The Financial Transition from Student to Employee:

Implications for Higher Education and Employers

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COHEAO's Financial Wellness Task Force identifies best practices, serves as a forum on existing programs and new ideas, and advocates for policies to promote financial wellness for college students and alumni with a particular focus on student debt. COHEAO seeks to help colleges and universities leverage one of the most "teachable moments" in personal finance – the process of effectively financing higher education and managing any debt that may be assumed as part of the strategy. In this paper, we wanted to provide some perspective on the importance of sound student financial decisions and behaviors while in school and as they transition to alumni and career. COHEAO would like to thank Katherine Sauer for her lead role in the development of this paper and all of the contributors; Bryan Ashton, T.G.; Elizabeth Coogan, Federal Student Aid; Paul Goebel, University of North Texas; Jodi Kaus, Kansas State University; Niki Pechinski, University of Minnesota-Duluth; and Todd Woodlee, iGrad; as well as all of the attendees of the COHEAO Financial Wellness Summit in August of 2016 for their assistance with this project.

If you would like a copy this paper, it is available on the COHEAO Financial Wellness Task Force website.

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To obtain an electronic copy of this paper with live links, please visit: http://www.coheao.com/taskforces-committees/financial-wellness/financial-literacy-task-force-resources/

Introduction

For many individuals, major strides toward financial independence happen during the transition from post secondary education into career-related employment. Many 18 to 24 year old students are financially dependent on family (to varying degrees) and view themselves as entering the "real world" only upon graduation[1]. A notable distinction of this group of individuals is their tendency to discount the importance of financial decisions made prior to graduation and their reliance on authority figures to make decisions for them well after graduation.

Much of the literature to date focuses on objective measures of financial standing (e.g., level of student debt, lack of retirement savings). There have been lengthy discussions about the need for appropriate topical and conceptual knowledge (e.g., how compound interest works). This paper aims to foster a conversation about action-oriented financial capability for emerging households. It describes the critical financial decisions that students and early career workers face and lays out a set of 13 key financial behaviors that can be cultivated irrespective of financial independence or financial standing. Higher education institutions and employers alike can use this framework to establish or enhance financial wellness programming.

Student Financial Behaviors and Critical Decisions[2]

In this section, we focus on behaviors that each student can achieve, rather than simply aspire to. For example, in this context we do not suggest that "saving" is a behavior that everyone should cultivate. We of course agree that it is a positive behavior and helps insulate an individual from financial shocks, however, it is a behavior that depends in large part one's income, regardless of spending choices. There are certainly additional behaviors (e.g., self-advocacy, budgeting) that will help individuals to successfully maneuver through their academic and financial lives. However, we limit our attention to financial behaviors.

Many decisions an individual makes during school have long-term ramifications for personal financial wellbeing and stability. Decisions made in the years leading up to graduation, such as student loan financing and use of credit cards, materially impact personal financial standing during the transition as well as in early career. We describe the implications of each critical decision.

A Note on Financial Independence

Financial independence can be thought of as a continuum. At one end of the spectrum, the individual has no income, no financial assets, no personal discretion over resource allocation and utilizes no financial instruments – relying completely on family for all aspects of personal finance. At the other end, the individual has their own source of income, pays their own living expenses, has savings and/or access to credit for an emergency, services any existing debt, holds all debt in their own name, has their own transactional account, and pays for applicable insurance coverage.

The state of financial dependence on family will vary – some individuals will be completely reliant on family during postsecondary education while others will work to pay their own rent but are still part of family insurance policies or needed some assistance with expenses. We hold the assumption that an individual can be financially independent but still receive information and advice from family members when financial decisions are to be made. Additionally, whether or not an individual has student loans (or other types of debt) does not necessarily have bearing on their degree of financial independence. An individual with no co-signers who can service their debt would be considered financially independent (when it comes to managing debt) while an individual with a co-signer or who receives family assistance with debt payments would be financially dependent.

[2] This is an expanded version of the list of Healthy Habits originally published on University of Colorado's Employee Services website (www.cu.edu/employee-services/financial-wellness).

FINANCIAL BEHAVIORS APPROPRIATE FOR STUDENTS

We posit that the following behaviors are appropriate for students to learn and practice, regardless of their independence, income, level of debt, or financial standing.

