The TIAA Institute-GFLEC Personal Finance (P-Fin) Index

Annamaria Lusardi, GFLEC
Noemi Oggero, GFLEC
Paul Yakoboski, TIAA Institute

April 27, 2017

Agenda

What is the *Personal Finance (P-Fin) Index*?

- What makes it unique?
- Methodology

Findings

- Overall personal finance knowledge
- Knowledge in functional areas of personal finance
- Correlation with behavior and outcomes

Implications

Financial decisions in life

Routine decisions
- Where to shop and what to buy?
- Cook dinner or eat out?

Decisions made that are rarely revisited
- Choosing the deductible on car insurance, on homeowner’s insurance.
- Choosing a bank.

Decisions made on a regular, periodic basis
- Vacation or staycation?
- Health insurance annual enrollment.

Decisions inevitably revisited with time
- Where to live? Rent or own? Fixed or adjustable rate mortgage? Refinance?
- Lease or purchase, new or used car?

Decisions with both short- and long-term consequences
- Go to college? Which college? How to pay?
- Using credit and credit cards.
- When, how and how much to save for various needs?

What is it?

The *Personal Finance Index* (*P-Fin Index*) measures knowledge and understanding which enable sound financial decisionmaking and effective management of personal finances.

- Relates to common financial situations that individuals encounter and, in that sense, can be viewed as a gauge of "working knowledge."
- Based on a 28-question survey fielded among a representative sample of U.S. adults.
- Annual project that will result in cross-sectional trend data.
- Includes an oversample of a particular demographic subgroup each year.

The *P-Fin Index*

Hasn't this been done?

- The *P-Fin Index* builds from existing research on financial literacy and capability, but is distinguished by the breadth of topics that it covers.

- The *P-Fin Index* evaluates financial literacy across eight areas of personal finance in which individuals routinely function.
  - These areas are consistent with the National Standards for Financial Literacy outlined by the Council for Economic Education.
  - This provides the framework for a 28-question survey, with 3 or 4 questions devoted to knowledge and understanding in each functional area.
  - Previous studies constrained to smaller question sets focused on fundamental concepts.

- This design results in:
  - A robust indicator of overall financial literacy.
  - The ability to compare personal finance knowledge across functional areas.
  - The ability to make comparisons across demographic groups.

- The survey also collects information about household finances and financial behavior, thus enabling examination of the relationship between knowledge and outcomes.

Functional areas	Description
Earning	Determinants of wages and take-home pay
Consuming	Budgets and managing spending
Saving	Factors that maximize accumulations
Investing	Investment types, risk and return
Borrowing	Relationship between loan features and repayments
Insuring	Types of coverage and how insurance works
Comprehending risk	Understanding uncertain financial outcomes
Go-to information sources	Recognizing appropriate sources and advice

Methodology

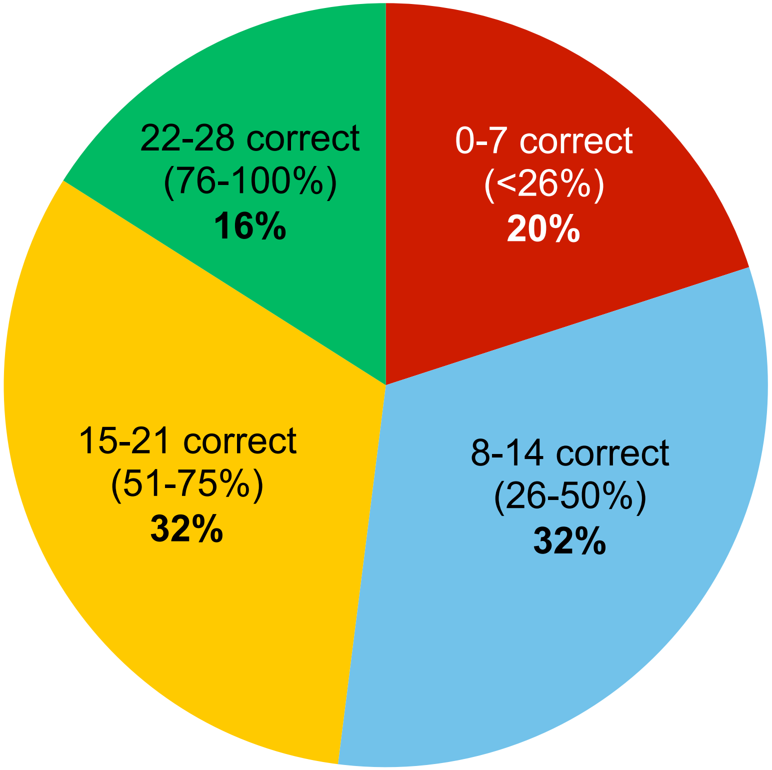
- The *P-Fin Index* is based on responses to 28 questions.
  - 3 or 4 questions devoted to each functional area.
  - Each question is multiple choice with four response options: the correct answer, two incorrect answers and "don't know."
- Initial wave of the survey was fielded online in September 2016 with a nationally representative sample of 1,043 U.S. adults, ages 18 and older.
- Sample was drawn from GfK's KnowledgePanel.
  - Large-scale probability-based online panel.
  - First online panel to recruit households by randomly selecting residential addresses rather than relying on traditional random-digit dialing; entire panel now based on address-based sampling.
  - Online access provided to panel members where necessary, but panelists are unable to participate using mobile devices.

