Financial Vulnerability of Americans in Later Life and its Implications for Retirement Well-being

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Motivation:

• Access to credit is easier and more widespread:
  ➢ Subprime mortgages
  ➢ Credit cards
  ➢ Payday loans, etc.

• Rising complexity of financial decisions and products.
• Consequences of debt mismanagement (worse credit score, default).
Previous work

• We have written a set of papers, documenting:
  ➢ The increase in debt across older cohorts
  ➢ Financial vulnerability associated with debt
  ➢ Low financial and debt literacy

• Grateful to the TIAA Institute and PRC for financial support
In this paper:

• Use a simple life-cycle model as framework
  • Wealth accumulation peaks at/near retirement.
• Use a rich set of data
  • 2015 National Financial Capability Study
• Examine the determinants of debt and heterogeneity of debt
  • What explains debt close to retirement?
  • Who is most affected by debt?
Empirical strategy:

- National Financial Capability Study (NFCS)
  - 2015 (wave)
  - Final Sample: 2,672 respondents
  - Focus on older individuals (56 - 61)
  - Included non-traditional methods of borrowing (i.e. payday loans, rent-to-own products, etc.)
  - Unique information about the burden of debt and financial fragility
The lowest income group are more likely to have an outstanding student loan for their own education.
## Debt by Socio-Demographics: Ethnic Groups

<table>
<thead>
<tr>
<th>Borrowing Behavior</th>
<th>White</th>
<th>African American</th>
<th>Hispanic</th>
<th>Asia</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home mortgage</td>
<td>0.38</td>
<td>0.30</td>
<td>0.43</td>
<td>0.31</td>
<td>0.30</td>
</tr>
<tr>
<td>Home Equity Loans</td>
<td>0.11</td>
<td>0.06</td>
<td>0.14</td>
<td>0.20</td>
<td>0.04</td>
</tr>
<tr>
<td>Auto loan</td>
<td>0.31</td>
<td>0.26</td>
<td>0.29</td>
<td>0.17</td>
<td>0.24</td>
</tr>
<tr>
<td>Own student Loan</td>
<td>0.05</td>
<td>0.17</td>
<td>0.06</td>
<td>0.01</td>
<td>0.15</td>
</tr>
<tr>
<td>Alternative fin. Service</td>
<td>0.14</td>
<td>0.36</td>
<td>0.21</td>
<td>0.10</td>
<td>0.28</td>
</tr>
<tr>
<td>Pay interest on C.C. Balance</td>
<td>0.35</td>
<td>0.43</td>
<td>0.4</td>
<td>0.2</td>
<td>0.41</td>
</tr>
<tr>
<td>C.C. fees/Exp. Behavior</td>
<td>0.21</td>
<td>0.38</td>
<td>0.25</td>
<td>0.13</td>
<td>0.17</td>
</tr>
<tr>
<td>Total</td>
<td>2,092</td>
<td>280</td>
<td>147</td>
<td>71</td>
<td>82</td>
</tr>
</tbody>
</table>

→ Some population subgroups are relatively more likely than others to use expensive forms of credit.
## Correlation of Borrowing Behaviors among Older Respondents

<table>
<thead>
<tr>
<th></th>
<th>Home mortgage</th>
<th>Home equity loans</th>
<th>Auto loan</th>
<th>Own student loan</th>
<th>Use altern. fin. service</th>
<th>Pay interest on credit card balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home Equity Loans</td>
<td>0.15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Auto loan</td>
<td>0.19</td>
<td>0.06</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Own student Loan</td>
<td>-0.06</td>
<td>-0.04</td>
<td>0.02</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alternative fin. Service</td>
<td>-0.10</td>
<td>-0.05</td>
<td>0.03</td>
<td>0.19</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay interest on C.C. Balance</td>
<td>0.16</td>
<td>0.09</td>
<td>0.20</td>
<td>0.05</td>
<td>0.06</td>
<td></td>
</tr>
<tr>
<td>C.C. fees/Exp. Behavior</td>
<td>0.06</td>
<td>0.07</td>
<td>0.09</td>
<td>0.05</td>
<td>0.15</td>
<td>0.54</td>
</tr>
</tbody>
</table>
Analysis of Financial Vulnerability

• We examine 3 indicators of financial vulnerability:
  ➢ Financial fragility
  ➢ Self-assessed debt
  ➢ Unable to make ends meet

• Controls:
  ➢ Age, marital status, gender, children, race and ethnicity, education, household income, income shocks
  ➢ Financial literacy
Indicators of financial vulnerability:

1. Financial fragility

• How confident are you that you could come up with $2,000 if an unexpected need arose within the next month?
  • I am certain I could come up with the full $2,000.
  • I could probably come up with $2,000.
  • I could probably not come up with $2,000.
  • I am certain I could not come up with $2,000.
  • Don’t know.
  • Prefer not to say.

_Lusardi and Tufano, BPEA, 2011_
1. Financial fragility

- How confident are you that you could come up with $2,000 if an unexpected need arose **within the next month**?
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  - I could probably come up with $2,000.
  - I could probably not come up with $2,000.
  - I am certain I could not come up with $2,000.
  - Don’t know.
  - Prefer not to say.

