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

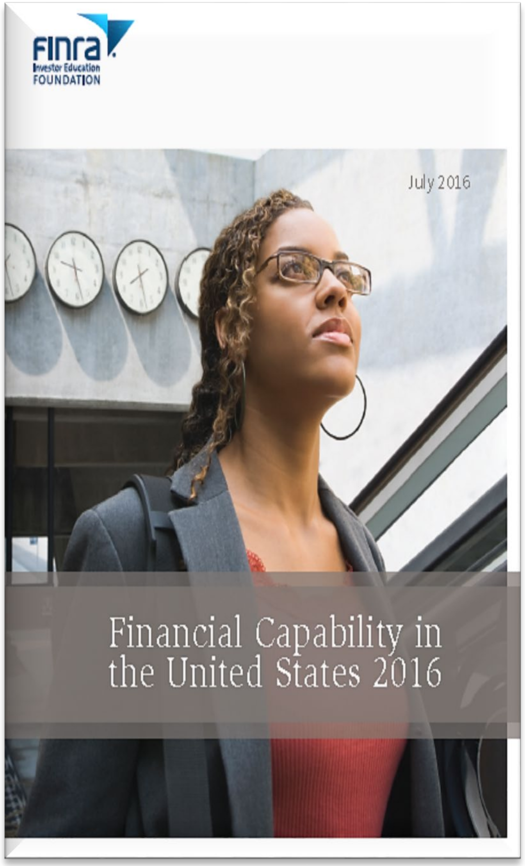
- Grateful to the TIAA Institute and PRC for financial support

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



Debt by Socio-Demographics: Income Level

Borrowing Behavior	< 35K	35–75K	>75K
Home mortgage	0.18	0.38	0.52
Home Equity Loans	0.04	0.10	0.17
Auto loan	0.15	0.34	0.38
Own student Loan	0.11	0.06	0.02
Alternative fin. Service	0.30	0.17	0.07
Pay interest on Credit Card Balance	0.33	0.43	0.33
Credit Card fees/Exp. Behavior	0.25	0.28	0.16
Total	815	903	954

→ The lowest income group are more likely to have an outstanding student loan for their own education.

Debt by Socio-Demographics: Ethnic Groups

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

→ Some population subgroups are relatively more likely than others to use expensive forms of credit.

Correlation of Borrowing Behaviors among Older Respondents

	Home mortgage	Home equity loans	Auto loan	Own student loan	Use altern. fin. service	Pay interest on credit card balance
Home Equity Loans	0.15					
Auto loan	0.19	0.06				
Own student Loan	-0.06	-0.04	0.02			
Alternative fin. Service	-0.10	-0.05	0.03	0.19		
Pay interest on C.C. Balance	0.16	0.09	0.20	0.05	0.06	
C.C. fees/Exp. Behavior	0.06	0.07	0.09	0.05	0.15	0.54

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

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  - Prefer not to say.

→ **Financially fragile**

→ 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'?

- 1 = "Strongly Disagree"
- 2
- 3
- 4 = "Neither Agree or Disagree"
- 5
- 6
- 7 = "Strongly Agree"
- Don't know
- Prefer not to say