TIAA Institute GFLEC GLOBAL FINANCIAL LITERACY EXCELLENCE CENTER

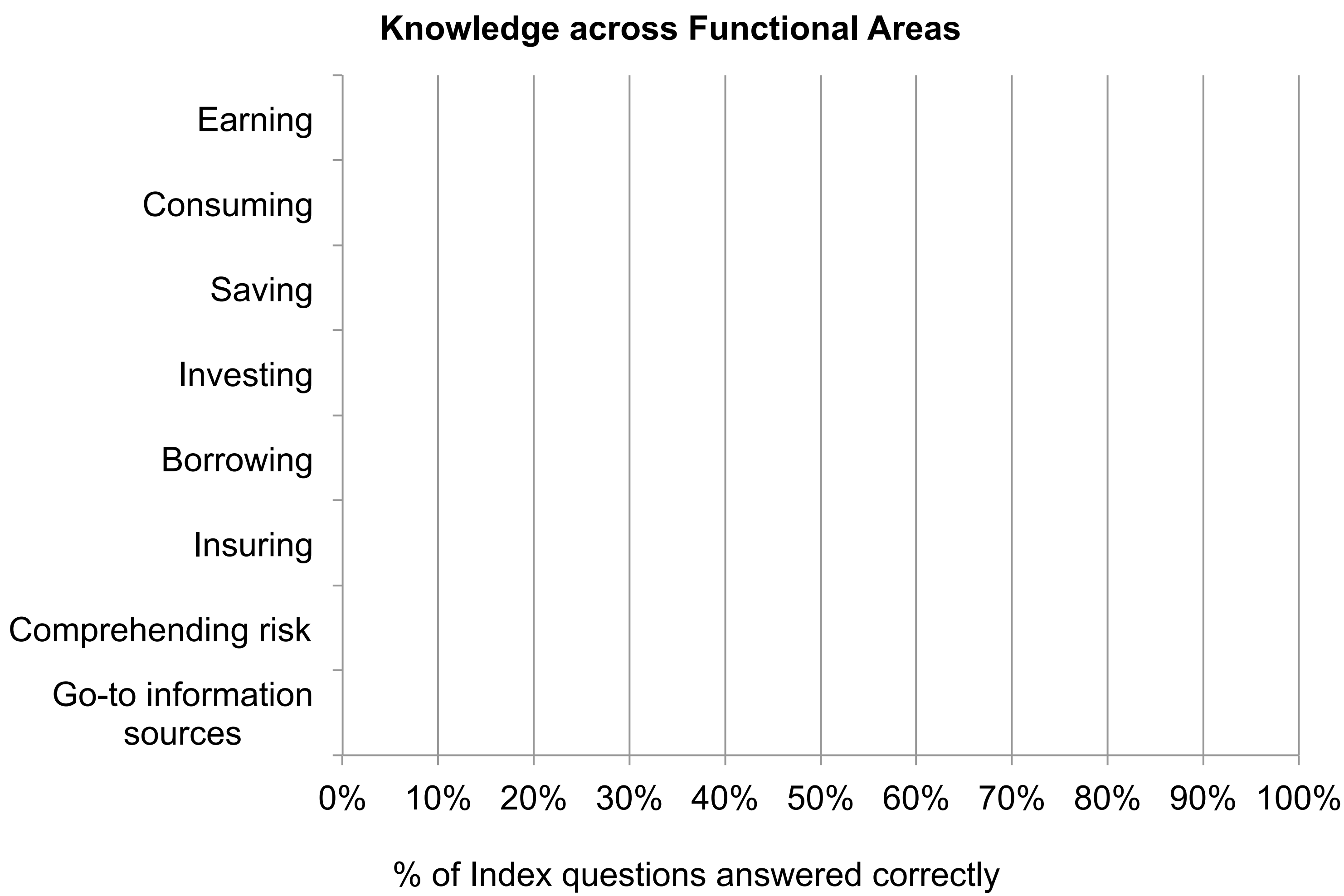
Gender	Male	48%	Work status	Retired	27%
	Female	52		Not retired	73
			Among those not retired		
Age	18-29	17		Employed	81
	30-44	26		Homemaker or student	11
	45-59	28		Unemployed or temporary lay-off	4
	60-plus	29		Disabled, not able to work	4
Race	White	65	Household income	Less than $25,000	16
	Non-white	35		$25,000-$49,999	21
				$50,000-$99,999	31
Education	Less than HS degree	11		$100,000 or more	32
	High school degree	29			
	Some college	28	Financial Education	Received financial education	28
	College degree	32		No financial education	72

P-Fin Index findings

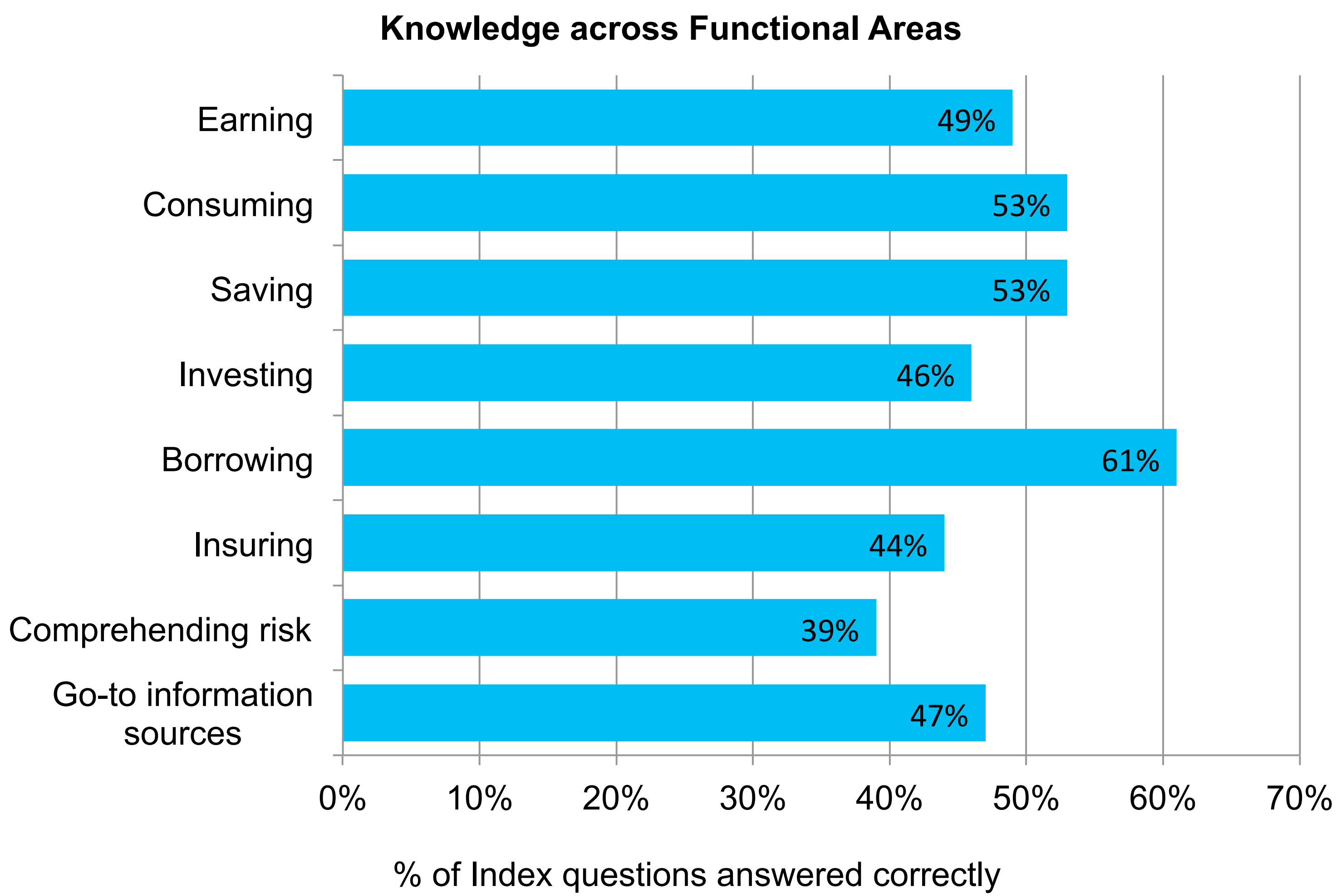
Distribution of Correct Answers to Index Questions Among U.S. Adults



