Public Policy & Aging Report
cite as: Public Policy & Aging Report, 2016, Vol. 26, No. 1, 23–29
doi:10.1093/ppar/prv029

THE GERONTOLOGICAL SOCIETY OF AMERICA®

OXFORD

Article

Americans' Troubling Financial Capabilities: A Profile of Pre-Retirees

Annamaria Lusardi, PhD,[1,2,*] and Carlo de Bassa Scheresberg, MSc[2]

[1]Denit Trust Chair in Economics and Accountancy, The George Washington University School of Business, Washington, DC
[2]Global Financial Literacy Excellence Center, Washington, DC

*Address correspondence to Annamaria Lusardi, PhD, Denit Trust Chair in Economics and Accountancy, The George Washington University School of Business, 2201 G Street, NW, Washington, DC 20052. E-mail: alusardi@gwu.edu

Manuscript received September 7, 2015; Accepted October 13, 2015

Decision Editor: Robert B. Hudson, PhD

Key words: Financial capability, Financial literacy, Pre-retirees

Introduction

Many people envision a life of work that builds to comfortable and enjoyable retirement years. For previous generations, the financial security that marked that post–labor-force chapter hinged on how generous employers were with pensions or how well employers invested and managed retirement accounts. In recent years, however, fast-paced changes to workforce dynamics, a dramatic shift from employer-provided retirement accounts to worker-managed retirement plans, and lengthening life expectancies have altered that safety net, making retirement security much more challenging to achieve.

In addition to changes in the pension landscape, changes in financial markets have made it much easier for consumers to access credit and to borrow large amounts with limited collateral. In past decades, U.S. households have become increasingly indebted and over-leveraged, becoming highly vulnerable to financial shocks and economic downturns. On the verge of the great recession, U.S. household debt as a percentage of annual disposable personal income was 127%, which compares with 77% in 1990 (Economist, 2008). With the burst of the housing bubble and the economic downturn, many households have undergone a deleveraging process that has reduced the total amount of indebtedness in the system. However, many families still struggle with debt; in 2012, over 40% of Americans reported feeling they have too much debt (FINRA Investor Education Foundation, 2012).

To determine how these shifts dovetail with both the aspirations and the actions of Americans nearing retirement, we use data from the 2012 National Financial Capability Study (NFCS) to examine the responses of pre-retirees (age 51–61) to a number of financial capability questions designed to gauge their financial behaviors and decisions and the factors that influence them. The data, which follow, portray a troubling picture of Americans close to retirement. Several of these behaviors can be linked to a lack of financial literacy.

A Financial Profile of Pre-Retirees

Retirement Accounts and Long- and Short-Term Debt

In 2009, the Financial Industry Regulatory Authority (FINRA) Investor Education Foundation undertook a detailed survey known as the NFCS, intended to benchmark key indicators of financial capability and link these indicators to demographic, behavioral, attitudinal, and financial literacy characteristics. The empirical analysis in this paper is conducted on the most recent wave of data, collected in 2012. Table 1 presents a set of descriptive statistics on the sample under consideration. The sample is restricted to respondents age 51–61, who were not retired at the time of the survey. The final sample is composed of 5,002 observations. We will analyze pre-retirees' economic conditions and financial behaviors through an examination of some of their assets, liabilities, and short- and long-term saving behaviors.

Table 1. Demographic Characteristics of the Pre-Retirees Sample

	Full sample
Age (51–61)	100%
Ethnicity	
White	78%
African American	11%
Hispanic	5%
Asian American	3%
Other ethnicity	3%
Marital status	
Married	62%
Single	14%
Separated	2%
Divorced	18%
Widowed	4%
Number of financially dependent children	
1	19%
2	9%
3 or more	4%
No financially dependent children/do not have any children	68%
Living arrangements	
Only adult in the household	23%
Live with spouse/partner/significant other	66%
Live with parents, other family, friends, or roommates	11%
Employment status	
Self-employed	10%
Work full time for an employer	46%
Work part time for an employer	10%
Homemaker	10%
Disabled	12%
Unemployed	11%
Income level	
<$35K	32%
$35K–$50K	14%
$50K–$75K	19%
$75K–$100K	13%
>$100K	22%
Education	
High school or less	34%
Some college	33%
College	21%
Postgraduate education	13%
N	5,002

Note. The sample is restricted to 5,002 individuals aged 51–61, excluding respondents who were retired at the time of the survey.

