

**REPORT**

# **Financial Capability Near Retirement: A Profile of Pre-Retirees**

## ***Evidence from the 2012 National Financial Capability Study***

Carlo de Bassa Scheresberg, Senior Research Associate, Global Financial Literacy Excellence Center, George Washington University

Annamaria Lusardi, Denit Trust Distinguished Scholar and Academic Director, Global Financial Literacy Excellence Center, George Washington University

## **ACKNOWLEDGMENTS**

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With special thanks from the authors to Erica Soultanian and Heather Hedges for their invaluable research assistance.

Filene thanks our generous supporters for making this important research possible.

The logo for Fiserv, featuring the word "fiserv." in a bold, lowercase, orange sans-serif font.

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# Executive Summary

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## Overview

Risky spending behaviors, high debt, and financial illiteracy are jeopardizing the financial futures of many pre-retirees. As these individuals inch closer to retirement, credit unions must work with them to prevent any potential economic shocks that result from poor retirement planning.

## MEET THE AUTHORS



**Carlo de Bassa Scheresberg**

Senior Research Associate,  
Global Financial Literacy  
Excellence Center, George  
Washington University



**Annamaria Lusardi**

Denit Trust Distinguished  
Scholar and Academic  
Director, Global Financial  
Literacy Excellence Center,  
George Washington  
University

The retirement landscape is undergoing a tectonic shift, and the resulting earthquake threatens the well-being of working Americans. Now, more than ever, everyday workers are on the hook for their own retirement planning. In 1985, four out of five employees of midsize and larger firms participated in a defined benefit (DB) or pension plan, while only two in five took advantage of a defined contribution (DC) plan like a 401(k). Twenty-five years later, only 30% of employees were still in pension arrangements, and more than half had DC plans (Employee Benefit Research Institute 2011).

Both DB and DC plans have their merits, but this unrelenting shift means that those approaching retirement increasingly must understand and plan for their own financial needs. By and large, they are not very good at it.

## What Is the Research About?

This report shows how pre-retirees—those between 51 and 61 years of age—face a number of financial challenges. Authors Carlo de Bassa Scheresberg and Annamaria Lusardi from the Global Financial Literacy Excellence Center at George Washington University use financial capability data from the 2012 National Financial Capability Study to highlight the troubling prevalence of long-term debt among individuals who are close to retirement. In addition, the data show that many pre-retirees use expensive credit card borrowing, lack both short-term and long-term financial management and planning, and use financial advice only sparingly:

- ➔ Nearly 30% of pre-retirees do not have a retirement plan or account.
- ➔ Sixty percent of pre-retirees have at least one source of long-term debt, and 26% have at least two.
- ➔ Nearly 40% of pre-retirees use credit cards expensively; the same percentage feel heavily indebted.
- ➔ The most important factor driving the increase in debt is the much higher value of primary-residence mortgages.
- ➔ One-fifth of pre-retirees have used alternative financial services, like payday loans or pawnshops, in the past five years.
- ➔ Only a minority of 51- to 61-year-olds have made provisions for rainy-day funds to carry them through unexpected economic shocks.

- ➔ Less than half of pre-retirees have even attempted to calculate the level of savings they will need once they stop working.

## What Are the Credit Union Implications?

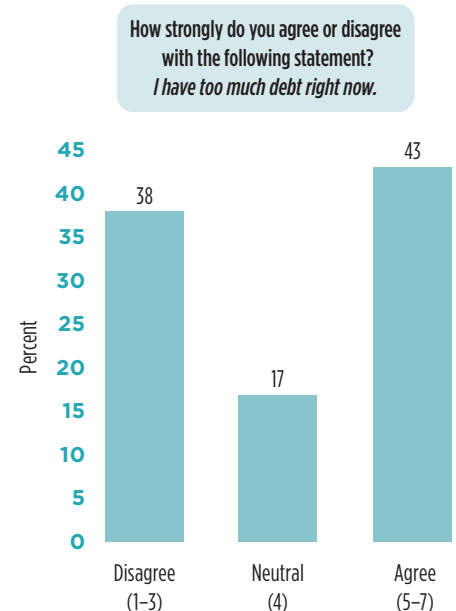
Credit unions cannot single-handedly solve these problems, but as member-owned cooperatives they can play a crucial role in braking some of the trends that lead to poor planning and risky borrowing behaviors:

- ➔ **Credit unions could work with pre-retirees to address problems of financial fragility and debt before retirement.** Use in-person and digital tools to address indebtedness and poor planning, not just investment accounts.
- ➔ **Financial advice specifically targeted to pre-retirees could be made more effective.** Use this report's data and insights about high debt, light savings, and delayed planning to improve marketing and advisory services.
- ➔ **Credit unions could help both pre-retirees and other individuals become aware of the need for retirement planning earlier in their careers.**

Encourage members to make regular contributions to retirement accounts and to address debt problems before they become unbearable.

These approaches will require credit unions to balance the legitimate need for profits against the well-being of their members. Independent of education, it's imperative that credit unions make their own loan and retirement products compelling and valuable, especially for members just starting their retirement planning.

### PRE-RETIREEES' PERCEIVED OVERINDEBTEDNESS



Note: N = 5,002. Percentages do not add up to 100% because “don’t know” and “prefer not to say” answers are excluded.

# Financial Capability Near Retirement: A Profile of Pre-Retirees

*Evidence from the 2012 National Financial  
Capability Study*



## CHAPTER 1

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# Introduction

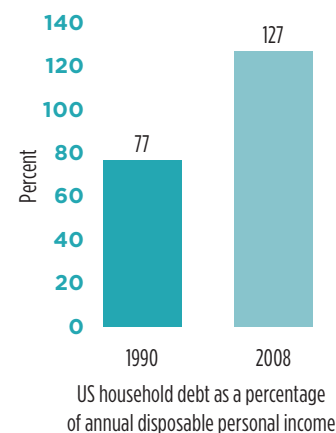
Many people envision a life of work that builds to comfortable and enjoyable retirement years. For previous generations, the financial security that marked that post-labor-force chapter hinged on how generous employers were with pensions or how well employers invested and managed retirement accounts. 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 recent decades, US households have become increasingly indebted and overleveraged, becoming highly vulnerable to financial shocks and economic downturns. On the verge of the Great Recession, US household debt as a percentage of annual disposable personal income was 127%, compared 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 American 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, and to understand the implications for credit unions, this study uses rich new data from the 2012 National Financial Capability Study (NFCS). We examine the responses of Americans aged 51–61 to a number of financial capability questions designed to gauge the financial condition of pre-retirees, their financial behaviors and decisions, and the factors that influence them. We also use the data to identify key demographic variances and to evaluate overall how the financial system can best serve the population of pre-retirees. The data portray a troubling picture of Americans close to retirement.