P-Fin Index findings



P-Fin Index findings

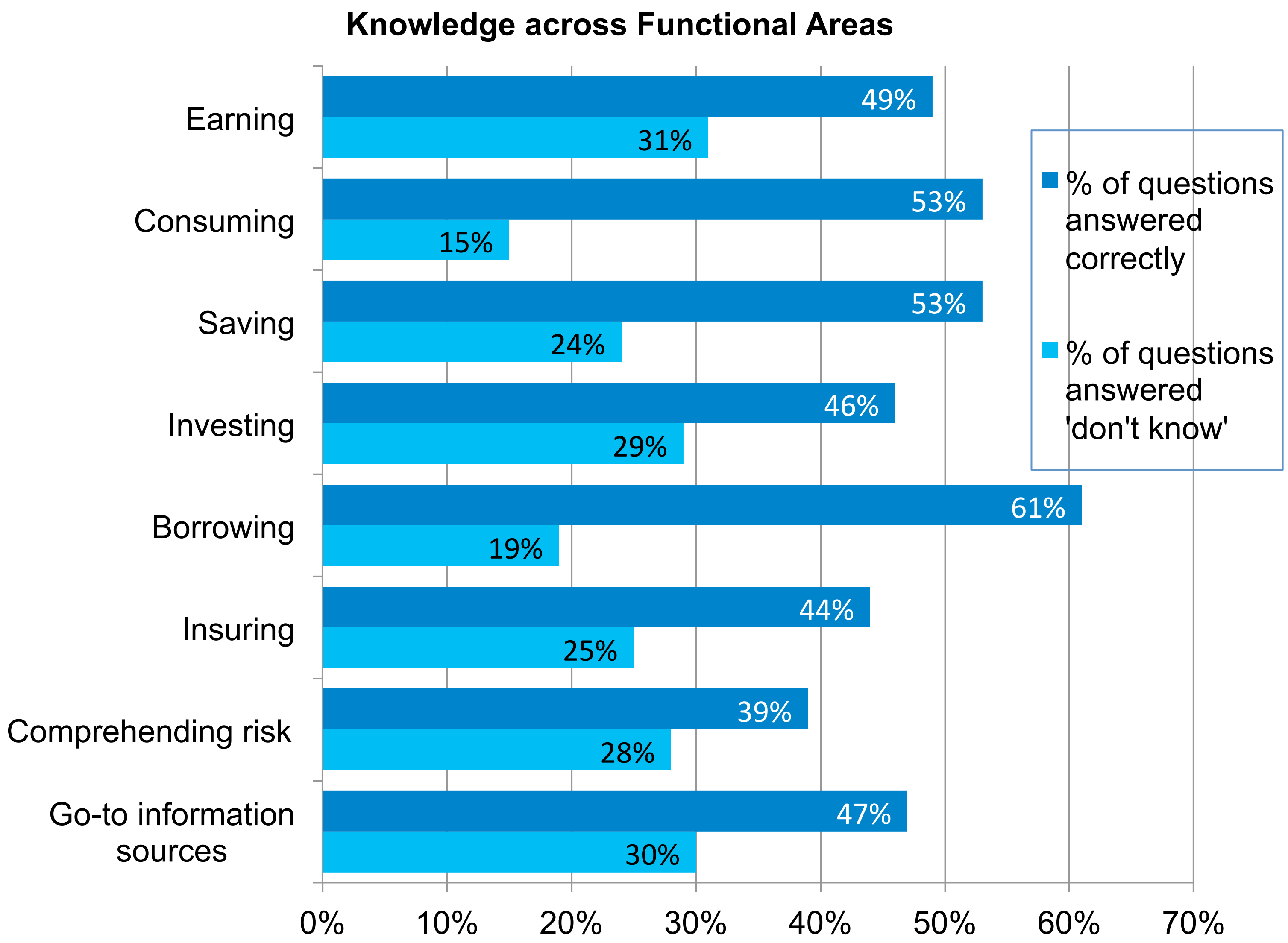


Comprehending risk

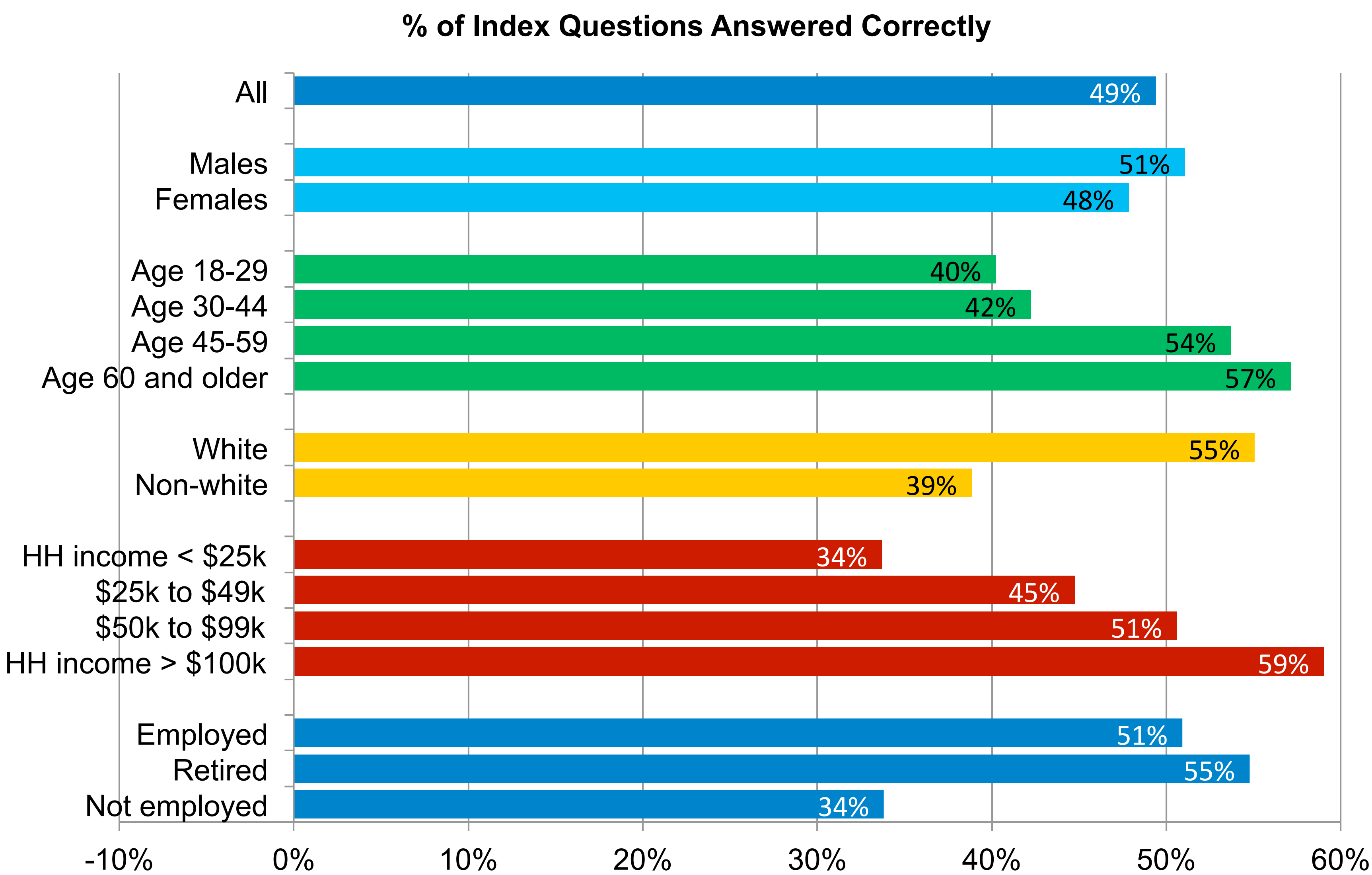
There's a 50/50 chance that Malik's car will need engine repairs within the next six months which would cost $1,000. At the same time there is a 10% chance that he will need to replace the air conditioning unit in his house, which would cost $4,000. Which poses the greater financial risk for Malik?