The NFCS contains data on asset ownership as well as information on asset management. Of interest for this analysis are retirement accounts. Sixty-one percent of the pre-retirees have retirement accounts through current or previous employers (see Table 2). These may be a Defined Benefits (DB) plan or a Defined Contribution (DC) plan, the latter of which can include Thrift Savings Plans (TSPs) and 401(k) plans. Consistent with the recent trend toward DC-type pensions, among respondents with employment-based retirement accounts, 68% report a plan where participants choose how the money is invested. In addition, more than a third of respondents (34%) have independent retirement accounts, such as IRAs. In total, 67% of pre-retirees reported having an employer-based or independent retirement account.

When broken down for more detailed demographic differences, the sample reveals that a married respondent or a respondent living with a partner is much more likely to have a retirement account than a single respondent (76% vs. 49%). A college degree also matters. Respondents with undergraduate degrees are 24 percentage points more likely to have a retirement account than those without degrees (83% vs. 59%). This gap is dramatic even when employment status and income are considered. Respondents employed full time are nearly 20 percentage points more likely to have a retirement account than respondents employed part time (86% vs. 67%).

Simply stated, nearly 30% of respondents appear to lack any form of retirement account. Even if, in these data, we do not have full information on the net assets of these respondents, it seems that many of these individuals will be highly exposed to financial insecurity when retired. Also, it is those who are married, have college degrees, are employed full time, and have higher levels of income that are much more likely to own retirement accounts than other pre-retirees.

To fully understand the financial capability and finances of pre-retirees, it is important to also look at the liabilities these households carry. Financial markets have made it easier for people to access credit, including access to alternative financial services, such as payday loans, pawnshops, and auto title loans, which charge high rates of interest, often well beyond what is earned on assets.

Several questions in the 2012 NFCS focus on sources of debt and perceived levels of indebtedness. These questions can be separated into two categories: long-term liabilities, such as a car loan, a mortgage, or a home equity loan, and short-term liabilities, such as credit-card debt.

Home mortgages are the primary source of long-term debt among pre-retirees (see Figure 1). Sixty-three percent of homeowners in the sample report having a mortgage, while among all respondents, 44% have a mortgage. Moreover, some 20% of respondents who own their home report having a home equity loan. Auto loans are the second most prevalent source of long-term debt. Nearly a third of respondents indicate that they or someone in their household has an auto loan.

An analysis of the sources of long-term debt shows that a vast majority of pre-retirees approach retirement with some long-term debt. Sixty percent have at least one source of long-term debt, and 26% have more than one source. This is of concern, especially in light of previous research findings that show that, with respect to past generations of pre-retirees, newer pre-retiree generations are approaching

Table 2. Retirement Plan Ownership among Pre-Retirees

Respondents with retirement plans through current or previous employers	*61%*
Respondents with defined contribution (DC) plans, among those with employment-based plan	68%
Respondents with retirement accounts NOT through employers	34%
Respondents with retirement plans, through employers or not	67%
Respondents currently making regular contributions among those with employment-based DC plans or a nonemployment-based plans	74%

Note. Percentages are calculated over the full sample of 5,002 observations.

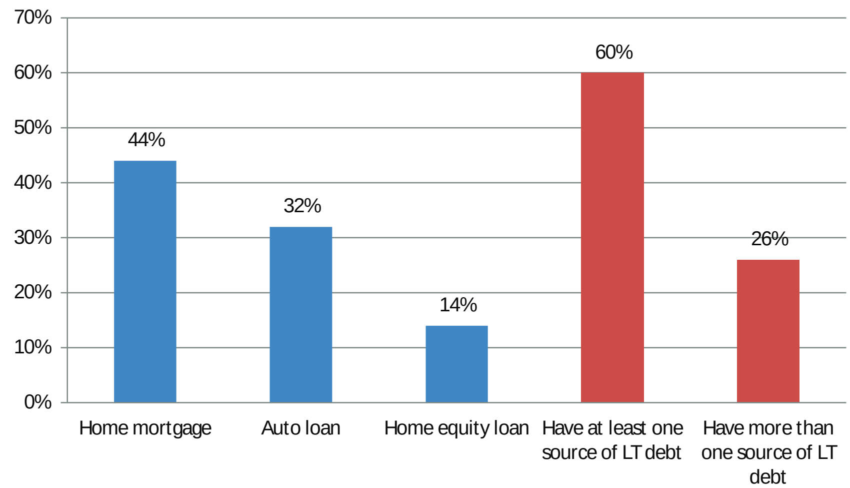

Figure 1. Sources of long-term (LT) debt. *Note*. Percentages are calculated over the total sample of 5,002 observations.