→ 33% of people age 56-61 were financially fragile in 2015 vs. 35% in 2012
Indicator of financial vulnerability

2. Having too much debt

How strongly do you agree or disagree with the following statement: ‘I have too much debt right now’?

• 1 = “Strongly Disagree”
• 2
• 3
• 4 = “Neither Agree or Disagree”
• 5
• 6
• 7 = “Strongly Agree”
• Don’t know
• Prefer not to say
2. Having too much debt

How strongly do you agree or disagree with the following statement: ‘I have too much debt right now’?

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- 2
- 3
- 4 = “Neither Agree or Disagree”
- 5
- 6
- 7 = “Strongly Agree”
- Don’t know
- Prefer not to say

→ 36% of people age 56-61 reported being over-indebted in 2015 vs. 40% in 2012
3. Making ends meet

‘In a typical month, how difficult is it for you to cover your expenses and pay all your bills?’

- Very difficult
- Somewhat difficult
- Not at all difficult
- Don’t know
- Prefer not to say

→ Financially vulnerable

→ 45% of people age 56-61 are unable to make ends meet in 2015
The Big Three: Financial literacy across age groups
2015 NFCS
## Results for Financial Vulnerability

<table>
<thead>
<tr>
<th></th>
<th>Have &quot;too much Debt&quot;</th>
<th>Financially fragile</th>
<th>Unable to make ends meet</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Literacy Index</strong></td>
<td><strong>-0.02</strong> <strong>II</strong></td>
<td><strong>-0.04</strong> ***</td>
<td><strong>-0.03</strong> ***</td>
</tr>
<tr>
<td><strong>Female</strong></td>
<td><strong>0.06</strong> ***</td>
<td><strong>0.05</strong> <strong>II</strong></td>
<td><strong>0.07</strong> ***</td>
</tr>
<tr>
<td>Age</td>
<td><strong>-0.01</strong> <strong>II</strong></td>
<td><strong>-0.01</strong> *</td>
<td>-0.01</td>
</tr>
<tr>
<td>African American</td>
<td>0.03</td>
<td><strong>0.12</strong> ***</td>
<td>-0.02</td>
</tr>
<tr>
<td>Hispanic</td>
<td><strong>-0.10</strong> *</td>
<td><strong>-0.11</strong> <strong>II</strong></td>
<td>-0.03</td>
</tr>
<tr>
<td>Asian</td>
<td><strong>-0.10</strong> *</td>
<td><strong>-0.11</strong> <strong>II</strong></td>
<td>-0.03</td>
</tr>
<tr>
<td>Other</td>
<td>0.09</td>
<td><strong>0.13</strong> <strong>II</strong></td>
<td>0.02</td>
</tr>
<tr>
<td>&lt;High School</td>
<td>0.07</td>
<td>-0.02</td>
<td>0.04</td>
</tr>
<tr>
<td>Some College</td>
<td>0.09</td>
<td>-0.03</td>
<td>0.04</td>
</tr>
<tr>
<td>&gt; College</td>
<td>0.060</td>
<td>-0.070</td>
<td>0.03</td>
</tr>
<tr>
<td>Single</td>
<td><strong>-0.08</strong> ***</td>
<td>-0.001</td>
<td>-0.05</td>
</tr>
<tr>
<td>Separated</td>
<td>0.01</td>
<td>-0.03</td>
<td>-0.02</td>
</tr>
<tr>
<td>Widow</td>
<td>0.003</td>
<td>-0.02</td>
<td>-0.06</td>
</tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Has dependent children</td>
<td>0.07***</td>
<td>0.08***</td>
<td>0.18***</td>
</tr>
<tr>
<td>Income $15 –25K</td>
<td>-0.05</td>
<td>-0.11***</td>
<td>-0.13***</td>
</tr>
<tr>
<td>Income $25 -35K</td>
<td>-0.01</td>
<td>-0.17***</td>
<td>-0.23***</td>
</tr>
<tr>
<td>Income $35 - 50K</td>
<td>-0.10***</td>
<td>-0.24***</td>
<td>-0.31***</td>
</tr>
<tr>
<td>Income $50 - 75K</td>
<td>-0.15***</td>
<td>-0.30***</td>
<td>-0.40***</td>
</tr>
<tr>
<td>Income $75 – 100K</td>
<td>-0.20***</td>
<td>-0.31***</td>
<td>-0.48***</td>
</tr>
<tr>
<td>Income $100 - 150K</td>
<td>-0.22***</td>
<td>-0.34***</td>
<td>-0.51***</td>
</tr>
<tr>
<td>Income $150K+</td>
<td>-0.32***</td>
<td>-0.28***</td>
<td>-0.48***</td>
</tr>
</tbody>
</table>
Inside the black box of financial vulnerability

• Low financial literacy
  • Financial knowledge is lower among respondents who are financially vulnerable

• Lack of information
  • Individuals are unaware of pricing options, credit scores, and student loan repayment options

• Behavioral biases
  • Psychological factors, lack of self-control, and impulsive spending behavior
Conclusions and implications

Financial vulnerability
Disproportionately ethnic minorities and low income

Heterogeneity in the types of debt people hold
short-term uncollateralized debt
student loans

Targeted educational programs are needed that focus on debt and debt management.