State of Affairs: FINRA Financial Capability Study Results

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What is financial capability?

Four main components:

- how people manage their resources
- how they make financial decisions
- the skill sets they use in making decisions
- the search and information elaboration that goes into their choices.
Major changes that increase individuals’ responsibility for their financial well-being

- **Changes in the pension landscape**
  - DC pensions and IRAs

- **Changes in the labor markets**
  - Divergence in wages – skills are critical
  - One of the most important decisions (invest in education) has to be made early in life

- **Changes in the financial markets**
  - Increased complexity, many financial products
  - More opportunities to borrow and large amounts
State-by-State Survey: Online survey of more than 25,000 respondents (roughly 500 per state + DC)

- Objective—Benchmark and better understand financial capability in America
- Representative of the US population
- First wave in 2009, second wave in 2012
- GFLEC has been FINRA’s academic advisor on the survey

We are currently designing the 2015 wave
How to measure financial capability?

Four key financial capability components:

1. Making ends meet
2. Managing financial products
3. Planning ahead (short-term and long-term)
4. Financial knowledge and decision-making
In a typical month, how difficult is it for you to cover your expenses and pay all your bills?

- Not at all difficult: 40%
- Somewhat difficult: 42%
- Very difficult: 16%
- Don't know/No answer: 2%
Low Income Households Under Greatest Strain

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

- **<$25K**:
  - Very difficult: 31%
  - Somewhat difficult: 47%
  - Not at all difficult: 19%

- **$25K-75K**:
  - Very difficult: 14%
  - Somewhat difficult: 38%
  - Not at all difficult: 46%

- **$75K+**:
  - Very difficult: 5%
  - Somewhat difficult: 29%
  - Not at all difficult: 64%

Respondents with unexpected large drop in income in past 12 months:

- **<$25K**: 41%
- **$25K-75K**: 30%
- **$75K+**: 18%
Second component of financial capability

✓ Making ends meet

2. Managing financial products
Assets & investments

<table>
<thead>
<tr>
<th>Percentage of respondents with:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Checking accounts</td>
<td>89%</td>
</tr>
<tr>
<td>Savings accounts</td>
<td>72%</td>
</tr>
<tr>
<td>(% Banked)</td>
<td>(91%)</td>
</tr>
<tr>
<td>Any retirement accounts, employer-based or independent</td>
<td>57%</td>
</tr>
<tr>
<td>Investments in stocks, bonds, or mutual funds</td>
<td>35%</td>
</tr>
<tr>
<td>Home</td>
<td>58%</td>
</tr>
</tbody>
</table>

- Need to look also at the liability side of balance sheets
- Many Americans are borrowing on their assets and investments

Let’s look closer at some of these assets and investments.
Overdrawing from checking accounts

- 89% of respondents have a checking account
- Many borrow from such account

![Pie chart showing overdraws from checking accounts]

Overdraws from checking account

- Yes; 22%
- No; 78%

*Note:* The statistic relative to overdrawing checking account is conditional on having a checking account.
Borrowing on the home

Among 58% of Americans who own their home:

- 60% have a mortgage on their home.
- 22% are underwater with home value.
- 21% are late with mortgage payments.
- 32% are at least one of the two.

Note: The statistic relative to home mortgages and the statistics displayed in the graph at the right are conditional means.
Tapping retirement accounts

Loans and hardship withdrawals

Note: The statistics displayed in the graph at the right are conditional means.
Borrowing for education (Millenials age 23-35)

- 38% of Millennials have a college degree
- Many Millennials are taking on debt to finance their education

**Have a student loan**
- Yes; 39%
- No; 59%
- DK; 2%

**Concerned might not be able to pay off student loan**
- Yes; 54%
- No; 42%
- DK; 4%

*Note: The statistic relative to ability to repay student loans is conditional on having a student loan.*
Millennials and student debt: is it a problem?