→ **Over-indebted**

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

3. Making ends meet

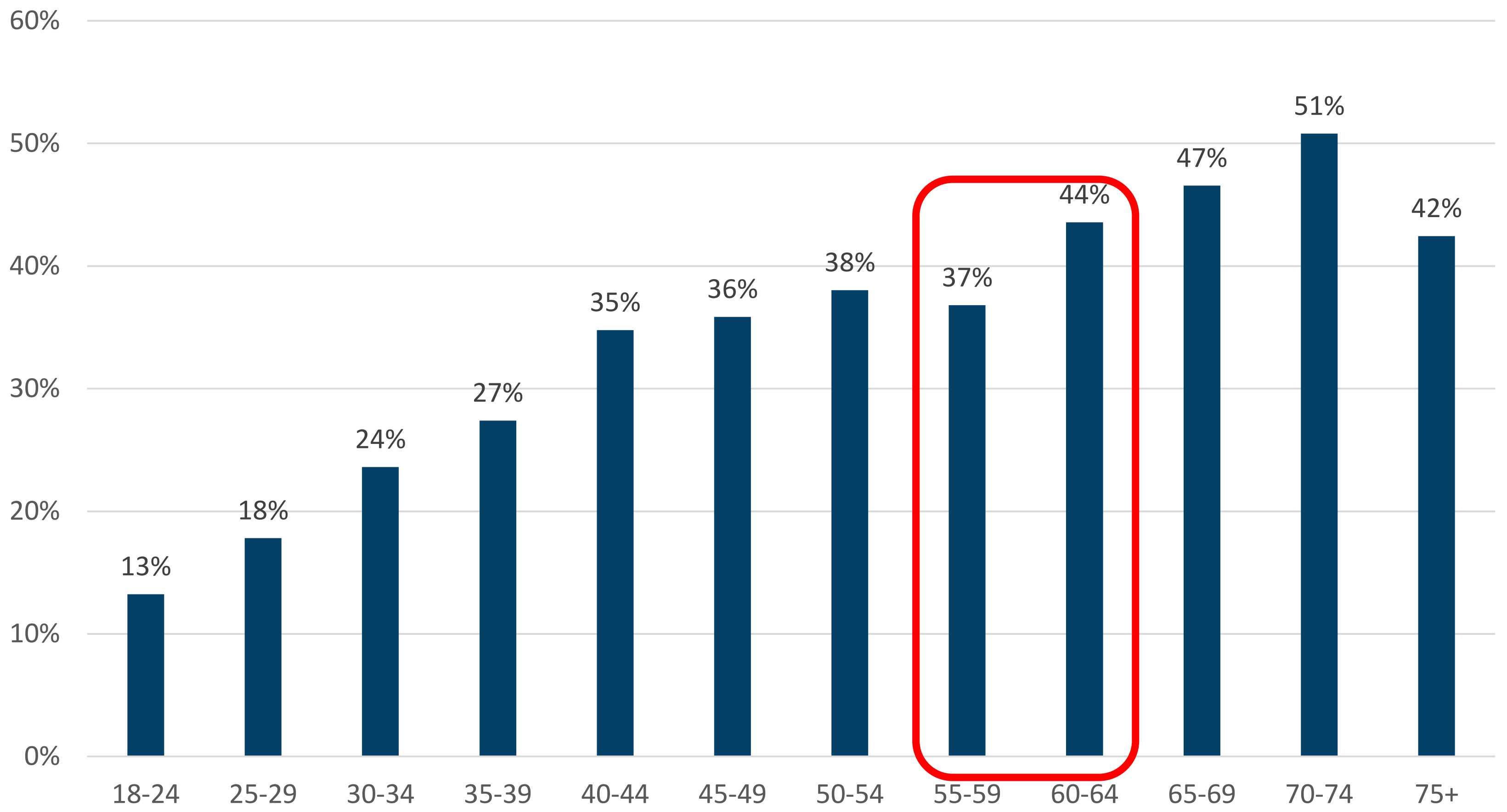
‘In a typical month, how difficult is it for you to cover your expenses and pay all your bills?’

- 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

	Have "too much Debt"	Financially fragile	Unable to make ends meet
Financial Literacy Index	-0.02**	-0.04***	-0.03***
Female	0.06***	0.05**	0.07***
Age	**-0.01****	**-0.01***	-0.01
African American	0.03	**0.12*****	-0.02
Hispanic	-0.05	0.04	**-0.08***
Asian	**-0.10***	**-0.11****	-0.03
Other	0.09	**0.13****	0.02
<High School	0.07	-0.02	0.04
Some College	0.09	-0.03	0.04
> College	0.060	-0.070	0.03
Single	**-0.08*****	-0.001	-0.05
Separated	0.01	-0.03	-0.02
Widow	0.003	-0.02	-0.06

Results for Financial Vulnerability

	Have "too much Debt"	Financially fragile	Unable to make ends meet
Has dependent children	**0.07*** **	**0.08*** **	**0.18*** **
Income $15 –25K	-0.05	**-0.11*** **	**-0.13*** **
Income $25 -35K	-0.01	**-0.17*** **	**-0.23*** **
Income $35 - 50K	**-0.10*** **	**-0.24*** **	**-0.31*** **
Income $50 - 75K	**-0.15*** **	**-0.30*** **	**-0.40*** **
Income $75 – 100K	**-0.20*** **	**-0.31*** **	**-0.48*** **
Income $100 - 150K	**-0.22*** **	**-0.34*** **	**-0.51*** **
Income $150K+	**-0.32*** **	**-0.28*** **	**-0.48*** **

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.**