economist William Walstad finds that where curricular standards were established, time was allocated and teachers were trained, there were significant increases in financial literacy among students. See also research on teacher effectiveness related to personal finance education: Wendy Way and Karen Holden, “Teachers’ Background and Capacity to Teach Personal Finance: Results of a National Study,” March 2009; Căzilia Loibl, 2010, “A look inside: Teacher information search for personal finance instruction” *International Journal of Consumer Studies*, 34(3), 287-297; Căzilia Loibl, 2008, “Mandating Financial Ed in High School: Are the teachers ready?”; and Networks Financial Institute, National K-12 Financial Literacy Research slide deck.

Tidbits according to Way and Holden, 2009:

- 11% of teachers agree that students should be required to take a personal finance course or pass a test for high school graduation (p. 103).
- However, anywhere from 28% to 67% of teacher education students (depending on subject matter), feel that they are not very competent in teaching financial topics (p. 76).
- Only 26% of teachers currently address personal finance topics in any way and only 8% of teacher education students are learning about developing personal finance curriculum (p. 103).

<sup>13</sup> Includes 3-4 year and 5-6 year high schools from National Center for Education Statistics for 2007-2008. Excludes “other secondary schools.” [http://nces.ed.gov/programs/digest/d09/tables/dt09\\_093.asp](http://nces.ed.gov/programs/digest/d09/tables/dt09_093.asp) Private schools include the 2007-2008 figure for private secondary schools. [http://nces.ed.gov/programs/digest/d09/tables/dt09\\_059.asp](http://nces.ed.gov/programs/digest/d09/tables/dt09_059.asp)

<sup>14</sup> As quoted in a press release for the 2010 report by Sandy Blaum and Patricia Steele, “Who Borrows Most: Bachelor’s Degree Recipients with High Levels of Student Debt”, The College Board, 2010, available at <http://advocacy.collegeboard.org/sites/default/files/Trends-Who-Borrows-Most-Brief.pdf>, <http://www.collegeboard.com/press/releases/211932.html>

<sup>15</sup> According to the College Board, in 2009, 1.53 million high school students took the SAT and 4.02 million juniors and sophomores took the PSAT. A reported 1.2 million students took the ACT. (<http://www.act.org/news/releases/2003/8-20-03.html>). The most recent data available on the number of high school test takers is from 2004. At the time, 82% had taken or were planning to take the SAT or ACT and 57% had taken or were planning to take the PSAT. <http://nces.ed.gov/pubs2010/2010203.pdf>

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In 2008, there were a total of 1.7 million first-time freshman enrolled at 4 year colleges, which nearly universally require an entrance exam, and 1.3 million freshman enrolled at 2 year colleges ([http://nces.ed.gov/programs/digest/d09/tables/dt09\\_198.asp](http://nces.ed.gov/programs/digest/d09/tables/dt09_198.asp)), which typically do not require them, although many of these students may have taken the SAT and/or ACT nonetheless. The total number of high school seniors in 2007 was just over 3 million, 96.4 % of which graduated in 2007 (2.9 million) ([http://nces.ed.gov/programs/digest/d09/tables/dt09\\_106.asp](http://nces.ed.gov/programs/digest/d09/tables/dt09_106.asp)).

<sup>16</sup> According to a 2004 Visa survey, 56% of parents think their high school grads are “totally unprepared” to responsibly manage personal finances), <http://www.gfn.practicalmoneyskills.com/about/press/releases/080304.php>; According to Packaged Facts, a 2007 Schwab survey shows that parents feel more prepared to teach about sex than about finances.

<sup>17</sup> The total number of high school seniors in 2007 was just over 3 million, 96.4 % of which graduated in 2007 (2.9 million) ([http://nces.ed.gov/programs/digest/d09/tables/dt09\\_106.asp](http://nces.ed.gov/programs/digest/d09/tables/dt09_106.asp)). There were 1.7 million freshmen at four-year colleges. This suggests that at least 50% of high school seniors take at least one college entrance exam during their senior year.

<sup>18</sup> Michael McDevitt, Spiro Kiouisis, Xu Wu, Mary Losch, Travis Ripley, “The Civic Bonding of School and Family: How ‘Kids Voting’ Students Enliven the Domestic Sphere,” Circle Working Paper 07, 2003, available at: <http://www.civicyouth.org/PopUps/WorkingPapers/WP07McDevitt.pdf>, Michael McDevitt and Steven Chaffee, (2002) “From Top-Down to Trickle-Up Influence: Revisiting Assumptions About the Family in Political Socialization”, *Political Communication*, 19: 3, 281 — 301, and David Evans, Noreen M. Clark, Moshe J. Levison, Bruce Levin and Robert B. Mellins, “Can Children Teach their Parents about Asthma?” *Health Education Behavior* 2001; 28; 500.

<sup>19</sup> While there are differences in each movement’s approach, both are considering the value of financial education. See [www.corestandards.org](http://www.corestandards.org) and [www.p21.org](http://www.p21.org).

<sup>20</sup> As of 2009, 26 states have or have plans for a mandatory high-school exit exam. Center on Education Policy, “State High School Exit Exams: Trends in Test Programs, Alternative Pathways, and Pass Rates,” November 2009. Available at [http://www.cep-dc.org/index.cfm?fuseaction=document\\_ext.showDocumentByID&nodeID=1&DocumentID=297](http://www.cep-dc.org/index.cfm?fuseaction=document_ext.showDocumentByID&nodeID=1&DocumentID=297)

<sup>21</sup> Becky Supiano, “For Students, A New Kind of Literacy is Financial: Colleges offer programs in managing money,” *Chronicle of Higher Education*, Volume 55:2, 9/5/2008. Representative Sheila Jackson (D-Texas), sponsored bill HR 1325, that would require colleges to provide a minimum of four hours of financial-literacy counseling to student borrowers.