<table>
<thead>
<tr>
<th>Student Loan Debt by Demographic Characteristic</th>
<th>% with outstanding student loan debt</th>
<th>% concerned about their ability to pay off the student loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full sample</td>
<td>39%</td>
<td>54%</td>
</tr>
<tr>
<td>Age 23-29</td>
<td>43%</td>
<td>54%</td>
</tr>
<tr>
<td>Age 30-35</td>
<td>35%</td>
<td>54%</td>
</tr>
<tr>
<td>Male</td>
<td>37%</td>
<td>49%</td>
</tr>
<tr>
<td>Female</td>
<td>40%</td>
<td>57%</td>
</tr>
<tr>
<td>No undergraduate degree</td>
<td>29%</td>
<td>62%</td>
</tr>
<tr>
<td>Have undergraduate degree</td>
<td>55%</td>
<td>47%</td>
</tr>
<tr>
<td>Ethnicity - White and Asian</td>
<td>35%</td>
<td>50%</td>
</tr>
<tr>
<td>Ethnicity – African American</td>
<td>54%</td>
<td>62%</td>
</tr>
<tr>
<td>Income &lt; $35K</td>
<td>35%</td>
<td>67%</td>
</tr>
<tr>
<td>Income $35K - $75K</td>
<td>42%</td>
<td>52%</td>
</tr>
<tr>
<td>Income &gt;$75K</td>
<td>42%</td>
<td>34%</td>
</tr>
</tbody>
</table>

Note: Percentages are calculated over the relevant subsamples, i.e., 39 percent of all respondents have outstanding student loan debt, and 54 percent of these respondents are concerned about their ability to pay off the loan.
Short term debt: Credit cards

- 70% of Americans have a credit card, and among them:

<table>
<thead>
<tr>
<th>In the past 12 months...</th>
<th>Total</th>
<th>18-34</th>
<th>35-54</th>
<th>55+</th>
</tr>
</thead>
<tbody>
<tr>
<td>I always paid credit cards in full</td>
<td>49%</td>
<td>52%</td>
<td>40%</td>
<td>56%</td>
</tr>
<tr>
<td>In some months, I paid the minimum payment only</td>
<td>34%</td>
<td>44%</td>
<td>40%</td>
<td>22%</td>
</tr>
<tr>
<td>In some months, I was charged a fee for late payment</td>
<td>16%</td>
<td>23%</td>
<td>19%</td>
<td>9%</td>
</tr>
<tr>
<td>In some months, I was charged a fee for exceeding my credit line</td>
<td>8%</td>
<td>14%</td>
<td>9%</td>
<td>3%</td>
</tr>
<tr>
<td>In some months, I used the cards for a cash advance</td>
<td>11%</td>
<td>17%</td>
<td>12%</td>
<td>7%</td>
</tr>
</tbody>
</table>

41% of cardholders used them in “expensive” ways
Many Americans use high-cost borrowing—29% have used one of these methods in the past 5 years.

- Pay-day loans (14%)
- Pawn shops (16%)
- Refund anticipation loans (8%)
- Auto title loans (10%)
- Rent-to-own stores (10%)

58% of users among the unbanked
AFS use by career stage and by education

- **Millennials**
  - High School Diploma or less: 55%
  - Some college education: 44%
  - Undergraduate degree: 31%
  - Postgraduate education: 24%

- **Mid-career**
  - High School Diploma or less: 38%
  - Some college education: 34%
  - Undergraduate degree: 23%
  - Postgraduate education: 16%

- **Pre-retirees**
  - High School Diploma or less: 23%
  - Some college education: 21%
  - Undergraduate degree: 13%
  - Postgraduate education: 13%
Third component of financial capability

- Making ends meet
- Managing financial products

3. Planning ahead
Many Americans don’t plan ahead

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

- Yes; 37%
- No; 63%

*Have you set aside an emergency or rainy day fund?*

- Yes 40%
- No 60%
Those most at risk are least prepared for emergencies...