FIGURE 1

#### HOUSEHOLD DEBT CRISIS



## CHAPTER 2

# Literature Review

Thirty years ago, most Americans looked forward to post-employment years that were supported to a large degree by defined benefit (DB) retirement plans. Under the DB system, employers promised to provide specific retirement payments, usually based on salary and tenure formulas. Today, those pension schemes have been replaced by defined contribution (DC) plans that shift the responsibility of retirement planning from the employer to the employee. This readjustment has a serious downside: If individuals fail to save adequate funds for retirement, they face a financially fragile future. Unfortunately, data show that a significant number of Americans nearing retirement *have* systematically failed to put aside enough money for their retirement. As an added concern, they have done so at a time when projected post-retirement costs for medical care, housing, and other necessities have risen dramatically relative to costs faced by prior generations of Americans.

The median retirement savings for workers aged 51–60 is \$49,000, just enough to replace approximately one year of income (Bricker et al. 2012). US retirees, of course, also have federal social security benefits to supplement their income and savings, but those payments average a mere \$1,269 per month (Social Security Administration 2013). This shortfall in retirement saving is compounded by the perilously high levels of debt that pre-retirees carry, a phenomenon that has accelerated in recent years. A recent study by Lusardi and Mitchell (2013) finds that recent generations of retirees are entering into retirement with increasing levels of debt, mostly due to the purchase of more expensive homes with smaller down payments. Similarly, Fellowes and Spiegel (2013) show that during 2010–2011 over 40% of individuals aged 50 or older added more debt to their family balance sheet than they contributed as savings to their retirement accounts. The monthly debt obligations of near-retirement households (occupied by workers aged 50–65) dependent on DC plans swelled by 69% between 1992 and 2010 and now account for 22 cents of every dollar earned. In addition, people carry debt until late in the life cycle. More than half (55%) of the US population aged 55–64 have a home mortgage; about the same fraction (50%) hold credit card debt (Bucks et al. 2009).

Compounding this are findings that, as they age, Americans have more trouble managing debt and other financial matters (FINRA 2006, 2007). Research has identified a U-shaped pattern when assessing financial literacy by age. Literacy levels start low, peak at midlife, and then decline again among senior citizens. Decision-making patterns found among the youngest and oldest consumers reflect their low levels of knowledge in 10 financial areas, among them credit card balance transfers, home equity loans and lines of credit, auto loans, credit card interest rates, mortgages, small-business credit cards, credit card late-payment fees, credit card over-limit fees, and credit card cash-advance fees (Agarwal et al. 2009). Consumers in their early 50s pay the lowest fees and interest rates. Not only do those expenses increase with age, but older individuals pay some of the highest costs (including fees and penalties) for credit cards and loan services.

People aged 55 and older should be at the peak of their wealth accumulation, yet evidence from the 2009 NFCS and the TNS Debt Survey shows that this cohort holds widespread credit card debt and accrues a great deal in fees linked to late payments and credit limit overages (Lusardi 2011; Lusardi and Tufano 2009a, 2009b). These studies also detected a link between debt management and financial literacy: The least financially literate were more likely to incur high fees and borrow at high rates. The least financially knowledgeable were also more likely to report that their debt load was excessive, and they were often unable to judge their debt position (Lusardi and Tufano 2009a).

**FIGURE 2**

**DEBT VS. RETIREMENT ACCOUNT SAVINGS, 2010–2011**

Over 40% of individuals aged 50 or older incurred more debt than they contributed in savings to their retirement accounts





# The Sample

Figure 3 presents a set of descriptive statistics on the sample under consideration. The sample is restricted to respondents aged 51–61 who were not retired at the time of the survey.<sup>1</sup> The final sample is composed of 5,002 observations, within which 14% of the respondents are single, 62% are married, and 24% are divorced, separated, or widowed. Only a minority (16%) of the divorced, separated, or widowed respondents reported living with a partner at the time of the survey. African Americans, Hispanics, Asian Americans, and respondents of other minority groups comprise 22% of the sample. Thirty-two percent of respondents have at least one financially dependent child.

FIGURE 3

## DEMOGRAPHIC CHARACTERISTICS OF PRE-RETIREEES SAMPLE

Aged 51–61	100% (full sample)
<i>Ethnicity</i>	
White	78%
African American	11%
Hispanic	5%
Asian American	3%
Other ethnicity	3%
<i>Marital status</i>	
Married	62%
Single	14%
Separated	2%
Divorced	18%
Widowed	4%
<i>Number of financially dependent children</i>	
1	19%
2	9%
3 or more	4%
No financially dependent children/Do not have any children	68%

(continued)

**FIGURE 3**

**DEMOGRAPHIC CHARACTERISTICS OF PRE-RETIREEES  
SAMPLE (CONTINUED)**

Aged 51–61	100% (full sample)
<i>Living arrangements</i>	
Only adult in the household	23%
Live with spouse/partner/significant other	66%
Live with parents, other family, friends, or roommates	11%
<i>Employment status</i>	
Self-employed	10%
Work full time for an employer	46%
Work part time for an employer	10%
Homemaker	10%
Disabled	12%
Unemployed	11%
<i>Income</i>	
Less than \$35K	32%
\$35K–\$50K	14%
\$50K–\$75K	19%
\$75K–\$100K	13%
More than \$100K	22%
<i>Education</i>	
High school or less	34%
Some college	33%
College graduate	21%
Post-graduate education	13%

*Note:*  $N = 5,002$ ; the sample is restricted to 5,002 individuals aged 51–61, excluding respondents who were retired at the time of the survey. Percentages may not add up to 100% due to rounding.

