

Behavioural Sciences and Investor Education Conference
Rio de Janeiro, December 8, 2016

Americans' Financial Capability

Prof. Annamaria Lusardi
The George Washington University School of Business
Academic Director, Global Financial Literacy Excellence Center



Background

- Several years after the financial crisis, how are families doing financially?
- Are Americans financially prepared, what is their financial capability?
- Taking the pulse of American families

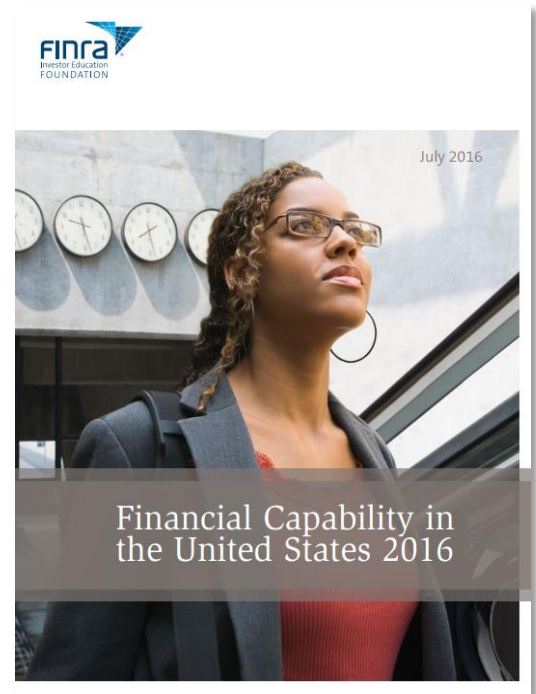
Scheme of presentation

- Americans' financial capability using data from the National Financial Capability Study (several waves including the most recent one in 2015)
- How research can help measure financial capability
- Applications to financial wellness programs

National Financial Capability Study (NFCS)

State-by-State Survey: Online survey of more than 25,000 respondents

- It started in 2009, 2nd wave in 2012, 3rd wave in 2015
- Survey offers unique information on financial literacy & capability
- The data provide an encompassing overview of households' finances
- New questions in recent waves



Framework

- Financial capability is measured by 4 key components:
 1. Short term money management
 2. Planning ahead
 3. Managing financial products
 4. Financial literacy

1. Short term money management

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.

From Lusardi and Tufano, BPEA, 2011

1. Short term money management

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.

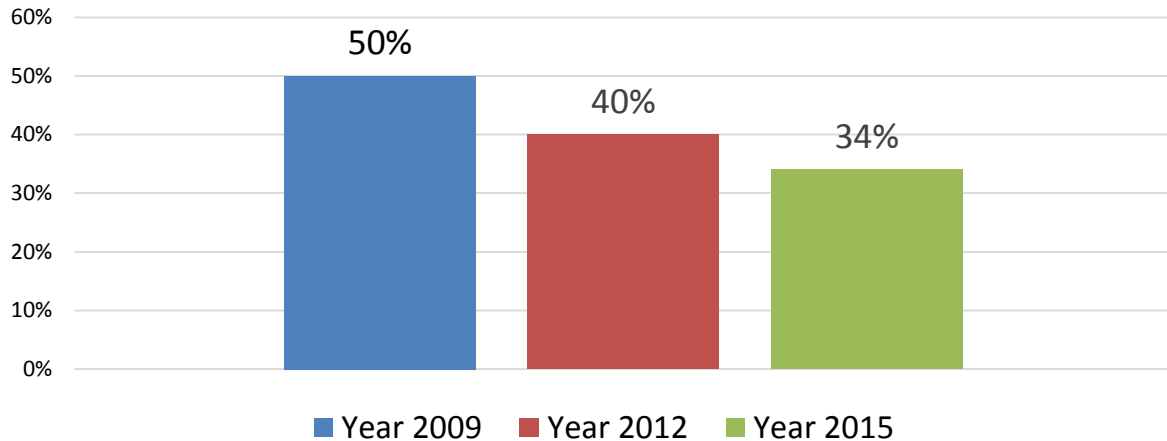


People with these responses are classified as financially fragile

From Lusardi and Tufano, BPEA, 2011

Financial fragility in the US

Financial Fragility Over Time



- Combining 2009 TNS data with 2012 and 2015 NFCS data we see families are less financially fragile in 2015

Who are the most financially fragile?