Maintain a transactional account

Students should establish and maintain their own transactional (e.g., checking) account at a bank or credit union. The use of financial products can help increase financial capability, and an entry-level financial product appropriate for all individuals is a transactional account.

Track cash flow

Whether using pen and paper or an app, students can be expected to learn to monitor their cash flow, including all incoming funds and each purchase. Whether or not students need to learn to make and stick to a formal budget is debatable; many financially stable households do not make formal budgets but do have a solid sense of cash flow. It is the behavior of monitoring the amounts of monthly income, expenses, and spending as well as planning for expenses and making appropriate adjustments that is critical.

Review financial standing

It is appropriate for students to periodically take stock of and review their financial standing by assessing all applicable financial instruments (e.g., financial accounts, credit/loans, insurance). Example behaviors include:

- requesting credit reports and reviewing them for accuracy
- reviewing debt levels, related interest rates, and payoff dates for all loans and credit cards
- reviewing insurance policies for coverage levels, deductibles, and premiums
- reviewing all financial accounts' balances and terms (e.g., checking and savings account statements)

Manage bills

Another positive financial behavior is paying bills on time or notifying billers and creditors in advance of a missed payment. While this may seem obvious, many students view deadlines and due dates as retroactively negotiable. They are used to asking for extensions on school work or to be able to "make up" missed assignments and often erroneously think that financial deadlines work the same way.

Maintain a personal records system

Everyone needs a system for managing important papers (whether electronic or truly paper). Though students may not yet have many documents to keep track of, establishing a system is an important habit – for many individuals, the bulk of their important papers end up being financially related (e.g., insurance policies, rental contracts, Social Security cards). Many students leave personal record management to their families, but there is no reason students can't begin to establish their own systems for keeping track of online records and important papers.

Maintain an emergency plan

Like a personal records system, everyone needs a plan for what they will do in the face of an emergency – whether health related or a natural disaster. Many students may be reliant on family in an emergency, but that doesn't mean students and families can't discuss and establish plans in advance.

Work toward a financial goal

The power of goal setting in personal finance is well-documented. Individuals can learn to set and work toward S.M.A.R.T. goals (i.e., goals that are specific, measurable, attainable, relevant, time bound). Goals don't always have to be about saving a certain amount – they can be behavior oriented such as "I will call my credit card company and learn my interest rate within the next month" or "I will spend one hour each weekend for the next four weeks working on my emergency plan".

Seek unbiased and accurate information for big financial decisions

Information literacy is increasingly important in today's world and knowing how to vet sources of financial information is key to sound decision making. Individuals need to learn about a variety of credible sources for financial information and to practice not simply defaulting to peer advice or asking family.

Protect against identity theft

Individuals can help guard against identity theft with a few simple habits. Shredding documents with personally identifying information on them and safeguarding personal records are two easy actions. Additionally, using secure passwords, changing them frequently, and not sharing them with others are simple and effective safeguards for devices and in the digital realm. Understanding consumer rights and remedies should they fall prey to fraud or identity theft is also critical. Students should be warned about the short and long term impacts of having to recover from identity theft.

Balance present and future financial needs

Some people seem to live entirely in the present while others seem to neglect the present in favor of the future. It is important for individuals to get in the habit of considering both the present and the future benefits and consequences of financial decisions. The outcome will vary depending on the situation and the individual, but all individuals can cultivate this practice as part of their decision making process.

Sleep on it

One of the most powerful financial behaviors one can practice is to take a pause before making a financial decision or purchase. Often times "sleeping on it" gives an appropriate amount of time to let any hot emotions (positive or negative) return to neutral, leaving the individual poised to make a more well-rounded decision. This practice is useful for both "impulse" buys as well as larger financial decisions.

CRITICAL DECISIONS FACED BY STUDENTS

In this section we trace back to critical decision points and behaviors for students, in order to explore how the school-to-work transition is impacted. Later in the paper we look forward to decisions faced in early career, and the potential consequences of earlier financial decisions made while in college or in the transition to career. We leave it to institutions to determine the most appropriate way of helping students prepare to make each decision.