- ***The car repair (correct answer; chosen by 41% of respondents)***
- *The air conditioning replacement (chosen by 19% of respondents)*
- *There is no way to tell in advance (chosen by 19% of respondents)*
- *Don't know (chosen by 20% of respondents)*

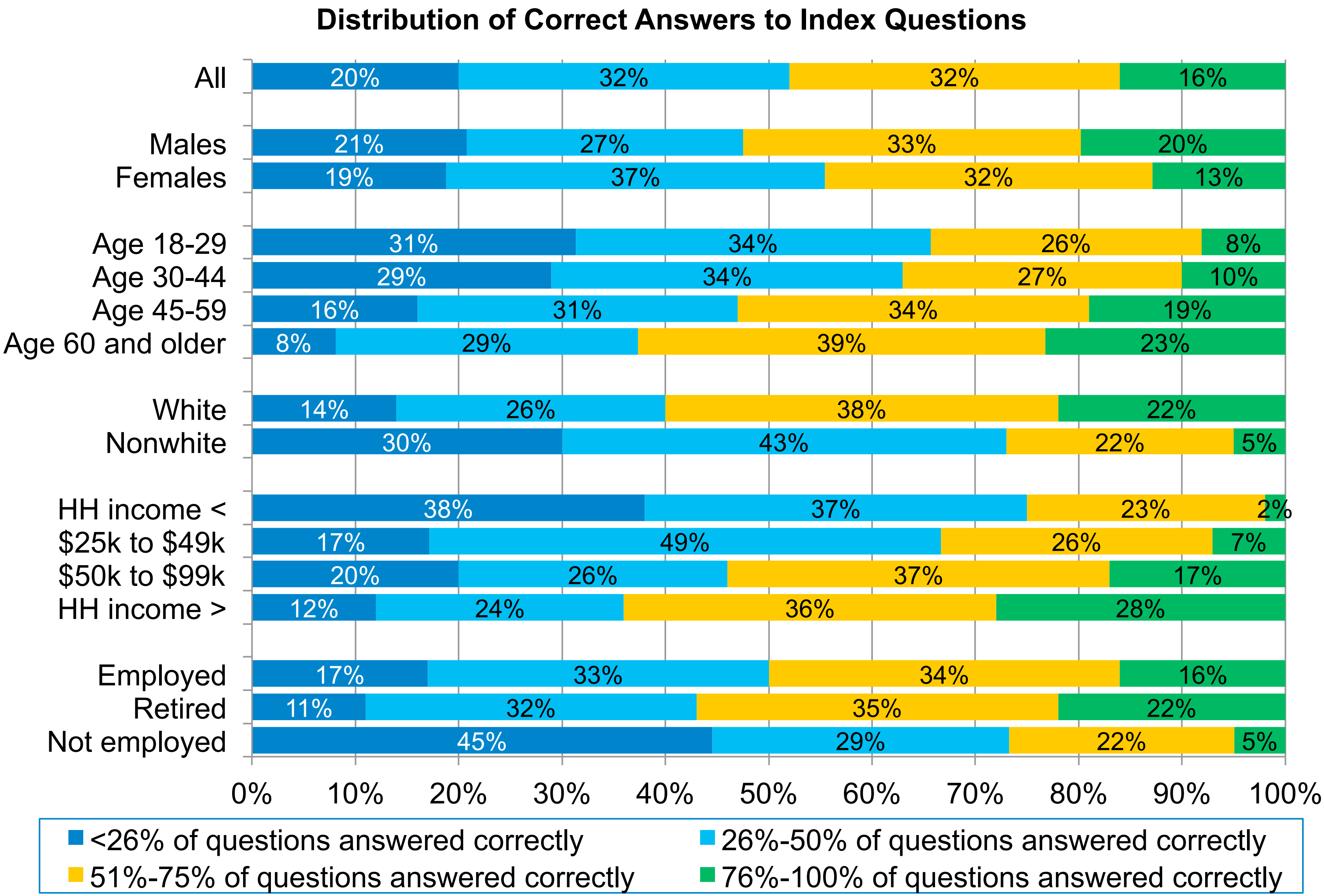
P-Fin Index findings



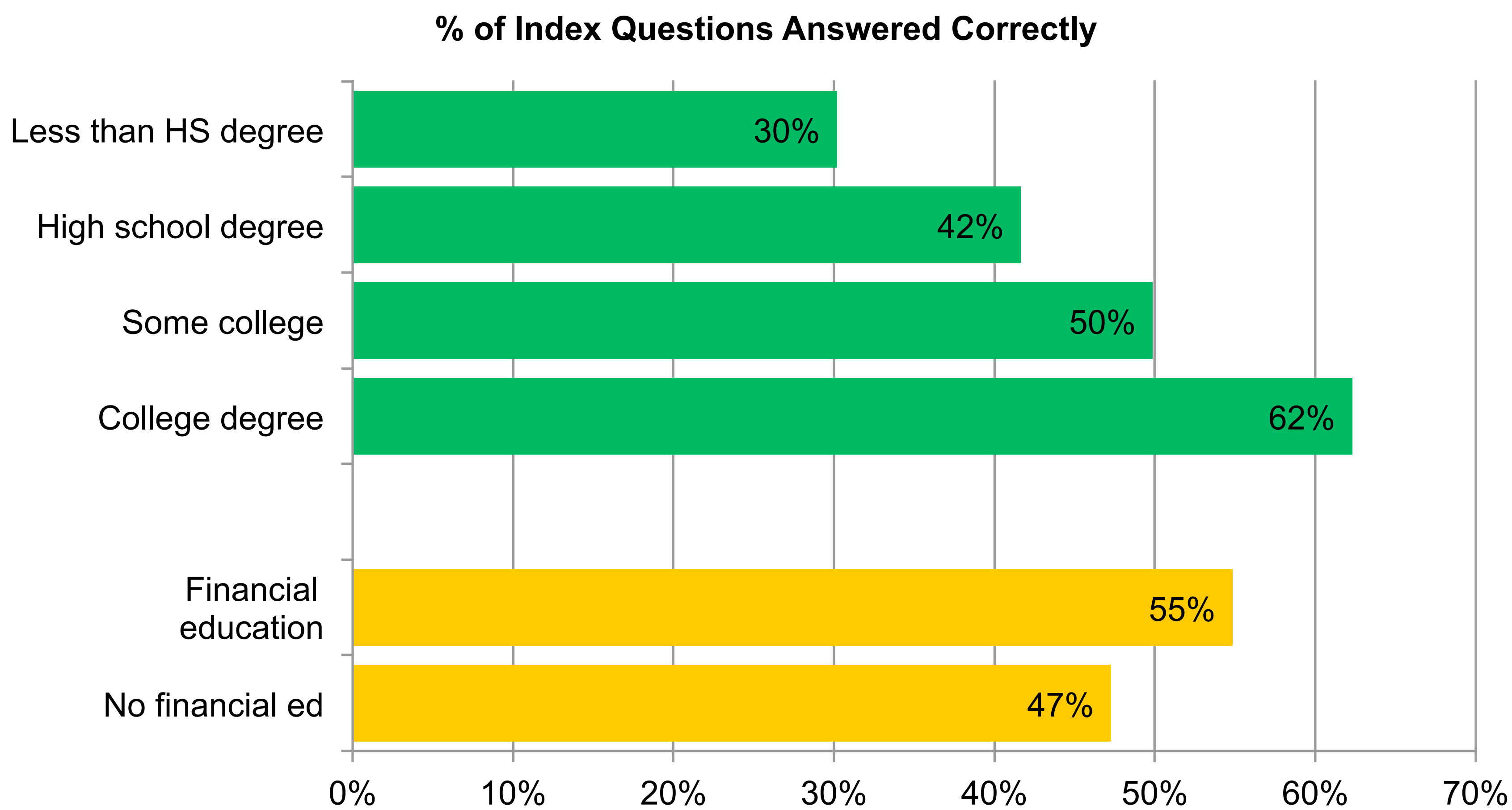
P-Fin Index findings



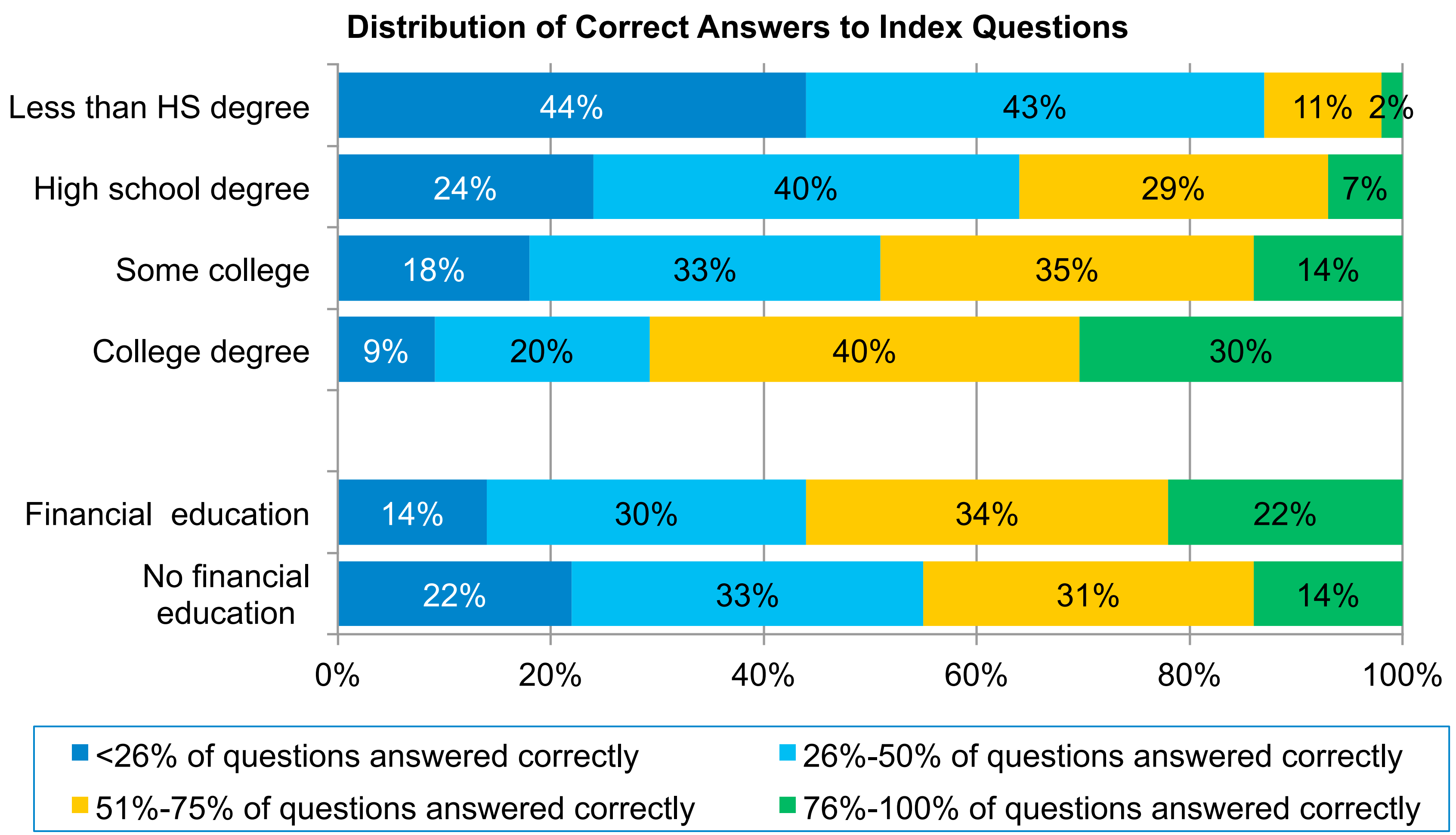
P-Fin Index findings



P-Fin Index findings



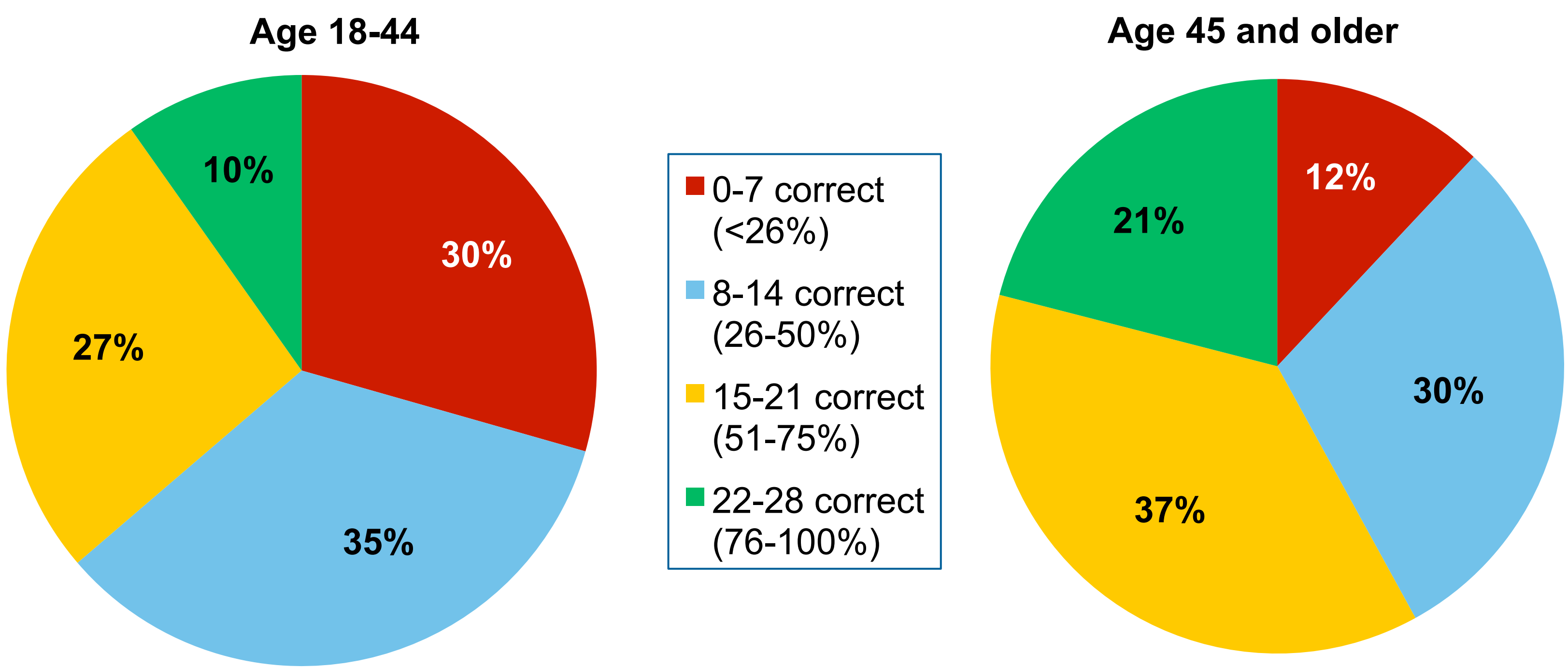
P-Fin Index findings



Young adult knowledge

TIAA Institute | GFLEC Global Financial Literacy Excellence Center

Distribution of Correct Answers to Index Questions

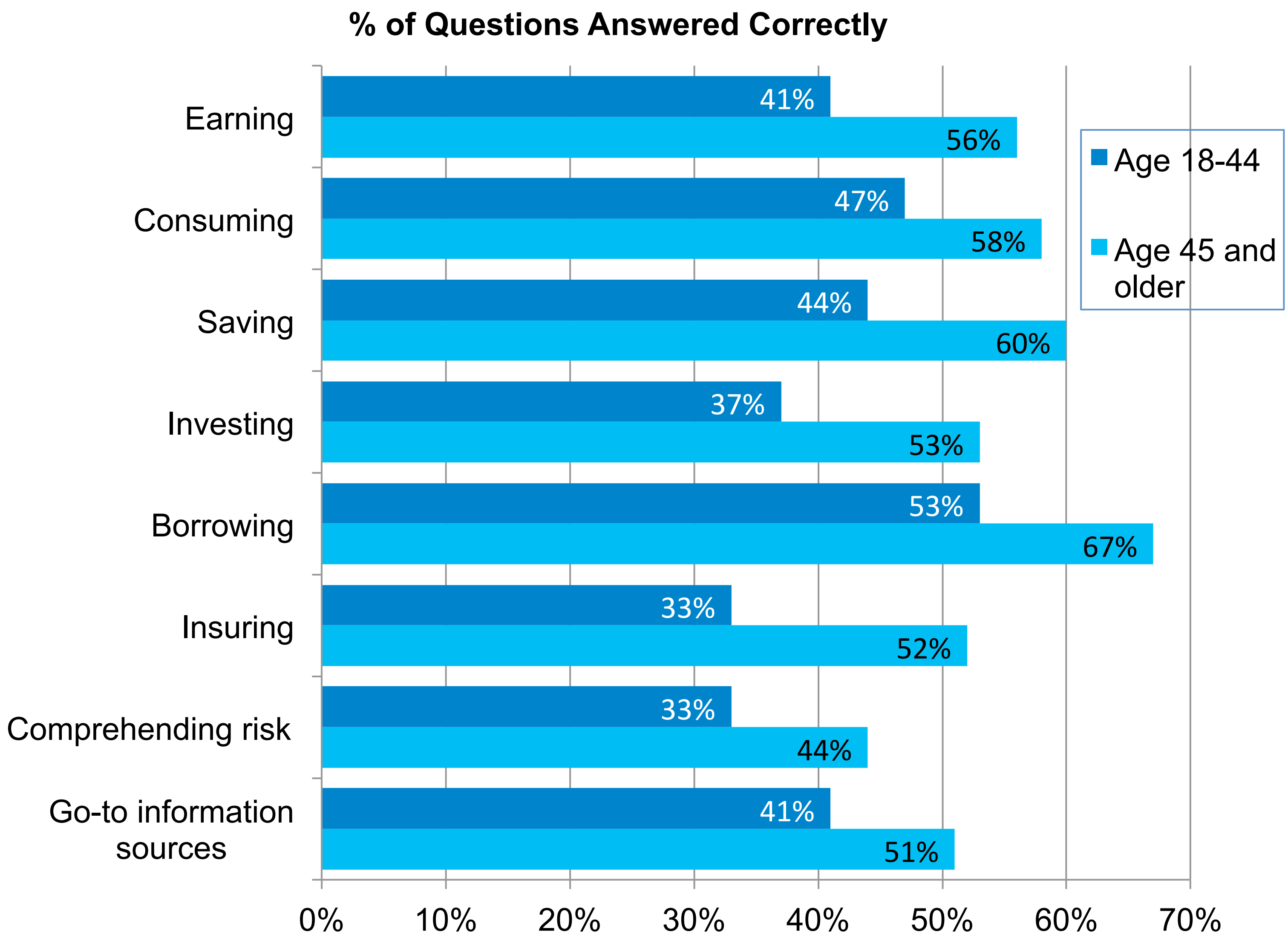


Young adult knowledge

Anna saves $500 each year for 10 years and then stops saving additional money. At the same time, Charlie saves nothing for 10 years but then receives a $5,000 gift, which he decides to save. If both Anna and Charlie earn a 5% return each year, who will have more money in savings after 20 years?