When it comes to education levels, about a third of respondents have a high school degree or less education while about a third have graduated from college. The remaining third attended but did not finish college. A respondent's average education level, therefore, is slightly lower than that of Millennials—the generation that is currently joining the workforce. (About 40% of new workers aged 23–35 have college degrees.) Almost half (46%) of respondents in the sample work full time for an employer, 10% are employed part time, and 10% are self-employed. Further, 10% (disproportionately women) identify themselves as homemakers, 11% are unemployed or temporarily laid off, and 12% are permanently sick, disabled, or unable to work.

Nearly half the sample (46%) reports annual household income below \$50,000, while almost a third reports income between \$50,000 and \$100,000. Another 22% report annual household income greater than \$100,000. As expected, income tends to be higher among respondents who are white, married, and employed full time, and who have a college degree.

## A Financial Profile of Pre-Retirees

The following sections will analyze pre-retirees' economic conditions and financial behaviors through a detailed examination of their assets, liabilities, short- and long-term saving behaviors, and use of financial advice.

### Assets

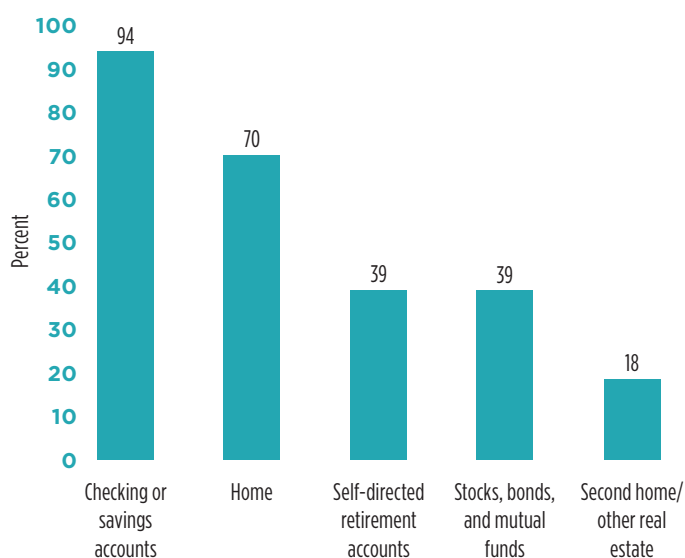
The NFCS contains data on asset ownership as well as information on asset management. These indicators include whether respondents have bank accounts, real estate, financial investments, and retirement accounts. In our sample, 94% of pre-retirees report having a bank account—either a checking account (92%) or a savings account<sup>2</sup> (76%) (see Figure 4). Interestingly, more than two-thirds of the unbanked (70%) were formerly banked; that is, they used to have a bank account but no longer do. Further, 70% of respondents indicate that they (or their spouse/partner) own their home, and 18% own second homes or other real estate assets.

There are, however, large disparities in asset ownership across demographic groups. Those who are married or living with a partner have many more assets than those who are single. Homeownership is a telling example. Eighty percent of married pre-retirees in the sample indicate that they or their spouse/partner own their home, but less than 50% of single respondents own their home.

A similar pattern exists with financial investments. The survey questionnaire asked, “Not including retirement accounts, do you [does your household] have any investments in stocks, bonds, mutual funds, or other securities?” Two in five respondents have such investments, but among single respondents, only 29% do. The percentage is even lower

FIGURE 4

#### ASSET OWNERSHIP



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

for separated, divorced, and widowed respondents: Only 25% have such investments. As noted earlier, married respondents tend to have higher incomes, so these differences are expected. But since the differences between married and unmarried respondents are so significant, we will provide distinct statistics for the two groups.

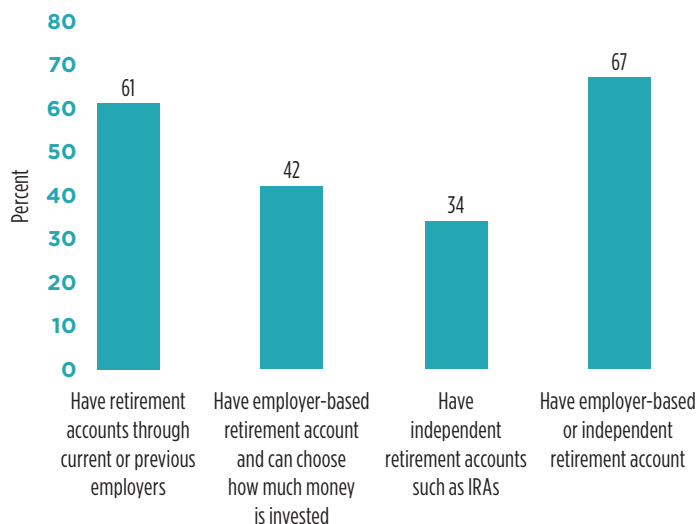
Sixty-one percent of the pre-retirees have retirement accounts through current or previous employers (see Figure 5). These may be DB plans or DC plans, the latter of which can include Thrift Savings Plans (TSPs) and 401(k) plans. Among respondents with employment-based retirement accounts, 68% report a plan where participants choose how the money is invested.<sup>3</sup> In addition, more than a third of respondents (34%) have independent retirement accounts, such as IRAs. In total, 67% of pre-retirees report having an employer-based or independent retirement account.

Nearly 30% of respondents appear to lack any form of retirement account (Figure 6).<sup>4</sup> And although 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. In some cases, respondents' formal retirement income will consist solely of Social Security benefits, provided that they are eligible for Social Security.

When broken down for more detailed demographic differences, the sample reveals that a married respondent or a respondent living with a partner is 27 percentage points more likely to have a retirement account than a single respondent (76% vs. 49%). A college degree also matters. Respondents with an undergraduate degree are 24 percentage points more likely to have a retirement account than those without a degree (83% vs. 59%). This gap is dramatic even when employment status is 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%). Furthermore, only 44% of individuals who were unemployed at the time of the survey report having a retirement account.

**FIGURE 5**

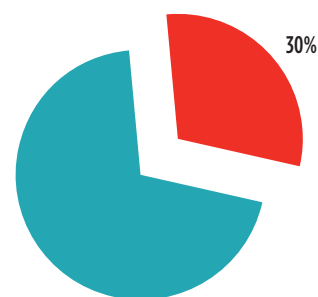
**RETIREMENT PLAN OWNERSHIP AMONG PRE-RETIREEES**



*Note:* Percentages are calculated over the total sample of 5,002 observations.