Choosing an institution

Students have varying degrees of discretion in the choice over which institution to attend. High achieving students can choose selective institutions, specific programs, or can base their choice on geographic preference. Some students (regardless of academic promise) are limited to institutions of geographic proximity (e.g., for in-state tuition or because of commuting distance) while others are limited to institutions with open-access mandates. It is important to note that many forms of aid (at the institutional level) are not offered to transfer students. Therefore the initial selection of an institution (and its resulting fit) can be very important for student finances. The implications of school choice are important but beyond the scope of this paper.

Understanding the cost of attendance at the chosen institution is paramount for the student. Tuition, fees, books, and the day-to-day cost of living form the basis for the expenditure portion of a student's budget, as well as influence the amount of money borrowed in student loans and the decision to use credit.

Choosing a program of study

There is a debate surrounding the purpose of higher education in America – to what extent it should be career preparation versus creating intellectually well-rounded individuals. On a practical level though, students do need to understand how their choice of major may impact their future earnings potential - especially their starting salary - and they need to form realistic expectations about what their income will be after graduation. Entry-level salaries vary vastly by industry and some majors help students build more easily-employable skills than others (e.g., business versus humanities). Ideally, starting salary information should be used when making student loan borrowing decisions.

For some students the choice of major is made only once in a while; for others it is a repeated decision.

Inability to meet program admission or forward progress requirements may force some students to choose an alternative course of study while other students may simply change their mind after taking a few courses in the discipline. Changing majors can impact timely completion of a degree as well as the overall cost and amount borrowed.

Choosing the source of student loan financing

Students can finance their education by borrowing from federal and private sources. While many schools provide substantial guidance around federal, institutional, and some scholarship sources, the student is often left to investigate private funding options on their own.

Choosing how much student loan debt to incur

For the most part, students understand that they must make a plan for paying back student loans. What many students are missing, however, is knowledge about how the amount of student debt they are taking on now will translate to monthly payments in the future. The decision tends to be based on "how much do I need to live now" as opposed to "what can I afford to pay back later" and many students over-estimate their future earnings and under-estimate their student loan repayment amount.

The decision to borrow is ongoing, to be made each year or term. However students should not consider their borrowing decisions to be piecemeal by academic calendars but the cost of completing one's program of study. Since the individual has already chosen an institution with a set tuition structure, the decision is subject to constraints. It effectively becomes given the school the student has chosen and given their major, how much debt is feasible to incur in the context of future earnings. Time to degree is a considerable factor in how much is borrowed.

The implications of incurring more debt than one can service are well documented. Late payments and default do serious damage to credit scores. This impacts the ability to borrow for major purchases in the future, the current interest rates on the individual's credit cards, and insurance premiums. Further, many employers are using credit scores as part of the applicant screening process.

Even if one can effectively service student debt payments, it may be at the expense of pursuing other positive financial goals. Early career workers may forego contributing to retirement, missing out on the benefits of compound growth. Debt service may take the place of building up emergency savings. It may also impact saving for a down payment for a car or home as well as one's ability to qualify for credit due to an unfavorable debt to income ratio.

Choosing how to use credit

Many students obtain their first credit card during college. This early exposure to credit can help an individual build a solid credit history or can start them down a path to credit score woes.

TRANSITIONAL DECISIONS

There are several important decisions that students face during the transition from school to work. In this section we highlight the potential financial consequences that stem from each. While schools are certainly providing guidance to students on student loan repayment and career search, they may not be adequately addressing the other decisions and should consider adding additional programming and resources.

Choosing a student loan repayment plan

One of the more important transitional decisions is choice of student loan repayment plan. The payment plan a student chooses has implications for how long the individual must service the debt as well as how much interest is paid over time. Additionally, some student loan forgiveness programs are only available for individuals with certain types of repayment plans. Because payment plans can be changed at any time, even if a borrower starts out in the "wrong" plan, they can change it with relative ease. However, if a student misses a payment or underpays because they don't understand their repayment plan, their credit score will be impacted.

Closely related is the issue of whether or not to consolidate multiple loans. Consolidation, however, is usually a one-time decision so the individual must carefully weigh the benefits and costs pertaining to their individual situation.

Financing the gap between school and work

In a financially ideal situation, students would start a new job immediately after graduation. In reality, many find themselves with substantial gap before staring work as well as costs related to job search and moving. There are three common options for financing the gap: drawing from savings, using credit, or getting a temporary job. Often all three may be used.