- ***Anna (correct answer; chosen by 44% of young adults)***
- *Anna and Charlie will have the same amount (chosen by 22% of young adults)*
- *Charlie (chosen by 6% of young adults)*
- *Don't know (chosen by 27% of young adults)*

Young adult knowledge



P-Fin Index key findings

- U.S. adults are split 50/50 between those who could and those who could not answer one-half of the *P-Fin Index* questions correctly.
- 16% of Americans demonstrated a relatively high level of personal finance knowledge and 20% have a relatively low level of knowledge.
- Uncertainty is inherent in the context of making financial decisions, but personal finance knowledge is lowest in the area of comprehending risk.
- Young adults confront a range of financial decisions with ramifications for their financial wellbeing, yet they are working from a limited base of personal finance knowledge.
    - The percentage of those under age 45 with a relatively low level of financial literacy (30%) is triple that with a relatively high level (10%.)
    - Comprehending risk and insuring are areas where young adult knowledge is lowest.

Compared to previous research

Demographic variations in the *P-Fin Index* data generally mirror previous research; more specifically, the findings that financial literacy…

- Is higher among men than women (Lusardi, Mitchell and Curto, 2010; Lusardi and Mitchell, 2009, 2014; Lusardi and Tufano, 2009, 2015).
- Tends to increase with age (Lusardi and Mitchell, 2011, 2011, 2014).
- Is higher among whites than nonwhites (Lusardi and Mitchell, 2007, 2007, 2009, 2011, 2014).
- Is positively correlated with both general education and financial education (Lusardi and Mitchell, 2007a, 2011c, 2014).

In addition, *P-Fin Index* results are consistent with research identifying risk-related concepts as the most difficult to grasp (Coppola et al., 2017; Lusardi and Mitchell, 2014).