**FIGURE 6**

**RESPONDENTS WHO LACK ANY KIND OF RETIREMENT ACCOUNT**



To fully understand the financial capability and finances of pre-retirees, however, it is not enough to examine the asset side of the balance sheet. There are three reasons the liability side must also be considered. First, financial markets have made it easier for people to access mortgages and home equity lines of credit, even when they have poor credit scores, little income, and few other assets. Second, over time, more people have gained access to alternative financial services, among them payday loans, pawnshops, auto title loans, tax refund loans, and rent-to-own contracts. Third, it appears that the prevalence of financially fragile and indebted households has risen over time, meaning that measuring assets alone does not offer a comprehensive understanding of the financial position pre-retirees find themselves in.

## **In Focus: How Do Pre-Retirees Receive Most of Their Income? How Do They Make Payments?**

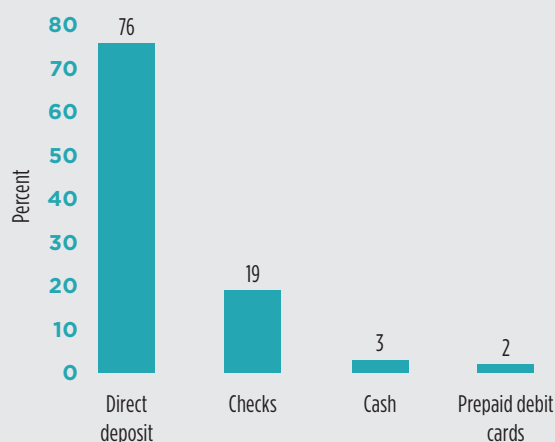
Respondents to the NFCS survey were asked a battery of questions regarding how they manage money inflows and outflows; e.g., how they receive income and how they make payments. When asked how they typically receive income, most pre-retirees indicated direct deposit to their bank account (76%). As expected, respondents with higher incomes are more likely to receive direct deposits than respondents with lower incomes. Conversely, respondents with lower incomes are more likely to receive income through a variety of sources, such as checks, prepaid debit cards, and cash. For example, 23% of respondents with household income less than \$50K receive most of their income by check, and among them, 10% sometimes cash checks at a check-cashing store.

When examining money outflows, the analysis shows that a large majority of respondents pay using cash (89%) and checks (78%) at least sometimes. A minority of respondents use prepaid debit cards (17%) or money orders (21%), and only 3% have sometimes used mobile payments.

Debit cards are the most frequently used method of payment (46% of pre-retirees use them frequently). Nearly two in five respondents (38%) frequently use online payments, and 29% pay frequently by credit card. Cash ranks fourth, as it is used frequently by 28% of respondents.

**FIGURE 7**

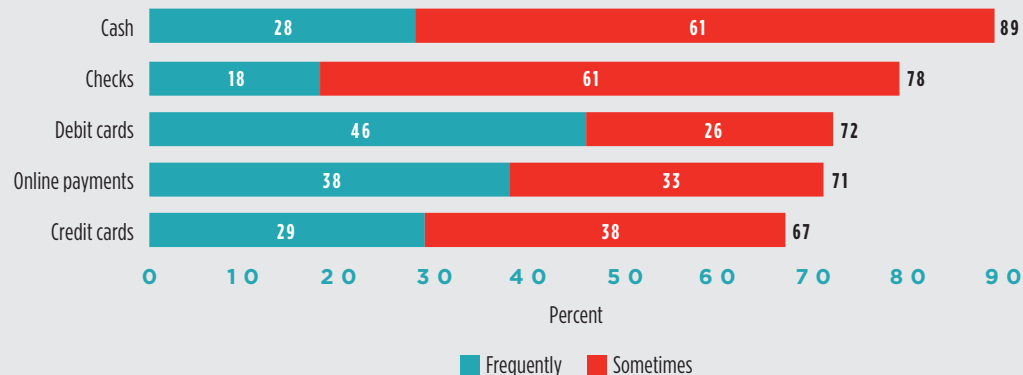
### **TYPICAL METHODS OF RECEIVING INCOME**



*Note:*  $N = 4,561$ . Percentages do not add up to 100% because “do not know” and “prefer not to say” answers are not reported; 441 respondents did not provide an answer to the question.

FIGURE 8

### TYPICAL METHODS OF PAYMENT FOR PRE-RETIREES



Note:  $N = 5,002$ . The figure reports answers to the question: “How often do you [does your household] use each the following methods to make payments (e.g., for shopping, for paying bills, or for any other purposes)?” The figure shows only the five methods of payment that are most commonly used among pre-retirees. The following methods have not been included in the figure: pre-paid debit cards, money orders, tapping/waving mobile phone over a sensor at checkout.

## Long-Term Liabilities

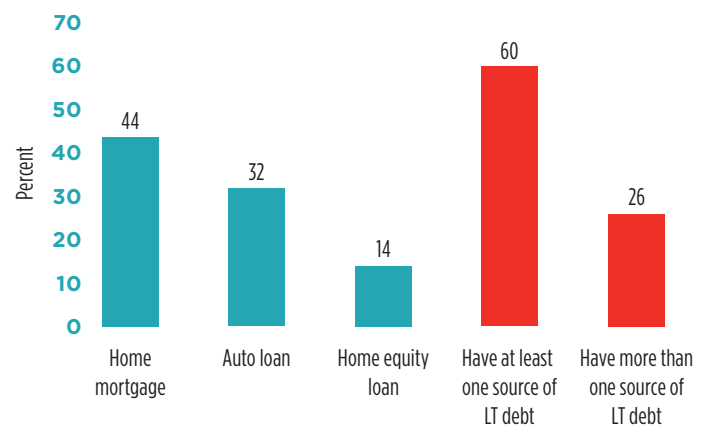
Several questions on the 2012 NFCS focused on sources of debt and perceived levels of indebtedness. These questions can be separated into two categories: long-term liabilities, such as a car loan, a mortgage, or a home equity loan, and short-term liabilities, such as credit card debt.