Drawing down savings during the gap isn't inherently bad; after all one of the purposes of savings is to have access to funds during times without income. But individuals are not likely to have substantial savings upon graduation so a prolonged period of job search or an unexpected financial shock can quickly drain reserves. Once employed, an individual must make a plan for replenishing and further building up savings.

Similarly, using credit to finance the gap doesn't doom an individual. However minimum payments must be made each month and individuals should understand that this type of financing is very costly to pay back. Missing payments can result in penalty interest rates and a damaged credit score, driving up the cost of borrowing and the cost of insurance, and potentially affecting their chance of getting hired by employers who conduct credit checks as part of the screening process. High balances also impact an individual's debt to income ratio.

A temporary job can help ease the burden of financing the gap but individuals need to weigh the benefits of that income versus having flexible time to devote to job search and attend interviews.

Spending decisions during this time can significantly impact an individual's financial standing in the future. It's important to economize on discretionary spending as much as possible when the duration of the gap is unknown. Some expenses are not realistically within the individual's ability to change in the short term - such as rent, student loan payments, and car insurance premiums – but a missed payment on these types of outlays will damage an individual's credit score, so such payments need to be prioritized in one's budget. New expenses are incurred as a necessary part of job search (e.g., interview suit) or relocation (e.g., moving truck) and must also be factored into the budget.

Choosing health insurance

During the gap, the individual may be able to carry coverage through their family's policy (if under age 26 and if the policy covers dependents), may purchase coverage through the marketplace, or may qualify for Medicaid. Additionally, short-term individual policies can be purchased outside the marketplace.

There are two main implications for not carrying appropriate health insurance. The first is the penalty assessed on the individual's annual federal income tax filing. The second is unmitigated exposure to a negative health event.

Choosing the location of a job search

An individual can choose a geographical area to focus job search. This has implications on net pay. Income taxes vary by state (and not all states have them), while salaries and the cost of living vary by metropolitan area. An individual may or may not be willing to search outside of the area where they currently live or have family or familiarity with.

Given the variety of personal preference over where to live, there is no inherently wrong place to search for a job. But individuals need to be aware of the general economic conditions, the cost of living, and the presence of relevant industries in areas where they are searching.

Choosing the size of employer

This decision has implications for benefits and to some extent net pay. Large employers typically offer more robust benefit packages than small businesses and may have more standardized pay bands for entry-level and more experienced workers. Advancement and professional development opportunities will differ as well. For some individuals, this may be a constrained choice due to major or geographical location.

Preparing for workplace related expenditures

While not a decision to be made per se, it is important for individuals during job search to think ahead to workplace expenditures and ask appropriate questions during interviews. For example, creating a wardrobe with acceptable attire may significantly impact an individual's budget when starting a new job. Additionally, some employers expect an individual to have high speed internet at home or an unlimited data plan for a mobile device but do not provide a subsidy.

During later rounds of interviews or when comparing multiple offers, individuals will want to learn about workplace culture at the employer. For example, it may be routine for everyone to pitch in money for flowers when someone is hospitalized or a birthday gift – and in larger divisions there may be multiple such occasions each month. In some groups, everyone goes out to lunch every day and if an individual doesn't, they'll miss out on the informal networking and building of office capital.

Other financial factors to consider include the cost of a commute, relocation expenses, and if applicable, union expenses or professional liability insurance and/or license bonds.

Financial Behaviors and Critical Decisions for Early Career Workers

In this section we examine decisions faced in early career.

EARLY CAREER FINANCIAL BEHAVIORS

In addition to the financial behaviors that students should practice, there are two more that are appropriate for early career workers.

Plan for retirement

Whether or not the individual can actually afford to start saving for retirement, they can begin the planning process. Setting aside a few hours a month to learn how Social Security works, about employer retirement plan options (e.g., 401(k)s), and about IRAs is something everyone can do. Writing goals related to retirement planning can also be an appropriate behavior.

If it is feasible for the individual to contribute to retirement savings, then their planning activities should go to learning about fees, tax treatment of contributions and withdrawals from retirement accounts, diversifying their portfolio, learning about employer matches and vesting, and determining whether to increase contributions.