retirement with sizable amounts of debt. Lusardi and Mitchell (2013) examined data from the Health and Retirement Study to evaluate changes in debt among three cohorts of individuals aged 56–61 at different time periods (1992, 2002, and 2008). Results of this research indicate that more recent cohorts have taken on more debt and face more financial insecurity, mostly through the purchase of more expensive homes with smaller down payments. Having a lot of debt near retirement can have important implications. For example, debt can have consequences for when workers retire or start claiming their Social Security benefits (Butrica & Karamcheva, 2013). In sum, a new trend has emerged that points to post-retirement Americans carrying debt and greater levels of debt.

... a new trend has emerged that points to post-retirement Americans carrying debt and greater levels of debt.

As the interest rate on debt normally exceeds the rate of return on assets and servicing debt requires regular periodic payments that may impact respondents' balance sheets, the analysis examines responses to questions designed to assess levels of financial distress:

- Do you currently owe more on your home than you think you could sell it for today? (Y/N)
- How many times have you been late with your mortgage payments in the last 2 years? (never/once/more than once)

The data show that mortgages and other debt prove problematic for a relatively large subset of near-retirement respondents. Some 17% of pre-retirees with housing debt reported being underwater, owing more on their homes than they believe they would receive by selling them. Further, nearly 20% reported being late with their mortgage payments at least once in the last year.

Short-term liabilities also contribute significantly to the total debt held by pre-retirees. Looking at the most common source of short-term borrowing, that is, credit cards, we find that 74% of all respondents use at least one credit card and 54% do not always pay the full amount due—a behavior that exposes pre-retirees to high fees (see Table 3). The data reveal other troubling credit-card behaviors. For example, 33% of pre-retirees with credit cards pay only the minimum due, 15% are charged late-payment fees, 6% are assessed fees for exceeding their credit limits, and 9% use their credit cards to obtain cash advances. Altogether, a troubling 39% of individuals aged 51–61 reported at least one expensive credit-card behavior. This is worrisome considering that, as mentioned above, pre-retirees should be at the peak, or close to the peak, of wealth accumulation.

Alternative financial services (AFS) are another source of significant short-term debt. The short-term lending practices of AFS are defined in related research as "high-cost"

Table 3. Credit-Card Practices among Pre-Retirees

Have at least one credit card	74%
Among card holders	
Always paid credit card in full	44%
Carried a balance and was charged interest in some months over previous year	54%
Engagement in expensive credit-card behavior in some months over previous year	
Paid the minimum payment only	33%
Was charged a late fee for late payment	15%
Was charged an over-the-limit fee for exceeding my credit line	6%
Used the cards for a cash advance	9%
Expensive credit-card behavior (minimum payment only, paying late fees, paying over-the-limit fees, or using the card for cash advances)	39%
N	3,714

Note. This table reports answers to the question: "In the past 12 months, which of the following describes your experience with credit cards?" Percentages are calculated over the sample of credit-card holders only (3,714 pre-retiree respondents).

because they carry unusually high fees (Lusardi & de Bassa Scheresberg, 2013). In the NFCS survey, respondents were asked a set of questions about use of high-cost borrowing methods; specifically, they were asked whether in the 5 years prior to the survey they used products such as auto title loans, pawnshop loans, payday loans, rent-to-own loans, or tax refund advance loans.

Across the sample, 22% of pre-retirees reported using one or more of these borrowing methods in the past 5 years. Use of these nontraditional borrowing methods is concentrated among vulnerable groups: single respondents (28%); separated, divorced, or widowed respondents (31%); respondents with low household income; non-Asian minority respondents (34%); and respondents without a retirement plan (38%). Education is another factor that is strictly associated with the use of nontraditional financial services. Respondents with college degrees are 11 percentage points less likely to rely on AFS than respondents without such a degree (26% vs. 15%; see Figure 2). As suggested by Lusardi and de Bassa Scheresberg (2013), this educational divide is relevant because pre-retirees with lower education may underestimate the total costs attached to use of these borrowing methods. Indeed, Lusardi and de Bassa Scheresberg (2013) find that the use of AFS is prevalent among those with low levels of financial literacy and financial literacy continues to be an important determinant of using AFS even after accounting for a large set of demographic and economic characteristics, including being banked. Lusardi and Tufano (2015) also found a strong link between financial literacy and borrowing behavior, which includes not only use of AFS but also credit-card borrowing.