Home mortgages are the primary source of long-term debt among pre-retirees (see Figure 9). Sixty-three percent of homeowners in the sample report having a mortgage, while among all respondents<sup>5</sup> 44% have a mortgage. 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. Finally, some 20% of respondents who own their home report having a home equity loan.<sup>6</sup>

Respondents who are married or living with a partner are much more likely to have a home mortgage than are unmarried respondents. Auto loans are especially common among married

FIGURE 9

### SOURCES OF LONG-TERM DEBT



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

respondents (39%), full-time employees (41%), and respondents who have financially dependent children (39%). Home equity loans tend to be evenly distributed across different groups of homeowners, with the exception of single respondents and respondents with household incomes lower than \$35,000, both of which are less likely than the overall sample to carry such liability.

A concurrent analysis of the three sources of long-term debt shows that a vast majority of pre-retirees approach retirement with long-term debt. Sixty percent have at least one source of long-term debt, and 26% have at least two. 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 retirement with sizable amounts of debt.

*A vast majority of pre-retirees approach retirement with long-term debt. Sixty percent have at least one source of long-term debt, and 26% have at least two.*

In a recent paper, 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 affect the point at which workers retire or start claiming their Social Security benefits (Butrica and Karamcheva 2013). In sum, a new trend has emerged that points to post-retirement Americans carrying greater and greater levels of debilitating debt. The “In Focus” sidebar explains this issue in detail.

*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.*

## ***In Focus: Debt and Debt Management among Older Adults***

Lusardi and Mitchell (2013) show that the percentage of people aged 56–61 who approach retirement with debt swelled to 71% in 2008, up from 64% in 1992. Additionally, the value of debt rose sharply over time. The median debt in 1992 was about \$6,200. By 2002 it had more than tripled. By 2008, it was \$28,300—nearly quadruple the 1992 level.

Moreover, the debt distribution appears to have changed across cohorts. The top quartile of the debt distribution held around \$50,000 in debt in 1992, while the two later cohorts in this same quartile of the population held \$100,000 and \$117,300, respectively. By 2008, the top 10% of the distribution reported debt of over \$259,000. Depending on the interest rate charged on this debt, these families are likely to feel the burden of sizable monthly debt repayments. There is also a high probability that they will carry this debt into retirement. In their paper, the authors show that the most important factor driving the increase in debt for more recent groups is the much higher value of primary-residence mortgages.

*The most important factor driving the increase in debt for more recent groups is the much higher value of primary-residence mortgages.*

Since the interest rate on debt normally exceeds the rate of return on assets, and since servicing debt requires regular periodic payments that may impact respondents' balance sheets, the analysis examines responses to two 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?” (Yes / No)
- ➔ “How many times have you been late with your mortgage payments in the last two 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 homeowners report being underwater—owing more on their home than they believe they would receive in selling it. Further, nearly 20% of respondents with a mortgage report being late with their mortgage payments at least once in the last two years.

Many respondents struggle to meet other debt obligations as well. For example, more than a fourth (26%) of respondents have unpaid medical bills. This is especially true among



respondents without health insurance (38%). Finally, although respondents in this sample should be at the peak of their earning potential, 13% still carry student loan debt, and among these borrowers 53% are concerned about being able to pay off their student loan. There are, however, significant demographic differences. Student loan debt is heavily concentrated among African Americans (25%), and within this group, 62% are concerned about being able to pay it off.

## Short-Term Liabilities

Short-term liabilities contribute significantly to the total debt held by pre-retirees. Seventy-four percent of all respondents use at least one credit card, and 56% do not always pay the full amount due—a behavior that exposes pre-retirees to high fees (see Figure 10). 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 limit, and 9% use their credit card to obtain cash advances. Altogether, a troubling 39% of individuals aged 51–61 report at least one expensive credit card behavior. This is worrisome considering that, as mentioned above, pre-retirees should be at the peak of their earning potential.

Expensive credit card behavior is more common among single respondents (47%); separated, divorced, or widowed respondents (49%); African American respondents (61%); respondents with annual household income lower than \$35,000 (53%); and respondents without college degrees (44%).

Alternative financial services (AFS) are another source of significant short-term

FIGURE 10

### CREDIT CARD PRACTICES AMONG PRE-RETIREEES

Have at least one credit card	74%
<i>Among card holders:</i>	
Always paid credit card in full	44%
Carried a balance and was charged interest in some months over previous year	54%
<i>Engagement in expensive credit card behavior in some months over previous year:</i>	
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%

*Note:* The 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).

FIGURE 11

### EXPENSIVE CREDIT CARD BEHAVIOR: DEMOGRAPHICS



*Note:* Percentages are calculated over the sample of credit card holders only (3,714 pre-retiree respondents).

debt. The short-term lending practices of AFS are defined in related research as high-cost because they carry unusually high fees (Lusardi and de Bassa Scheresberg 2013). In the NFCS survey, respondents were asked a set of questions about their use of high-cost borrowing methods; specifically, they were asked whether in the five years prior to the survey they had used products such as auto title loans, pawnshop loans, payday loans, rent-to-own loans, or tax refund advance loans.

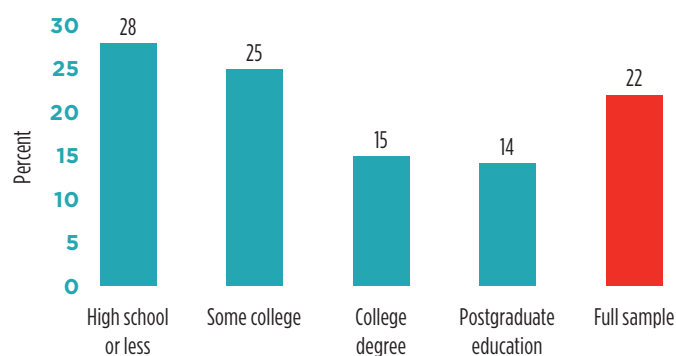
Across the full sample, 22% of pre-retirees report having used one or more of these borrowing methods in the past five years.<sup>7</sup> Use of these nontraditional borrowing methods is concentrated among single respondents (28%); separated, divorced, or widowed respondents (31%); respondents with annual household income lower than \$35,000 (36%); African Americans (41%); and respondents without a retirement plan (38%). Users of AFS also seem to pay the costs of a sizable gap in credit access. Forty-six percent of those who do not have a checking account or a savings account borrowed using a nontraditional financial product in the past five years, as did 48% of respondents without a credit card. However, even a large proportion of banked respondents or those with a credit card used one of these methods: 21% of those who have a bank account have relied on AFS, as have 16% of those who have a credit card. According to previous research, a recurrent reason these customers do not borrow from their bank or credit card is that they do not qualify for a loan or their credit card is maxed out (Bourke, Horowitz, and Roche 2012).