Maintain an estate plan

The main estate planning documents include a HIPAA authorization and release form, medical power of attorney (i.e., health care proxy), medical advanced directive (i.e., living will), financial power of attorney, and a will and/or trust. While a will and financial power of attorney are arguably not critical for young individuals with limited assets, it is especially important for unmarried individuals to prepare (and keep up to date) the other documents.

EARLY CAREER CRITICAL DECISIONS

Considering net pay

Once a job offer is secured, it is important for the individual to estimate their net pay taking into account the cost of benefits (e.g., health insurance), retirement contributions, and taxes. Doing so will guard against inappropriately ratcheting up their spending or lifestyle as they start the new job.

Individuals who are employed by public or governmental agencies should verify whether or not they are paying into Social Security. About 30 percent of U.S. workers don't pay in because they work for an employer who is exempt. These workers are not eligible for Social Security benefits upon retirement, unless they work for other non-exempt employers for the required 40 quarters.

Managing health insurance

Early career workers have several options for health insurance: employer (if offered), the marketplace, Medicaid, or on a parent/guardian's plan (if under age 26). It is possible to purchase an individual policy outside the exchange as well.

It is important for individuals to understand the implications of declining a health insurance policy through an employer. The individual will not be allowed to elect coverage until the next open enrollment period. Additionally, starting a new job is not a qualifying event for purposes of obtaining insurance through the marketplace; the individual would have to wait until the next marketplace open enrollment period to elect coverage.

As previously mentioned, the main implications for not carrying health insurance coverage are the IRS penalty and unmitigated exposure to a negative health event.

Choosing other available employer-sponsored benefits

Depending on the employer, individuals may have access to flexible spending accounts, health savings accounts (to accompany qualified high deductible health plans), disability insurance, and life insurance. Typically, there is a 30 day election period upon starting employment, otherwise the individual can't elect participation until the next open enrollment period. Changes can only be made once a year, during the open enrollment period.

Flexible spending accounts and health savings accounts are both useful tools for lowering one's income tax liability and as a mechanism for saving for health care expenses. Flexible spending accounts are often subject to "use it or lose it" provisions so it is important to correctly estimate how much to save in that vehicle.

Short term disability insurance is often ignored by young adults but can be a relatively inexpensive way to guard one's finances against not being able to work for a short period of time due to an injury. It is especially important for young women to consider since pregnancy is a covered event.

Life insurance coverage is also often ignored by young adults and again may be quite inexpensive as part of an employer's group policy.

Saving for retirement

Many employers offer a retirement plan, although whether or not they offer a match on employee contributions varies widely. Individuals need to understand any vesting schedules and waiting periods on participation. If there is an employer match, individuals should do their best to contribute in order to receive that match.

When individuals put off saving for retirement (whether due to other budgetary issues or procrastination), they miss out on the benefits of compound growth. Even saving 1% of earnings, when starting early, can be hugely beneficial to individuals – both in terms of compound growth and by starting a habit of saving.

Leaving an employer

Whether an individual voluntarily separates service or is fired, there are several decisions to make with respect to benefits. Individuals who were participating in an employer's health insurance plan may be entitled to continue coverage (i.e., through COBRA) – provided they pay the full premium cost themselves. Loss of coverage through an employer is also a qualifying event in the healthcare exchange so the individual may wish to explore coverage through that venue. Additionally, individuals under age 26 may be able to be added back on to a family plan.

For tax-deferred (i.e., not ROTH) employer-sponsored retirement plans, typical options include leaving the money invested within the plan, rolling the money into another tax-qualified plan (e.g., IRA or another employer's plan), or "cashing out" the balance. A cash withdrawal is subject to an IRS penalty in addition to ordinary income tax.

If individuals had other employer-sponsored benefits, they should learn about options and any applicable deadlines or dates. Common examples include flexible spending accounts, health savings accounts and group life insurance. In certain professions (e.g., medical) individuals may have had access to or coverage through the employer for professional liability insurance. They should find out how the coverage works during transition.

Gap Analysis

Schools with existing financial education programming are likely targeting some but not all of the key behaviors and critical decisions. Employers' programming likely focuses significantly on retirement planning and perhaps provides some benefits education during onboarding. We encourage schools and employers to benchmark their existing programming against the key behaviors and critical decisions. This will help identify gaps and can inform future planning.