Millennials (age 23-35)

- **38%** of Millennials are financially fragile

Who are the most financially fragile?



Women

- **39%** of American women are financially fragile vs. **28%** of men

2. Planning ahead

Retirement planning

- Have you ever tried to figure out how much you need to save for retirement?*
- Yes
- No
- Don't know
- Prefer not to say

* Or, if already retired: Before you retired, did you try to figure out how much you needed to save for retirement?

2. Planning ahead

Retirement planning

- Have you ever tried to figure out how much you need to save for retirement?*

- Yes



People with this response
are classified as planners

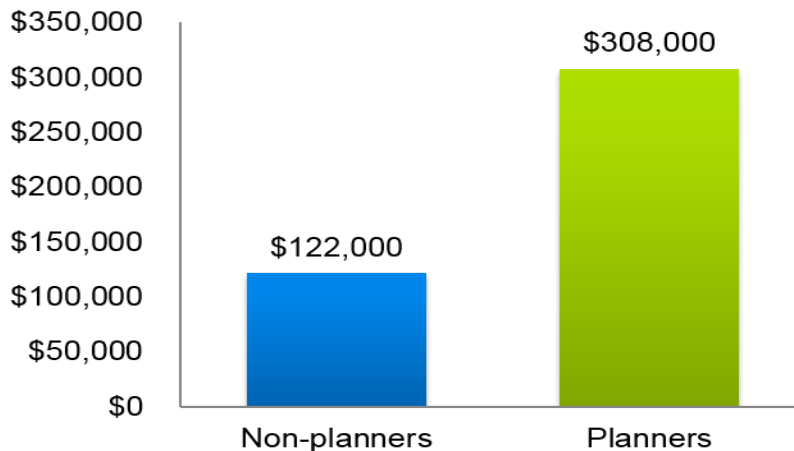
- No

- Don't know

- Prefer not to say

* Or, if already retired: Before you retired, did you try to figure out how much you needed to save for retirement?

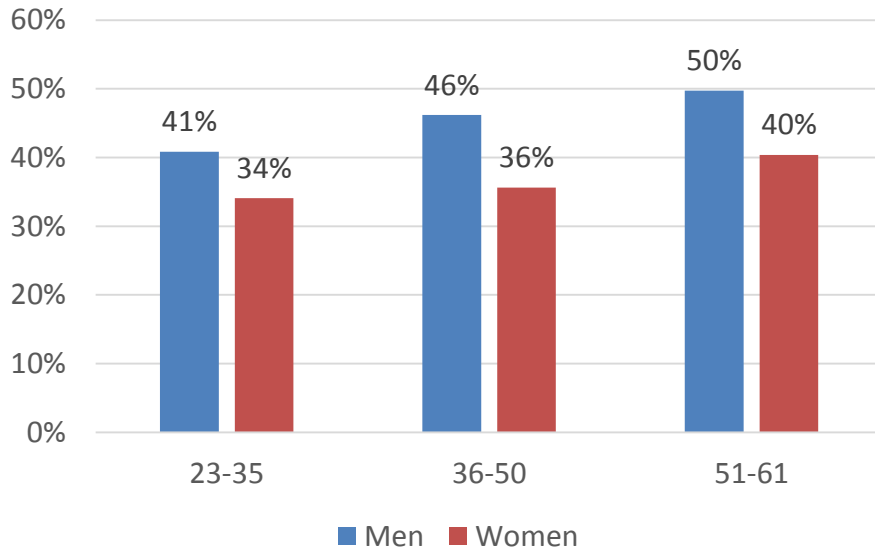
Retirement planning is a strong predictor of wealth



Median Net Worth, age 50+
Source: 2004 Health & Retirement Study

- Planners accumulate about three times the amount of wealth of non-planners (Lusardi and Mitchell, 2011)

Retirement planning by age and gender



- Retirement planning slightly increases over the life-cycle
- Women are less likely to plan than men