Education is another factor that is strongly associated with the use of nontraditional financial services. Respondents with a college degree are 11 percentage points less likely to rely on AFS than respondents without a degree (15% vs. 26%) (see Figure 12). As suggested by Lusardi and de Bassa Scheresberg (2013), this educational divide is relevant because pre-retirees with lower education levels may underestimate the total costs attached to the use of these borrowing methods.

Financial distress may also lead respondents to borrow from their retirement accounts. Thirteen percent of respondents who have a retirement account indicate that they or their spouse/partner took loans from their retirement accounts or made hardship withdrawals from their accounts in the 12 months prior to the survey. This phenomenon is particularly worrisome for African Americans: 23% of these

FIGURE 12

#### PRE-RETIREEs' USE OF AFS BY EDUCATION LEVEL



*Note:* Percentages are calculated over a sample of 4,904 observations for which information on AFS use is non-missing. The survey questions ask respondents whether they have used at least one of the following five AFS products in the five years prior to the survey: rent-to-own, pawnshop, payday loan, tax advance, auto title loan.

respondents report having taken loans from their retirement accounts or making hardship withdrawals.

## Overindebtedness 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 from 1 to 7, with the following statement: “I have too much debt right now.”

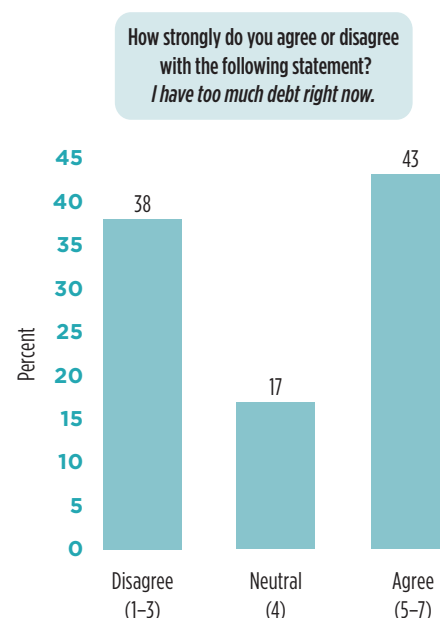
Overall, 43% of respondents agreed that they have too much debt (see Figures 13 and 14). Only 17% were neutral, and less than 40% of pre-retirees disagreed with the statement.<sup>8</sup> In other words, a disturbing number of respondents in our sample are overburdened with debt, and this may greatly influence their financial management choices and their ability to weather unfavorable economic times. Moreover, even among those aged 60 or 61, 39% indicate that they have too much debt. This poses serious questions as to the ability of these respondents to pay off their debt while in retirement.

*Even among those aged 60 or 61, 39% indicate that they have too much debt.*

Too much debt reduces the ability to save. Inadequate emergency funds, in turn, can trigger severe financial consequences in the event of an income shock. To see how indebtedness impacts pre-retirees’ saving behavior, our analysis looked at respondents’ short-term savings set aside to buffer shocks as well as their long-term financial planning.

FIGURE 13

### PRE-RETIREEES’ PERCEIVED OVERINDEBTEDNESS



Note: N = 5,002. Percentages do not add up to 100% because “don’t know” and “prefer not to say” answers are excluded.

FIGURE 14

### DEBT PERCEPTIONS AMONG PRE-RETIREEES

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

Note: The table reports answers to the question: “How strongly do you agree or disagree 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.

Measures of financial fragility reveal that many pre-retirees are exposed to unpredictable shocks in the short term. When asked whether in the 12 months prior to the survey they had suffered a large unexpected income shock, 30% of respondents replied that they had. But despite the prevalence of economic shocks, most pre-retirees do not save and do not have emergency or rainy-day funds. Only 45% of pre-retirees report spending less than they are earning. Furthermore, only 40% report having set aside sufficient funds to cover three 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 plan, only 15% report having a rainy-day fund. That compares with 52% with a rainy-day fund among those with a retirement plan.

*Those who do not save for the long run also do not save for the short term. Among those with no retirement plan, only 15% report having a rainy-day fund.*

Pre-retirees' vulnerability is confirmed by their responses to the survey 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 report that they probably or certainly could not come up with the funds (see Figures 15 and 16). In other words, many pre-retirees are unprepared for short-term economic shocks, having neither savings nor alternative sources of funds to cover expenses in such a scenario. For example, 19% of pre-retirees lack health insurance, and among those who do not have health insurance, 61% say they probably or certainly could not 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 one 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 be certain that they could come up with the full \$2,000 (24% vs. 42%). More than four 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

FIGURE 15

#### PRE-RETIRES' FINANCIAL VULNERABILITY

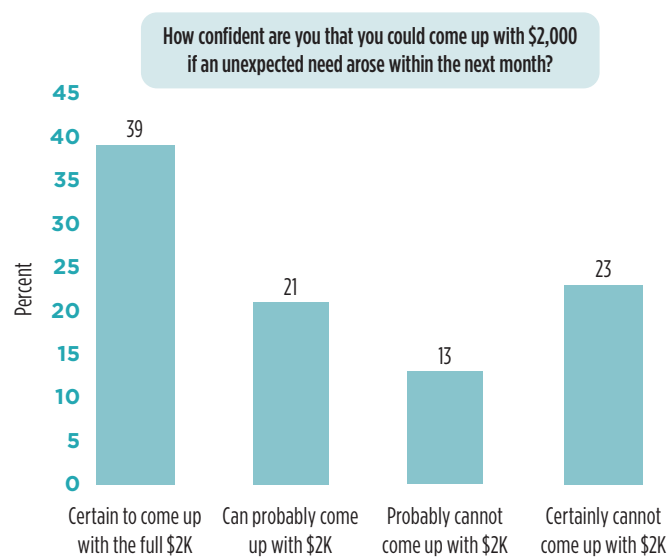


FIGURE 16

## FINANCIAL FRAGILITY AMONG PRE-RETIREEES

	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
Ethnicity: Other	24	22	16	32
Income less than \$35K	13	15	17	49
Income between \$35K and \$75K	33	28	16	19
Income greater than \$75K	67	20	6	5
Undergrad degree	54	21	10	13
No undergrad 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:* The 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.