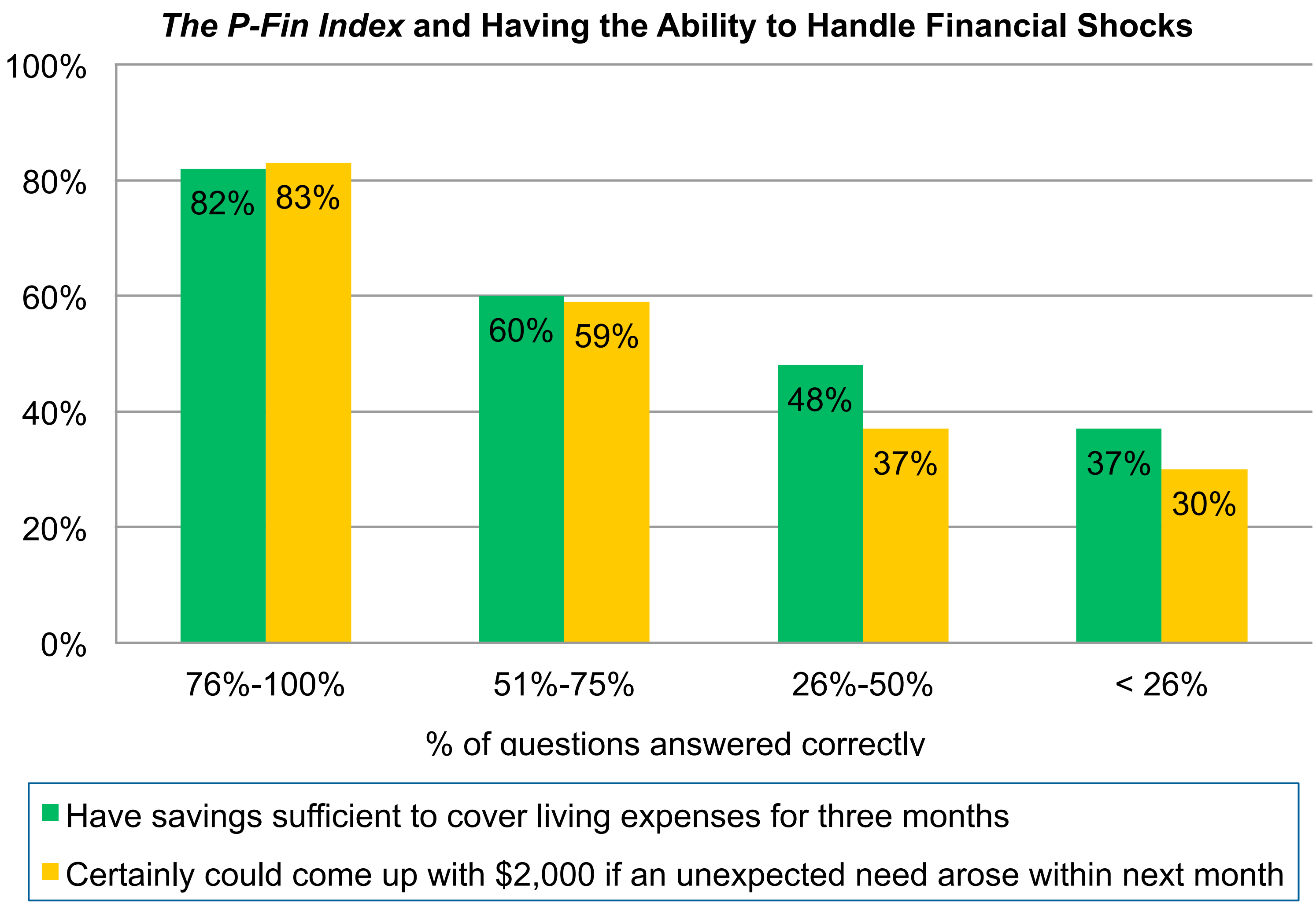
Compared to previous research

- Several P-Fin Index questions can be compared with other studies.
- This question tests understanding of interest compounding.
- Consistent with previous research, approximately 30% de facto underestimate the impact of interest compounding (Lusardi and Tufano, 2009, 2015).
- Also, the “don’t know” response rate is similar to the 25% figure found by the *2015 National Financial Capability Study*.

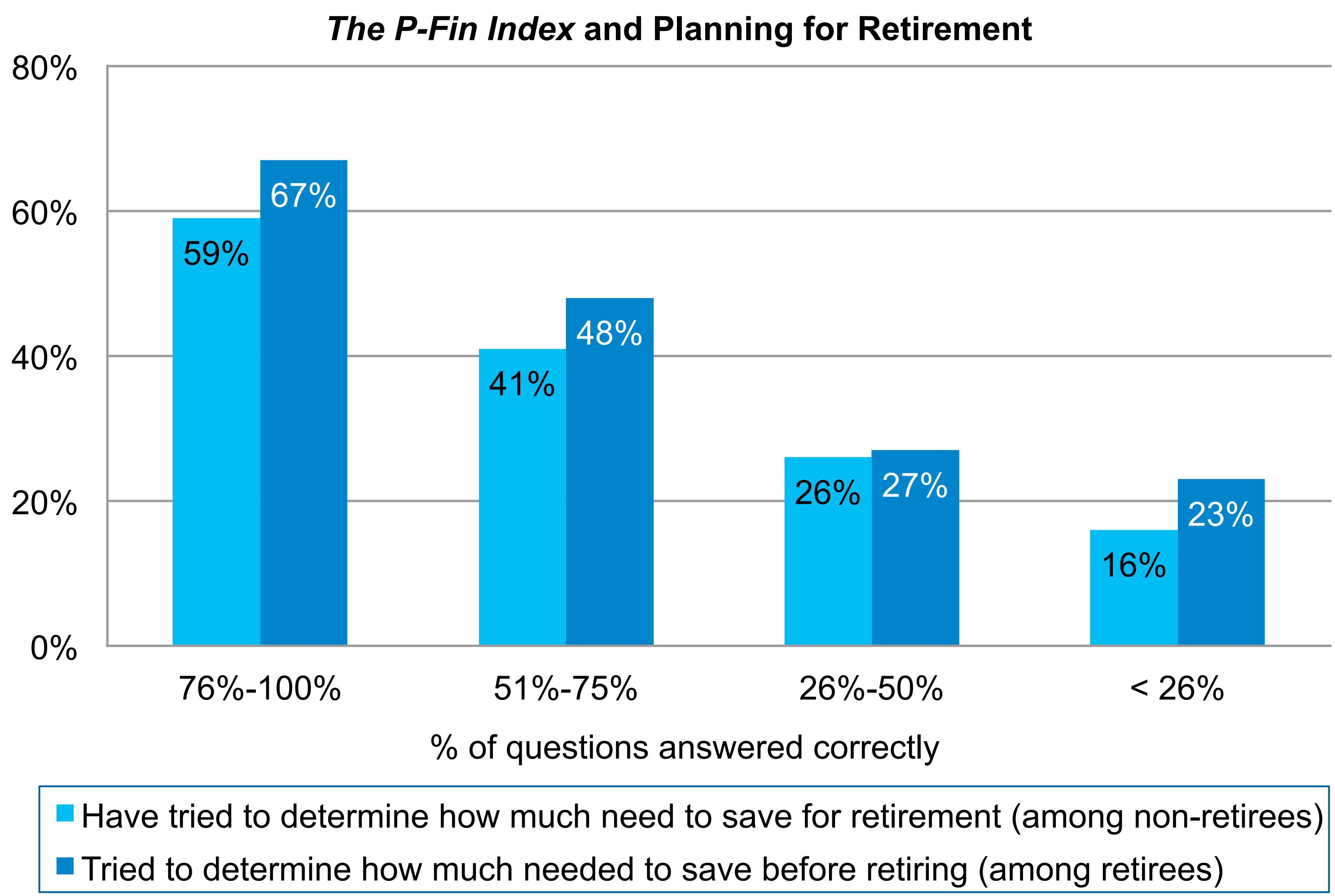
Jose owes $1,000 on a loan that has an interest rate of 20% per year compounded annually. If he makes no payments on the loan, at this interest rate, how many years will it take for the amount he owes to double?

- *Less than 5 years (correct answer; chosen by 43% of respondents)*
- *5 to 10 years (chosen by 20% of respondents)*
- *More than 10 years (chosen by 8% of respondents)*
- *Don’t know (chosen by 28% of respondents)*