Over-Indebtedness and Financial Fragility

For additional insight into the overall level of indebtedness of pre-retirees, respondents were asked to rate their agreement, on a scale of 1–7, with the following statement:

> "I have too much debt right now." (Disagree = 1–3, Neutral = 4, Agree = 5–7)

Overall, 43% of respondents agreed that they have too much debt (see Table 4). Only 17% were neutral and less than 40% of pre-retirees disagreed with the statement. In other words, a disturbing number of respondents in our sample are overburdened with debt, and this may greatly influence their financial management choices and their ability to weather unfavorable economic times. Moreover, even among older respondents (those age 60 or 61), 39% indicated that they have too much debt. This poses serious questions on the ability of these respondents to pay off their debts while in retirement.

Measures of financial fragility also reveal that many pre-retirees are exposed to unpredictable shocks in the short term. Most pre-retirees do not save and do not have emergency or "rainy day" funds. Only 45% of pre-retirees reported spending less than they are earning. Furthermore, only 40% report having set aside sufficient funds to cover 3 months of expenses in the event of an unexpected shock. And those who do not save for the long run also do not save for the short term. Among those with no retirement plans, only 15% report having rainy day funds. That compares with 52% with rainy day funds among those with retirement plans.

Pre-retirees' vulnerability is confirmed by their responses to the question *"How confident are you that you could come up with $2,000 if an unexpected need arose within the next month?"* Fully 36% of respondents reported that they probably or certainly could not come up with the funds (see Table 5). In other words, pre-retirees are unprepared for short-term economic shocks, having neither savings nor alternative sources of funds to cover expenses under such a scenario. For example, 19% of pre-retirees lack health insurance, and among those who do not have health insurance, 61% probably or certainly cannot come up with $2,000 in case of emergency.

The ability to cover expenses in the event of an unexpected economic shock varies across subgroups. While 17% of married pre-retirees report that they certainly could not come up with $2,000 in 1 month, 36% of single, separated, divorced, or widowed pre-retirees would have such trouble. African Americans, Hispanics, and members of other non-Asian minorities are 18 percentage points less likely than whites and Asian Americans to feel, with certainty, that they could come up with the full $2,000 (24%

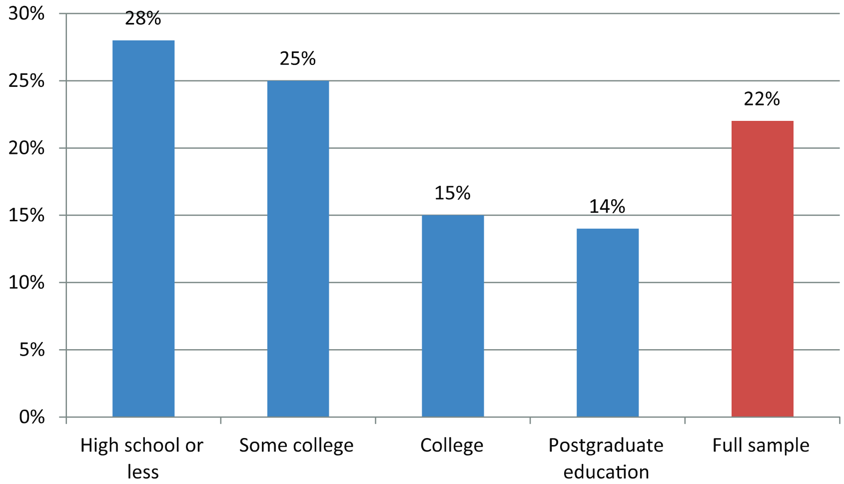

Figure 2. Pre-retirees' use of alternative financial services by education level. *Note*. Percentages are calculated over a sample of 4,904 observations for which information on AFS use is nonmissing. The survey questions ask respondents whether they have used at least one of these five AFS products in 5 years prior to the survey: rent-to-own, pawnshop, payday loan, tax advance, and auto title loan.