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 an important question in light of prior research showing that planners accumulate far more retirement wealth than non-planners (Lusardi 1999; Lusardi and Beeler 2007; Lusardi and Mitchell 2007a, 2007b, 2011). It is particularly significant for individuals nearing retirement.

Only 47% of respondents in our sample have tried to figure out how much they should save for retirement, and this pattern is pervasive across all groups examined. Those who are less likely to plan include singles (37%); divorced, separated, or widowed respondents (36%); respondents without undergraduate degrees (38%); and non-Asian minorities (40%). A closer examination of retirement planning behavior also reveals notable gender differences: Men are six percentage points more likely than women to have tried to figure out how much they need to save for retirement (50% vs. 44%).

*Men are six percentage points more likely than women to have tried to figure out how much they need to save for retirement (50% vs. 44%).*

## In Focus: Predictors of Retirement Planning

To better understand 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 descriptive statistics reported previously. 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.

Beyond education, another indicator significantly correlates with retirement planning: financial literacy. To obtain an objective measure of respondents' level of financial literacy, we analyzed their answers to a set of questions designed to test their 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.

*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.*

## Use of Financial Advice

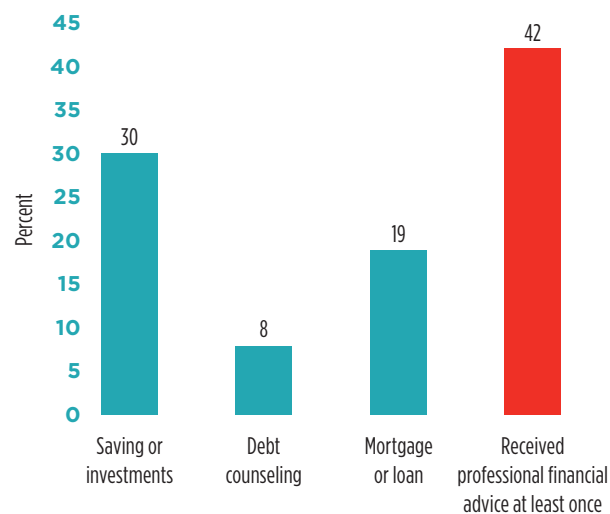
In addition to long-term financial planning, a key indicator of pre-retirees' behavior in terms of preparing for retirement is their use of professional financial advice. The NFCS asked respondents about their use of professional advice in the five years prior to the survey on such topics as mortgages, saving and investments, and debt counseling. Overall, the study revealed that pre-retirees are most likely to seek advice on saving and investments and more likely to seek advice on mortgages than on debt. Among this group of pre-retirees, however, an alarming 58% had not sought financial advice of any kind in the five years prior to the survey.

*An alarming 58% of pre-retirees had not sought financial advice of any kind in the five years prior to the survey.*

It is worrisome that many of the pre-retirees in the sample report feeling overburdened with debt obligations, and yet few have sought debt counseling. In fact, of those who agree with the statement "I have too much debt right now," 61% have not sought financial advice of any kind. Indeed, debt counseling remains the least popular source of professional advice. Similarly, pre-retirees who are not satisfied with their personal financial conditions are also failing to seek professional financial advice. Thirty-seven percent of the full sample of pre-retirees indicate

FIGURE 17

### PRE-RETIREEES' USE OF FINANCIAL ADVICE



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

dissatisfaction with their personal financial condition, yet two-thirds of these respondents admit to not seeking financial advice of any kind in the five years prior to the survey.

*Thirty-seven percent of the full sample of pre-retirees indicate dissatisfaction with their personal financial condition, yet two-thirds of these respondents admit to not seeking financial advice of any kind in the five years prior to the survey.*

The use of financial advice among those with and without retirement plans is another telling example. Among those with one or more retirement accounts, 53% had received some form of financial advice in the five years prior to the survey. On the other hand, only 18% of those without retirement plans report having sought one or more forms of professional financial advice in recent years. This seems to indicate that making retirement plans is an all-encompassing activity; those planning for retirement are likely to both own retirement accounts and seek professional advice, while those who are not looking ahead may not engage in either activity.

Lastly, it is interesting to note that financial literacy is *positively* correlated with the use of financial advice. Among those who were able to correctly answer all five questions designed to measure respondents' degree of financial knowledge, 57% report using financial advice. Conversely, among those who could not correctly answer all five financial literacy questions, 38% use financial advice. These descriptive findings are in line with other research on the topic showing that financial literacy is complementary to financial education, not a substitute for it (Collins 2012).

## CHAPTER 4

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# In Summary

## What Are the Main Financial Challenges Facing This Generation?

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



financial management and planning, and use financial advice only sparingly. Key findings from the analysis include:

- ➔ **Nearly 30% of pre-retirees do not have a retirement plan or account.** This is particularly troubling given that respondents without a retirement plan will have to rely only on other savings or assets, if they have them, and on Social Security benefits, if they are eligible. Ownership of retirement accounts varies by marital status, education level, employment status, and income level. 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.
- ➔ **Sixty percent of pre-retirees have at least one source of long-term debt, and 26% have at least two.** Both long-term and short-term sources of debt pose significant challenges for pre-retirees in this study. Among all 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, and more than a fourth of all respondents have at least two sources of long-term debt. 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.
- ➔ **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. Nearly 40% of all pre-retirees in the sample report engaging in at least one form of expensive credit card behavior, although the prevalence of such credit card usage is higher among single respondents, non-Asian minority respondents, respondents without a college degree, and respondents with lower household incomes.
- ➔ **More than 40% of pre-retirees feel heavily indebted.** 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 the peak of their earning potential, a disturbing percentage of individuals in this group are 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 aged 60 or 61, 39% indicate that they have too much debt. This poses serious questions as to the ability of these respondents to pay off their debt while in retirement.
- ➔ **Even if they are close to retirement, only a minority of pre-retirees have made provisions for a rainy-day fund to carry them through unexpected economic shocks.** Lack of saving by pre-retirees makes them particularly vulnerable to unexpected shocks or emergencies that may arise. Only 60% of respondents report that they probably or certainly could come up with \$2,000 if an unexpected need

arose within the next month. This report also reveals that lack of short-term savings is often related to lack of long-term savings. For example, only 15% of pre-retirees without a retirement account report having an emergency fund.