**Respondents with emergency or rainy day funds that would cover expenses for 3 months**

- **Total**: 40%
- **Female**: 37%
- **18-34**: 33%
- **<$25K**: 18%
- **Black**: 34%
- **Hispanic**: 37%
- **High-school or less**: 22%
...And least likely to plan for retirement

Respondents who have tried to figure out how much to save for retirement

- Total: 37%
- Female: 34%
- 18-34: 37%
- <$25K: 18%
- Black: 36%
- Hispanic: 33%
- High school or less: 24%
Evidence of financial fragility

Can people cope with unexpected expenses?

Use a measure of financial fragility developed by Lusardi, Schneider and Tufano (2011):

➢ 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

➢ The measure captures respondents’ ability to cope with mid-size, unexpected income shocks
How confident are you that you could come up with $2,000 if an unexpected need arose within the next month?

Note: The figure 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 do not total 100 percent because “do not know” and “prefer not to say” answers are not reported in the figure.
**Financial fragility by demographic**

*Respondents who either certainly or probably cannot come up with $2,000*

- Total: 40%
- Female: 44%
- 18-34: 49%
- <$25K: 67%
- Black: 50%
- Hispanic: 46%
- High school or less: 51%
Fourth component of financial capability

✓ Making ends meet
✓ Planning ahead
✓ Managing financial products

4. Financial knowledge and decision-making
### Financial literacy

#### Answers to five financial literacy questions

<table>
<thead>
<tr>
<th>Question</th>
<th>% Correct</th>
<th>% Don’t Know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Numeracy question</td>
<td>75%</td>
<td>11%</td>
</tr>
<tr>
<td>Inflation question</td>
<td>61%</td>
<td>20%</td>
</tr>
<tr>
<td>Risk diversification question</td>
<td>48%</td>
<td>42%</td>
</tr>
<tr>
<td>Mortgage question</td>
<td>75%</td>
<td>15%</td>
</tr>
<tr>
<td>Bond prices question</td>
<td>28%</td>
<td>37%</td>
</tr>
</tbody>
</table>

- Answered the first three questions correctly: 34%
- Answered all five questions correctly: 14%
Financial literacy across income groups

Financial literacy by income level in the United States
(3 questions answered correctly)

- <$15K: 14%
- $15-25K: 19%
- $25-35K: 25%
- $35-50K: 31%
- $50-75K: 38%
- $75-100K: 48%
- $100-150K: 56%
- $150K+: 62%
Gender differences in financial literacy

Women and financial literacy

- Large gender differences in financial literacy
  - Similar pattern across 13 countries

- Women answer in the same way
  - They frequently state they “do not know” the answer

- Women report lower levels of self-assessed knowledge
  - A group to target
Financial knowledge among the young

Compared to other age groups, financial knowledge among the young is very low.
From research to applications

Ideal venues for financial education and most scalable

- **Schools**
  - Easier to reach the young
  - Need to prepare new generations
  - Have a basis on which to build

- **The workplace**
  - Easier to reach the adults
  - Many teachable moments
  - Part of benefits and training
Are students well prepared for future challenges? Can they analyze, reason and communicate effectively? Do they have the capacity to continue learning throughout life?

Every three years the OECD Programme for International Student Assessment (PISA) answers these questions and more. It assesses to what extent students near the end of compulsory education have acquired some of the knowledge and skills essential for full participation in society.
A program for any company

- Ten steps divided into 3 stages
  Basic, Intermediate, and Advanced

- Customize the program for employees
  One size does not fit all

- The Employee Checklist
  Ten guidelines with implementation tips to improve employees’ financial fitness
Our approach is multidisciplinary
New initiative: FinLab

- FinLab—An innovation lab
  - Focus on experimentation
  - Focus on financial education programs

- Technology + financial literacy
  - They are complements not substitutes
The survey provides evidence that:

1. Many Americans are overly indebted and financially fragile.
2. Many incur behaviors that generate fees, interest payments, and other costs.
3. The majority of Americans do not plan ahead for life-cycle events and do not insure against unexpected ones.
4. Americans are not well equipped to make financial decisions.
5. The groups displaying lower financial capability are the young, those with low income, those with low education, and minorities.
Thank you

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