Table 4. Debt Perceptions among Pre-Retirees

	Full sample	Married/living with partner	Single	Separated, divorced, and widowed	Has retirement plan	Does not have retirement plan
Disagree (1–3)	38%	39%	34%	33%	27%	43%
Neutral (4)	17%	18%	16%	16%	18%	17%
Agree (5–7)	43%	41%	48%	49%	53%	39%
N	5,002	3,393	1,609	1,204	1,469	3,375

Note. This table reports answers to the question: "How strongly do you agree with the following statement? *I have too much debt right now*." Answers are on a scale from 1 to 7, where 1 means *strongly disagree*, 4 is *neither agree nor disagree*, and 7 is *strongly agree*. Percentages are calculated over the full sample of 5,002 respondents. Results do not total 100% because "do not know" and "prefer not to say" answers are not reported in the table.

vs. 42%). More than 4 times as many respondents with retirement plans, relative to those without plans, expressed certainty about the ability to secure the money. Although this likely reflects the ability to borrow or withdraw funds from retirement plans, it nonetheless illustrates the particularly fragile situation faced by pre-retirees without a retirement plan. Household income is also an important determinant. Sixty-seven percent of those earning above $75,000 per year, 33% of those earning between $35,000 and $75,000 per year, and 13% of those earning below $35,000 per year were certain they could come up with $2,000 if needed.

Despite their age and nearness to retirement, pre-retirees tend to find themselves vulnerable to short-term economic shocks, an outcome likely linked to their long-term and short-term liabilities. An income shock, which would likely translate into additional debt, threatens to be particularly deleterious for these individuals.

Long-Term Financial Planning

Understandably, the resources available in the short term intrinsically influence short-term saving behavior. But to understand how—and if—short-term financial challenges impact long-term saving behavior, it is important to examine whether people plan for retirement. The survey asked, "*Have you ever tried to figure out how much you need to save for retirement?*" This is important in light of prior research showing that planners accumulate far more retirement wealth than nonplanners (Lusardi, 1999; Lusardi & Mitchell, 2011).

Only 47% of respondents in our sample have tried to figure out how much they should save for retirement, a small percentage given how close these respondents are to retirement. To understand more about what factors are associated with retirement planning, we built a multivariate regression model that accounts for demographic characteristics, economic circumstances, education level, and degree of financial sophistication. The findings on the likelihood of planning for retirement are consistent with the studies mentioned above. Income is positively correlated with retirement planning. While expected, this means that lower earners who are already experiencing financial fragility may be exposed to additional financial insecurity upon retirement because of their failure to plan. Education and financial risk tolerance also matter. Higher education and higher financial risk tolerance strongly increase the likelihood that respondents have planned for retirement.

Table 5. Financial Fragility among Pre-Retirees

	Certain to come up with the full $2,000 (%)	Can probably come up with $2,000 (%)	Probably cannot come up with $2,000 (%)	Certainly cannot come up with $2,000 (%)
Full sample	39	21	13	23
Ethnicity				
White and Asian	42	21	12	21
Other	24	22	16	32
Income				
<$35K	13	15	17	49
$35K and $75K	33	28	16	19
>$75K	67	20	6	5
Degree				
Undergraduate degree	54	21	10	13
No undergraduate degree	31	21	15	29
Married or living with partner	45	22	12	17
Single	25	19	15	36
Separated, divorced, or widowed	24	19	16	36
Has children	40	23	15	20
No children	38	20	12	25
Has retirement plan	51	24	11	12
No retirement plan	11	16	19	48

Note. This table reports answers to the question "How confident are you that you could come up with $2,000 if an unexpected need arose within the next month?" Percentages are calculated over the full sample of 5,002 observations on pre-retirees. Results do not total 100% because "do not know" and "prefer not to say" answers are not reported in the table.

Beyond education, another indicator significantly correlates with retirement planning, that is, financial literacy. To obtain a measure of respondents' level of financial literacy, we analyzed answers to a set of questions designed to test knowledge of basic economics and financial concepts. The questions were worded in the language of everyday transactions and were set up to test five fundamental concepts: numeracy and the capacity to do calculations related to interest rates, understanding of inflation, understanding of risk diversification and of stocks and mutual funds, understanding of interest payments on a mortgage, and understanding of the relationship between interest rates and bond prices. The analysis shows that financially literate individuals are 10 percentage points more likely to plan for retirement. This holds true even after controlling for levels of education, suggesting that financial literacy increases the likelihood of planning beyond the effect of schooling (for brevity, estimates are not reported, but are available from the authors upon request).