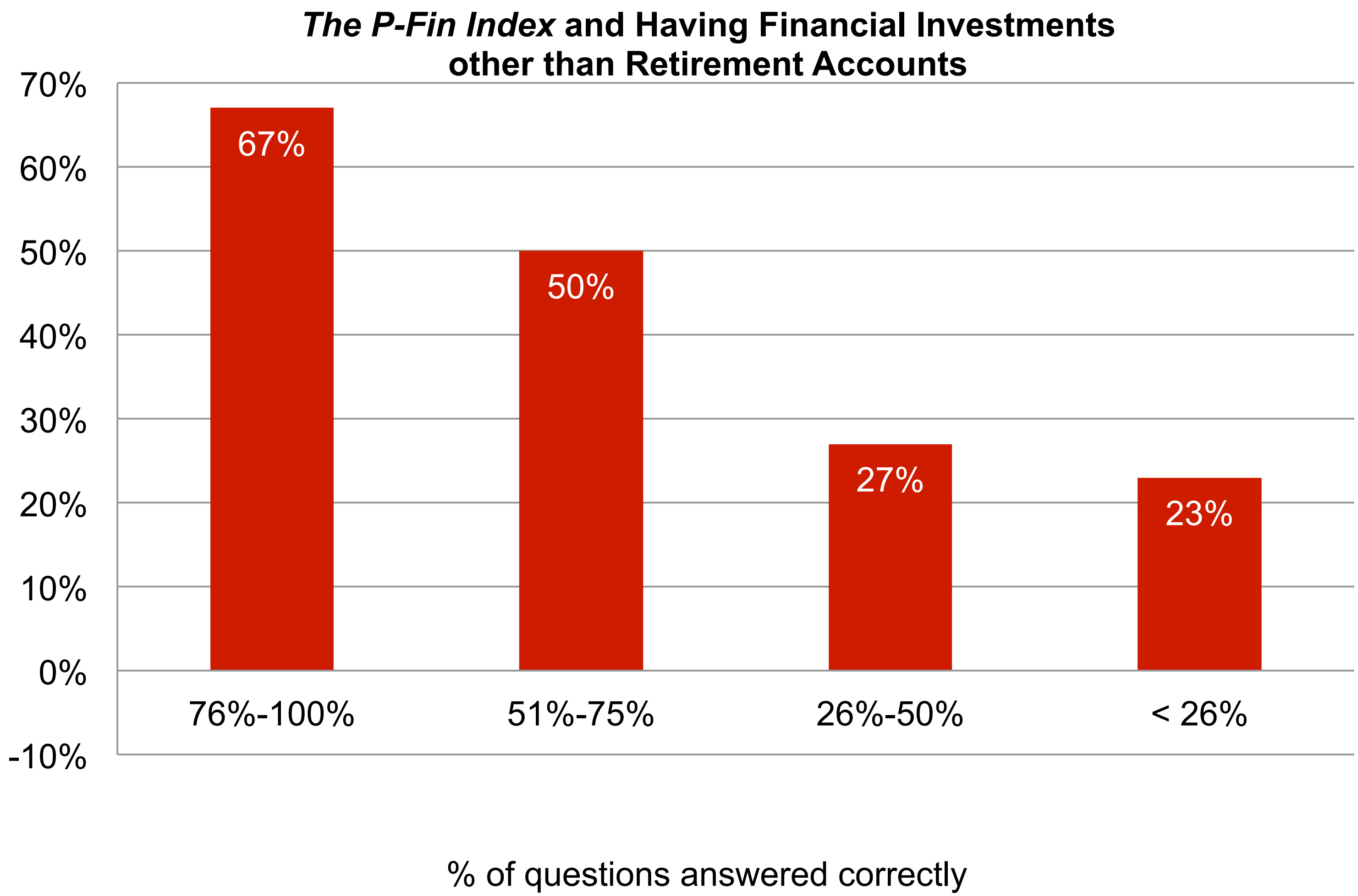
P-Fin Index and outcomes



P-Fin Index and outcomes



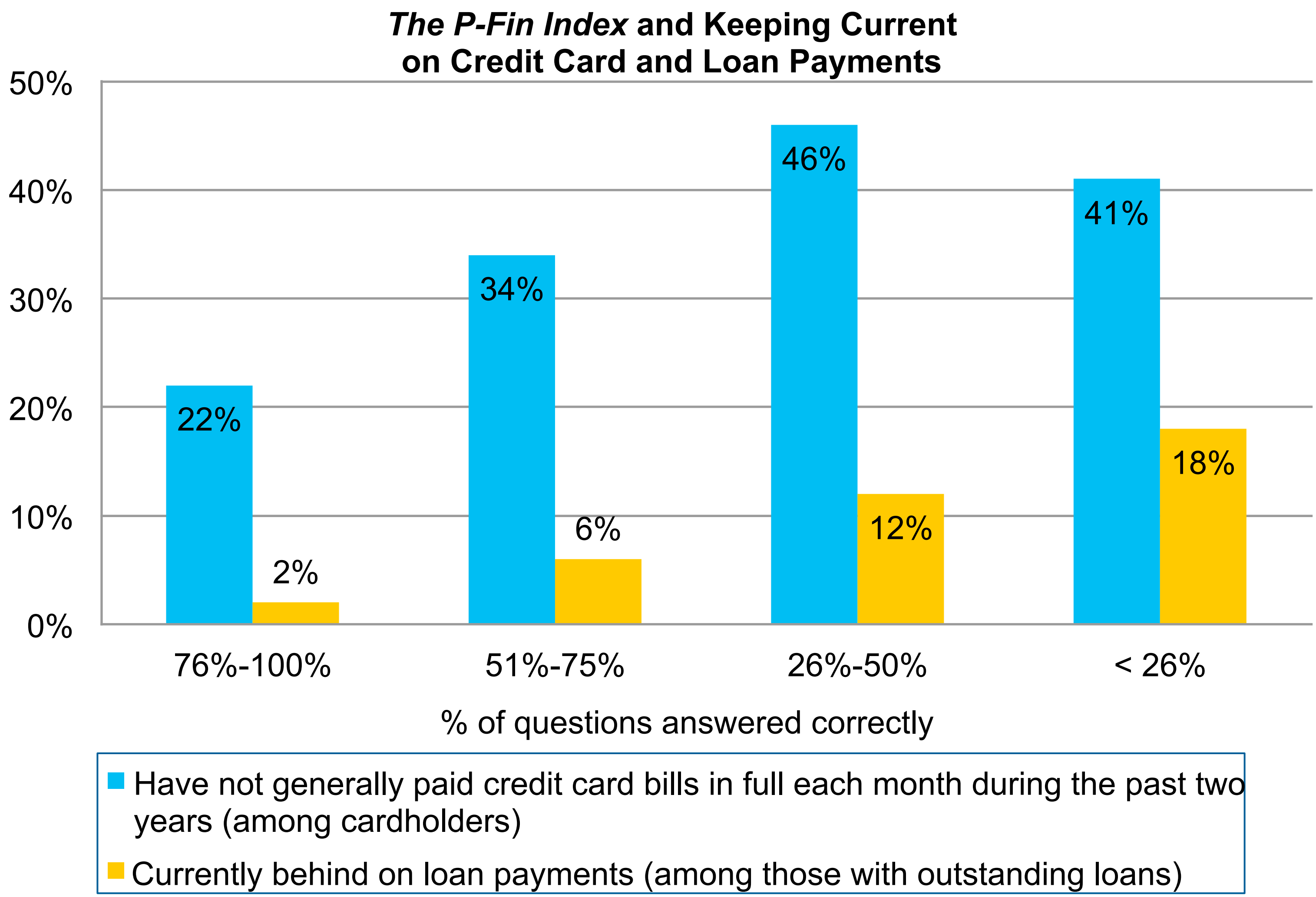
P-Fin Index and outcomes



P-Fin Index and outcomes

TIAA Institute

GFLEC GLOBAL FINANCIAL LITERACY EXCELLENCE CENTER



Implications

Individuals would benefit greatly from increased financial literacy levels at the beginning of their careers.

- High school and college would thus be ideal times for financial literacy programs.
- Understanding risk and uncertainty should be an area of emphasis.

Alternative strategies to improve financial behavior and outcomes—choice architecture and professional advice—are not substitutes for financial literacy.

- Best viewed as complements to improved financial literacy.
- Auto-enrollment increases retirement plan participation, but individuals should eventually manage their participation so it aligns with their specific circumstances.
- Previous research has shown that financial advice is a complement to financial knowledge; ideally, individuals would be proactive participants in any advice session.
- Receiving advice or nudges on every financial decision is simply not realistic.

TIAA Institute

The TIAA Institute provides the educational, nonprofit and public sectors with objective, actionable information needed to address strategic challenges. The Institute's areas of focus are financial security, higher education, and endowments and foundations. Through in-depth research, convenings, award programs and collaborations, the Institute produces knowledge and insights to better inform decisionmaking that creates real-world solutions to complex problems.

Global Financial Literacy Excellence Center (GFLEC)

GFLEC seeks to inform policy as well as develop and promote financial literacy programs around the world. GFLEC focuses on groundbreaking research, with particular emphasis on financial education in schools, the workplace and the community. It also engages in research that examines financial literacy among women and the young. GFLEC seeks to make research findings more accessible to policymakers and practitioners in order to help shape national and international dialogue around financial literacy.