3. Managing financial products

Indebtedness

- 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

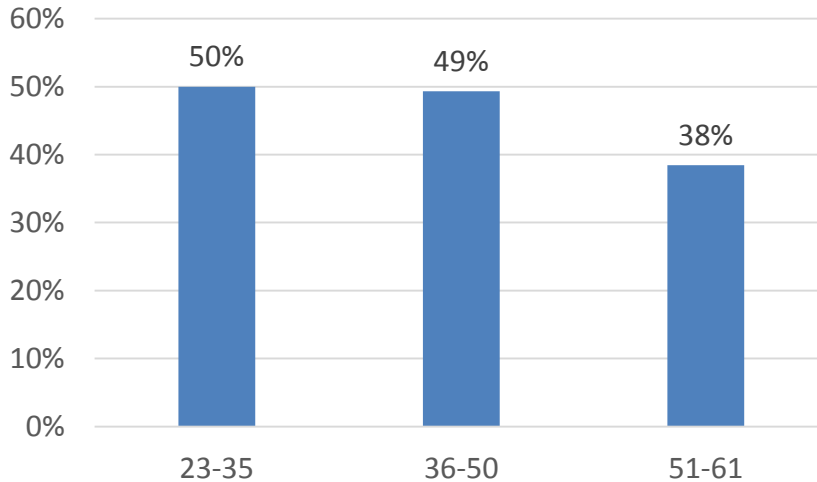
3. Managing financial products

Indebtedness

- 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
- People with these responses are classified as over-indebted

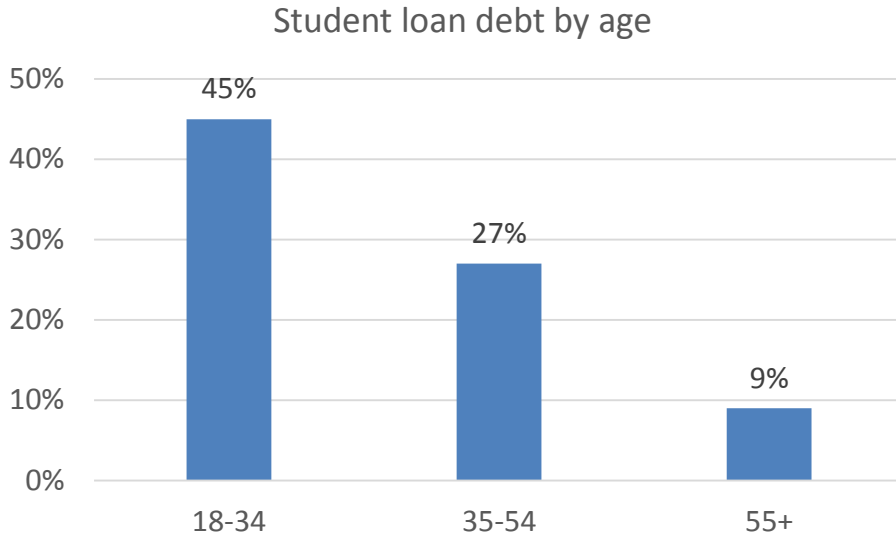
Who are the most over-indebted?

Over-indebtedness by age



- Over-indebtedness decreases over the life-cycle
- But still 38% of people close to retirement feel over-indebted

Long-term debt: Student loans

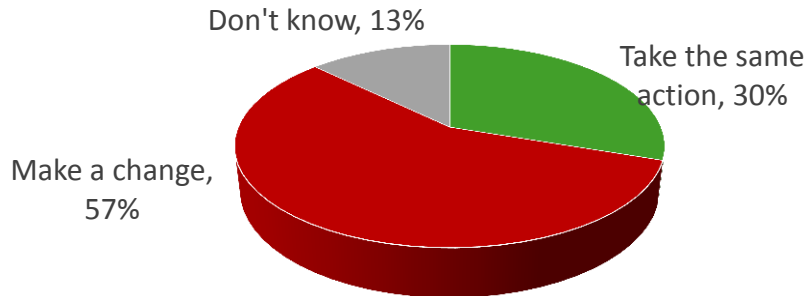


- Student loans are much more prevalent among the young
- But many individuals carry student loan debt late in life

Student loans: Focus on Millennials (age 23-35)

- The majority of those with student loans would make a change in their decision

If you could go through the process of taking out loans to pay for your education all over again, would you take the same actions or make a change?