Student programming gap analysis

FINANCIAL BEHAVIOR	CURRENT PROGRAMMING / RESOURCES	NEEDED PROGRAMMING / RESOURCES
Maintain a Transactional Account		
Track Cash Flow		
Review Financial Standing		
Manage Bills		
Maintain a Personal Records System		
Maintain an Emergency Plan		
Work Toward a Financial Goal		
Seek Unbiased and Accurate Information for Big Financial Decisions		
Protect Against Identity Theft		
Balance Present and Future Financial Needs		
Sleep On It		

CRITICAL DECISION	CURRENT PROGRAMMING / RESOURCES	NEEDED PROGRAMMING / RESOURCES
Choose Institution		
Choose Major		
Source of Student Loan Funding		
How Much Student Loan Debt to Incur		
How to Use Credit		
Student Loan Repayment Plan		
Finance Gap Between School and Work		
Choose Transitional Health Insurance		
Choose Location of Job Search		
Choose Size of Employer		
Workplace Related Expenditures		

Early career worker programming gap analysis

FINANCIAL BEHAVIOR	CURRENT PROGRAMMING / RESOURCES	NEEDED PROGRAMMING / RESOURCES
Maintain a Transactional Account		
Track Cash Flow		
Review Financial Standing		
Manage Bills		
Maintain a Personal Records System		
Maintain an Emergency Plan		
Work Toward a Financial Goal		
Seek Unbiased and Accurate Information for Big Financial Decisions		
Protect Against Identity Theft		
Balance Present and Future Financial Needs		
Sleep On It		
Plan for Retirement		
Maintain an Estate Plan		

CRITICAL DECISION	CURRENT PROGRAMMING / RESOURCES	NEEDED PROGRAMMING / RESOURCES
Consider Net Pay		
Manage Health Insurance		
Choose Other Benefits		
Save for Retirement		
Leaving an Employer		

Conclusion

Schools have been taking student financial literacy seriously, rolling out numerous initiatives and adopting best-practices. This paper seeks to encourage schools to evaluate existing programming in terms of its effectiveness in helping students with action-oriented financial capability. Specifically, schools should consider to what extent current programming is focused on helping students cultivate each of the positive financial behaviors and to make critical financial decisions.

Employers are also increasingly turning attention and resources to financial literacy programming for employees. While most programming is focused on understanding the specific benefits sponsored by the employer (e.g., health insurance, retirement plan), employers are beginning to consider more comprehensive programs. This paper provides insight to employers when designing such programming, especially when it comes to serving early career workers. Retirement plan service providers and other financial services providers (e.g., banks and credit unions) may also wish to utilize this approach.

It is important to note that effective financial education does not take a stance on any particular financial decision. That is, the right decision for one individual can differ from the right decision for another individual – even in seemingly similar situations. Financial education initiative from both schools and employers should help lay out the pros and cons of various financial decisions and provide for a decision-making framework.

Additionally, it is advisable to provide guidance about how an individual can learn to recognize when something is going "off track". Exposing young adults to financial warning signs and red flags (both for short and long term aspects of personal finance) can help them take a more proactive approach to dealing with financial issues.

Acknowledging Contributors

Katherine M. Sauer is an economic and personal financial literacy educator, with a decade of classroom experience and over 75 scholarly articles and presentations. At the University of Colorado, she was the Director of Financial Wellness, Education, and Research – implementing personal financial literacy programming for employees and retirees of the university's four campuses and system administration office, as well as administering the *Enhancing Student Financial Education* grant from the Council of Graduate Schools. Dr. Sauer frequently teaches continuing education workshops and courses for K-12 teachers. She is the former Co-Director of the Center for Economic Education at Metropolitan State University of Denver. She has consulted for the U.S. Department of Commerce, Colorado Department of Higher Education, Colorado Council for Economic Education, National Endowment for Financial Education, and ChinaLinks Educational Consultants. She has held faculty positions at the University of Colorado, University of Southern Indiana, and Metropolitan State University of Denver. She earned her doctorate in economics in 2006 from the University of Colorado at Boulder.