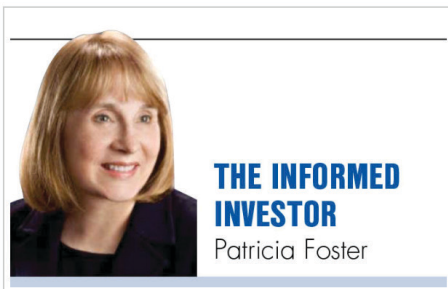


## Amateur hour is over: Back to the basics



We are noticing a discernible trend away from the intense online trading activity against the backdrop of rising interest rates, continuing inflation and market volatility that emerged during the pandemic in certain meme stocks.

The Wall Street Journal recently recounted the experience of an amateur trader who, during the early days of the pandemic, amassed approximately \$1.5 million in gains, only to lose it all. While we do not know whether this trader's experience is typical, market analytics suggest that many investors who got into online trading during the lockdowns of 2020 and 2021, may have left the market altogether. What will these investors do next? In this column, we explore the need for financial literacy education.

### THE IMPORTANCE OF FINANCIAL LITERACY

High school students often wonder about the relevance of the courses that they are required to take over a period of four years. What could be

more relevant to a high school student than a course that would provide a framework for making sound financial decisions upon graduation and over a lifetime? The need for financial literacy education has become readily apparent. While schools in many states offer a personal finance course, only 15 states currently require students to take a financial literacy course as a requirement for graduation. New York State is not among the 15 states.

And, as the United States Supreme Court considers whether the administration's student loan forgiveness program will move forward, we wonder whether financial literacy education might have made a difference in the decision-making process of the millions of students who now hold \$1.6 trillion in student-loan debt. Taking on debt to finance a four-year college education is one of the most consequential financial decisions a high school graduate may make in his or her lifetime. The Wall Street Journal has published a useful guide titled "The WSJ Guide to Student Loans: Navigating the Myths and Misunderstandings About College Debt." Published in 2022, this 148-page guide would be useful to any high school student who might be considering a student loan as a means of financing a post-high school education.

We are envisioning a course that would provide guidance to young people on such topics as banking basics, budgeting, managing credit and debt, including the legal and moral obligations incurred when credit is obtained and debt is incurred, and investing for retirement. As described below, we have identified two specific trends that point to a need for financial literacy education beginning in high school and continuing throughout one's lifetime.

### THE NEW RETIREMENT

The first trend is the emergence of the defined contribution plan as the predominant retirement savings plan provided by employers in the private sector. Expectations for long term service with a single employer in the private sector have virtually disappeared. The days of working for one employer for 25 years followed by coverage under a defined benefit pension plan upon retirement are over. The emergence of the defined contribution plan, such as the 401(k) plan, as the predominant retirement savings plan in the private sector has changed the manner in which employees save for retirement in two significant ways. Participants in these plans now assume primary responsibility for funding their retirement benefits and significant re-

sponsibility for making investment decisions. A typical 401(k) plan provides plan participants with the opportunity to choose from a menu of investment options provided by the plan sponsor. However, even with the benefit of educational sessions provided by an employer, this feature places the ultimate responsibility for investment decisions on the plan participants. As a result, investment risk is transferred to individuals who have varying degrees of investment experience and sophistication.

Until well into the 1980s, the employer-sponsored pension plan was typically a defined benefit plan that provided employees with a benefit at retirement, based on a formula that typically took into account, age, earnings and years of service. These plans were designed to encourage long-term service, and to provide a specified benefit during retirement. Importantly, the investment risk associated with providing that benefit rested solely with the employer rather than the employee.

The obligations of plan sponsors became more onerous after the enactment of the Employee Retirement Income Security Act of 1974 (ERISA) which imposed advance funding requirements and the extensive reporting obligations. The legal and administrative costs associated with these plans skyrocketed. Moreover, employers were faced with the daunting responsibility for achieving investment results that would be adequate to fund their plans. Eventually, many employers in the private sector ter-

minated their defined benefit plans and replaced them with defined contribution plans which permitted participants to make contributions to the plan on a pre-tax basis. The appeal of these plans from a participant's perspective is the ability to save for retirement on a pre-tax, systematic basis with the possibility of an employer match.

### **COMPLEXITY IN THE FINANCIAL MARKETS**

The second trend that points to a need for financial literacy is the increased complexity and fragility of the financial markets. As financial innovation proceeds apace, the dazzling array of new products and services poses new risks for investors and new challenges for our domestic regulators. Fourteen years ago, the United States Securities and Exchange Commission (SEC) acknowledged these increased risks when, in response to the Financial Crisis of 2008, it created the Division of Economic and Risk Analysis (initially known as the Division of Risk, Strategy and Financial Innovation).

The development was significant because the division was the SEC's first new division in 37 years. The Division of Economic and Risk Analysis uses a multi-disciplinary approach to assist the SEC in its efforts to identify, analyze, and respond to economic and market issues, including those related to new financial products, investment and trading strategies, systemic risk, and fraud. The spectacular collapse of Sam Bankman-Fried's FTX cryp-

to empire, once valued at \$32B, into bankruptcy late last year provides a current example of a significant challenge for the SEC. Although the U.S. Securities and Exchange Commission (SEC) has charged Bankman-Fried with violating the anti-fraud provisions of the federal securities laws, it is not yet clear how the crypto asset class will be regulated apart from enforcement actions.

In future columns we will discuss initiatives undertaken by the SEC's recent efforts provide investors with useful information about investing. We will also explore options for investors who might find it useful to work with a financial advisor.

#### *Caveat Emptor!*

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