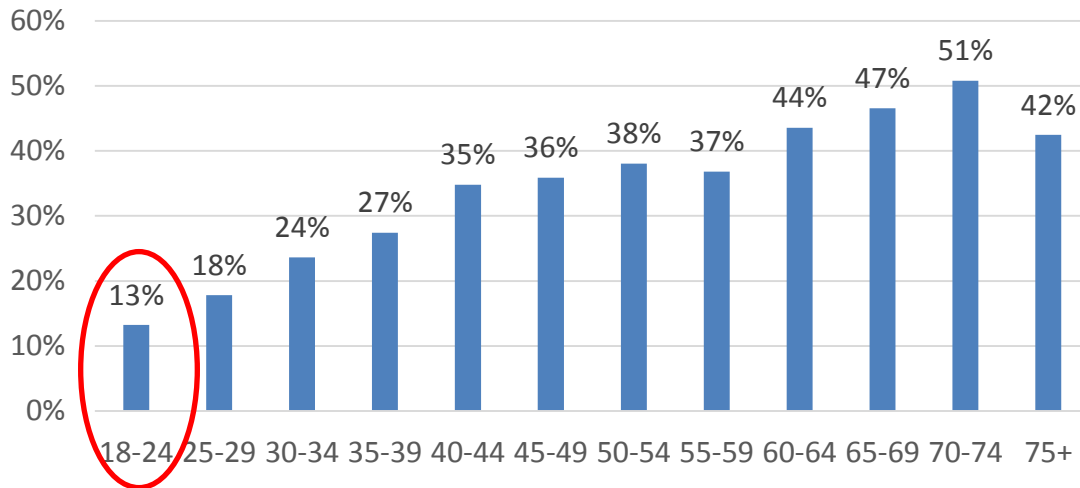
Note: The statistics are conditional on having a student loan.

4. Financial literacy

- Three simple questions:
 - Numeracy/interest rate
 - Inflation
 - Risk diversification
- *Being financially literate*: How many can answer these 3 questions correctly?
- These 3 questions have been used in 15 countries: Financial Literacy around the World (FLAT World) project

Financial literacy by age in the United States

2015 National Financial Capability Study
(% answering 3 questions correctly)



Building block approach

To promote financial capability, we need to address many needs

First building block:

- Precautionary savings

Second building block:

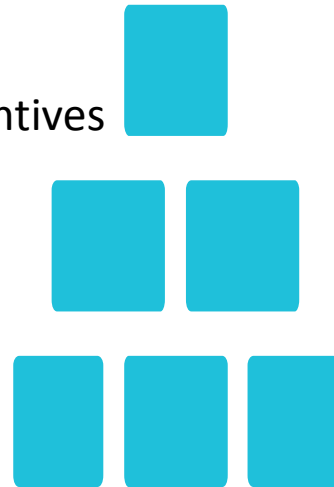
- Planning and taking advantage of tax incentives and employer matches

Third building block:

- Debt and debt management

Fourth building block:

- Higher financial literacy



A simple analogy

- A check-up is necessary for people to understand if they are doing well
- A financial check-up should look at financial capability (not just one variable)
- Important to do prevention



What can be done to improve financial capability

How research can inform policy and programs:

- 1. Financial literacy is very low**
 - We are at a crisis level
- 2. Some segments of the population are more vulnerable**
 - E.g., the young and the women
- 3. One size does not fit all**
 - We need more targeted programs, particularly for vulnerable groups
- 4. One-time financial education programs are not going to be effective**
 - Robust interventions are necessary



Targeting Millennials: 5 steps to planning success

Our research-based programs:

- Are targeted to young workers
- Use new methods of communication
- Keep the message free of economic/ finance jargon (helpful especially for women)
- Cover concepts that people know the least, such as risk diversification, in a simple story



Our initiatives for the workplace

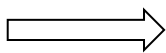
Our **Workplace Financial Wellness** describes the financial wellness programs we have designed based on our research

<http://gflec.org/initiatives/workplace-financial-wellness/>



Concluding remarks

- Several years after the financial crisis, the finances of many families have not recovered
- Need to step up the effort for financial wellness
- Many programs have proved effective



GFLEC can help design solutions