➔ **Less than half of pre-retirees have even attempted to calculate the level of savings they will need once they stop working.** Given findings from prior research that show that individuals who plan for retirement accumulate much greater wealth for their retirement than do those who do not plan, it is alarming that only 47% of pre-retirees report ever having tried to figure out how much to save for retirement. While there are notable differences across demographic groups, an important consideration is that most pre-retirees who do not have a retirement plan also have never considered how much saving is required. These findings indicate that limited resources impact not only short-term saving decisions but also long-term saving behavior by constraining pre-retirees' ability to think ahead.

## How Can Credit Unions Address These Challenges to Serve This Cohort Well?

The findings reported above suggest three actions that credit unions can take to meet the needs of pre-retirees and serve this cohort well. These actions may also enable credit unions to retain a larger share of members as they approach retirement.

➔ **Credit unions could work with pre-retirees to address problems of financial fragility and debt before retirement.** As individuals exit the workforce and begin to rely solely on retirement savings, existing problems with making ends meet and financing debt obligations will only worsen. Given that debt obligations prevent saving for both the short term and long term, more capably managing these debt burdens must be a priority for individuals before and during their retirement period. This research has revealed, however, that pre-retirees are not widely conscious of the need to resolve these problems in the near future, given that the tendency to plan for retirement or seek professional financial advice is fairly weak among those in the sample. Credit unions could enact a marketing strategy that seeks to increase the level of acknowledgment of these challenges among the pre-retiree population and suggests the use of financial advice as an effective way to tackle these problems.

➔ **Financial advice specifically targeted to pre-retirees could be made more effective.** Pre-retirees are in a different financial position than others who might seek financial advice on saving and investing, mortgages, or debt counseling. Pre-retiree sources of income will change vastly upon entering retirement, but any lingering problems with financial management will remain. This puts pre-retirees

in a unique position, and financial advice that is tailored to their specific needs can be very effective.

➔ **Credit unions could help both pre-retirees and other individuals earlier in their careers to become aware of the need for retirement planning, to encourage them to make regular contributions to retirement accounts, and to address debt problems before they become unbearable.** Retirement planning is most successful when begun early in an individual's career. Because nearly one-third of pre-retirees do not have a retirement account, many individuals aged 51–61 have forgone the benefits of compounding interest that they could have obtained by contributing to retirement funds earlier in their career. Moreover, this study reveals that patterns in long-term saving are related to short-term saving behaviors, meaning that a focus on planning for the future may induce more short-term saving as well. Financial service providers should be more aware of their role in encouraging individuals to engage in long-term financial planning earlier in their careers in order to prevent pre-retirees from being saddled with debt burdens while carrying low retirement funds into their later stages of adult life. Financial education programs can also be a viable way to improve members' financial decision making and increase their use of financial advice; as documented in previous research, financial literacy is strongly associated with retirement planning, and those who have higher financial literacy tend to use financial advice more frequently.

# Endnotes

<sup>1</sup> We chose age 61 as a threshold because 62 is the earliest age one can begin receiving retirement payments from the Social Security Administration. According to data from the US Census Bureau, 62 is the most popular retirement age in the United States (Brandon 2013).

<sup>2</sup> The definition of savings account includes money market accounts and CDs.

<sup>3</sup> This corresponds to 42% among the total population of pre-retirees.

<sup>4</sup> The remaining 3% did not explicitly indicate that they lack retirement accounts, so they were coded as “undetermined.”

<sup>5</sup> That is, also including in the calculation respondents who do not own their home.

<sup>6</sup> The percentage among the total sample of pre-retirees is 14%.

<sup>7</sup> The most common nontraditional borrowing methods are pawnshops and payday loans, used by 12% and 9% of respondents, respectively.

<sup>8</sup> Demographic groups that suffer the most from overindebtedness are African Americans (51%) and separated, divorced, or widowed respondents (49%).

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# About the Authors



## Carlo de Bassa Scheresberg

Senior Research Associate, Global Financial Literacy Excellence Center,  
George Washington University

Carlo de Bassa Scheresberg is a senior research associate at the Global Financial Literacy Excellence Center at the George Washington University School of Business. At the Center, he develops research projects in financial literacy for major government organizations and corporate institutions. He holds a master's in economics from Bocconi University in Italy.

## Annamaria Lusardi

Denit Trust Distinguished Scholar and Academic Director, Global Financial  
Literacy Excellence Center, George Washington University



Annamaria Lusardi is the Denit Trust Distinguished Scholar and Professor of Economics and Accountancy at the George Washington University School of Business. Previously, she was the Joel Z. and Susan Hyatt Professor of Economics at Dartmouth College, where she taught for 20 years. She has also taught at Princeton University, the University of Chicago Harris School of Public Policy, the University of Chicago Booth School of Business, and Columbia Business School. From January to June 2008, she was a visiting scholar at Harvard Business School. Moreover, she is the academic director of the GW Global Financial Literacy Excellence Center, and the director of the Financial Literacy Center, a joint center with Dartmouth College, the RAND Corporation, and the Wharton School. Dr. Lusardi has won numerous research awards; among them is a research fellowship from the University of Chicago Harris School of Public Policy, a faculty fellowship from the John M. Olin Foundation, a junior and senior faculty fellowship from Dartmouth College, the William E. Odom Visionary Leadership Award from the Jump\$tart Coalition, and the National Numeracy Network's inaugural 2012 Steen Award. She was also the recipient of the Fidelity Pyramid Prize, an award given to authors of published applied research that best helps address the goal of improving lifelong financial well-being for Americans.

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612 W. Main Street  
Suite 105  
Madison, WI 53703

p 608.661.3740  
f 608.661.3933

Publication #322 (6/14)

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