Summary and Concluding Remarks

This paper has documented that pre-retirees face a number of financial challenges. The analysis of the financial capability data highlights widespread presence of long-term debt even for individuals who are close to retirement. In addition, the data show that many pre-retirees use expensive credit-card borrowing and lack both short-term and long-term financial management and planning. The main findings are summarized below.

1. Nearly 30% of pre-retirees do not have retirement plans or accounts. This is particularly concerning given that respondents without retirement plans will rely only on other savings/assets, if they have them, and on Social Security benefits (if they are eligible). Those who are married, have college degrees, are employed full time, and have higher levels of income are much more likely to own retirement accounts than other pre-retirees.
2. Sixty percent of pre-retirees have at least one source of long-term debt and 26% have more than one source.

   Both long-term and short-term sources of debt pose significant challenges for pre-retirees. Home mortgages and auto loans are the most prevalent sources of long-term debt. Importantly, these sources of debt leave pre-retirees feeling overburdened. As other research has documented, such debt burdens for respondents nearing retirement means that many pre-retirees will carry debt with them beyond their working years.
3. Nearly 40% of pre-retirees use credit cards expensively. Expensive credit-card behavior, including making only minimum payments, being charged late-payment fees, and exceeding credit lines, adds to the burden of short-term debt faced by respondents.
4. Overall, 43% of respondents agreed with the statement "I have too much debt right now." In other words, even if pre-retirees are expected to be at or close to the peak of their wealth accumulation, a disturbing percentage of pre-retirees feel overburdened with debt, and this may greatly influence their financial management choices and their

ability to weather unfavorable economic times, especially during retirement. Moreover, even among those age 60 or 61, 39% indicated that they have too much debt. This poses serious questions on the ability of these respondents to pay off their debts while in retirement.

5. Lack of savings by pre-retirees makes them particularly vulnerable to unexpected shocks or emergencies that may arise. Only 36% of respondents reported that they probably or certainly could come up with $2,000 if an unexpected need arose within the next month. Lack of short-term savings is also often related to lack of long-term savings. For example, only 15% of pre-retirees without retirement accounts reported having emergency funds.
6. Only 47% of pre-retirees report having ever tried to figure out how much to save for retirement. Moreover, most pre-retirees who do not have retirement plans have also never considered how much savings is required.
7. Many of the behaviors mentioned can be traced back to a lack of financial literacy. In a time of increased individual responsibility for financial security, financial literacy has become an essential skill that people need in order to make sound financial decisions.

Acknowledgments

We would like to thank Erica Soultanian and Heather Hedges for excellent research assistance. We are also grateful to the Filene Research Institute for financial support. All errors are our responsibility.

References

Butrica, B., & Karamcheva, N. (2013). *Does household debt influence the labor supply and benefit claiming decisions of older Americans?* (Boston College Center for Retirement Research Working Paper No. 2013–22). Boston, MA: Boston College Center for Retirement Research.

Economist. (2008). The end of the affair. America's return to thrift presages a long and deep recession. Retrieved from http://www.economist.com/node/12637090 (accessed November 20, 2015).

FINRA Investor Education Foundation. (2012). 2012 National Financial Capability Study. Retrieved from http://www.usfinancialcapability.org/ (accessed November 20, 2015).

Lusardi, A. (1999). Information, expectations, and savings for retirement. In H. Aaron (Ed.), *Behavioral dimensions of retirement economics* (pp. 81–115). Washington, DC: Brookings Institution and Russell Sage Foundation.

Lusardi, A., & de Bassa Scheresberg, C. (2013). *Financial literacy and high-cost borrowing in the United States* (NBER Working Paper No. 18969). New York: National Bureau of Economic Research.

Lusardi, A., & Mitchell, O. S. (2011). Financial literacy and planning: Implications for retirement wellbeing. In O. S. Mitchell, and A. Lusardi (Eds.), *Financial literacy: Implications for retirement security and the financial marketplace* (pp. 17–39). Oxford: Oxford University Press.

Lusardi, A., & Mitchell, O. S. (2013). *Debt and debt management among older adults* (GFLEC Working Paper No. 2013-2). Washington, DC: Global Financial Literacy Excellence Center.

Lusardi, A., & Tufano, P. (2015). Debt literacy, financial experiences and overindebtedness. *Journal of Pension Economics and Finance*, 14, 329–365.