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Americans' Financial Capability

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Americans' Financial Capability

Presentation to the Financial Crisis Inquiry Commission
Research Symposium, February 26, 2010



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Questions

Financial literacy and the financial crisis:

- 1. Are Americans financially *capable*?**
- 2. Do financial literacy and financial capability matter?**
- 3. Does financial illiteracy generate risks at the macro level?**

Background

Before the financial crisis

- 1. Americans were saving very little, saving rate had been very low and reached zero**
- 2. Household debt had been growing steadily**
- 3. Opportunities to borrow became widely available**
 - 3a. Mortgages**
 - 3b. Credit cards**

Main points

- 1. Most Americans are not financially capable**
- 2. Levels of financial literacy are strikingly low**
- 3. Lack of financial literacy and financial capability create instability at both the micro and macro level**

Study Methodology

National Financial Capability Study includes three linked surveys:

1. **National Survey**: Nationally-projectable telephone survey of 1,488 American adults
2. **State-by-State Survey**: Online survey of approximately 25,000 respondents (roughly 500 per state + DC), **currently in the field**
3. **Military Survey**: Online survey of 800 military personnel and spouses, **currently in the field**

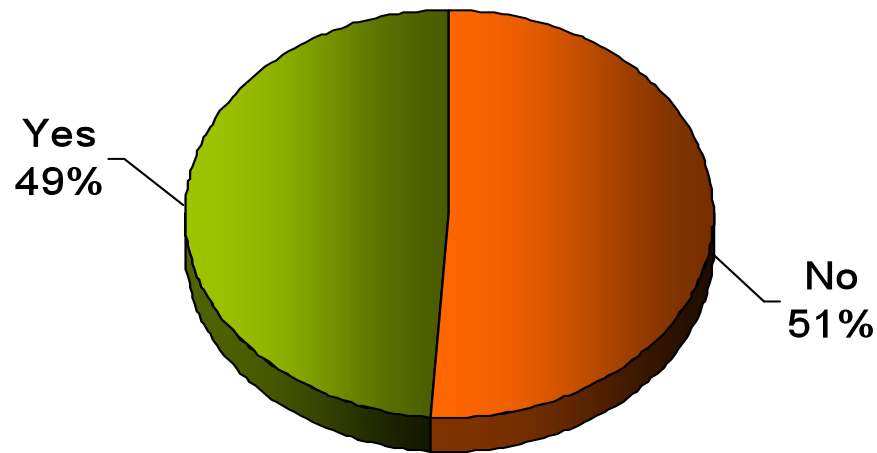
Some findings are from the TNS Global Economic Crisis Survey

Four Key Financial Capability Components

- 1. Making Ends Meet**
- 2. Planning Ahead**
- 3. Managing Financial Products**
- 4. Financial Knowledge and Decision-Making**

Setting aside an emergency/rainy day fund

Have you set aside an emergency or rainy day fund?

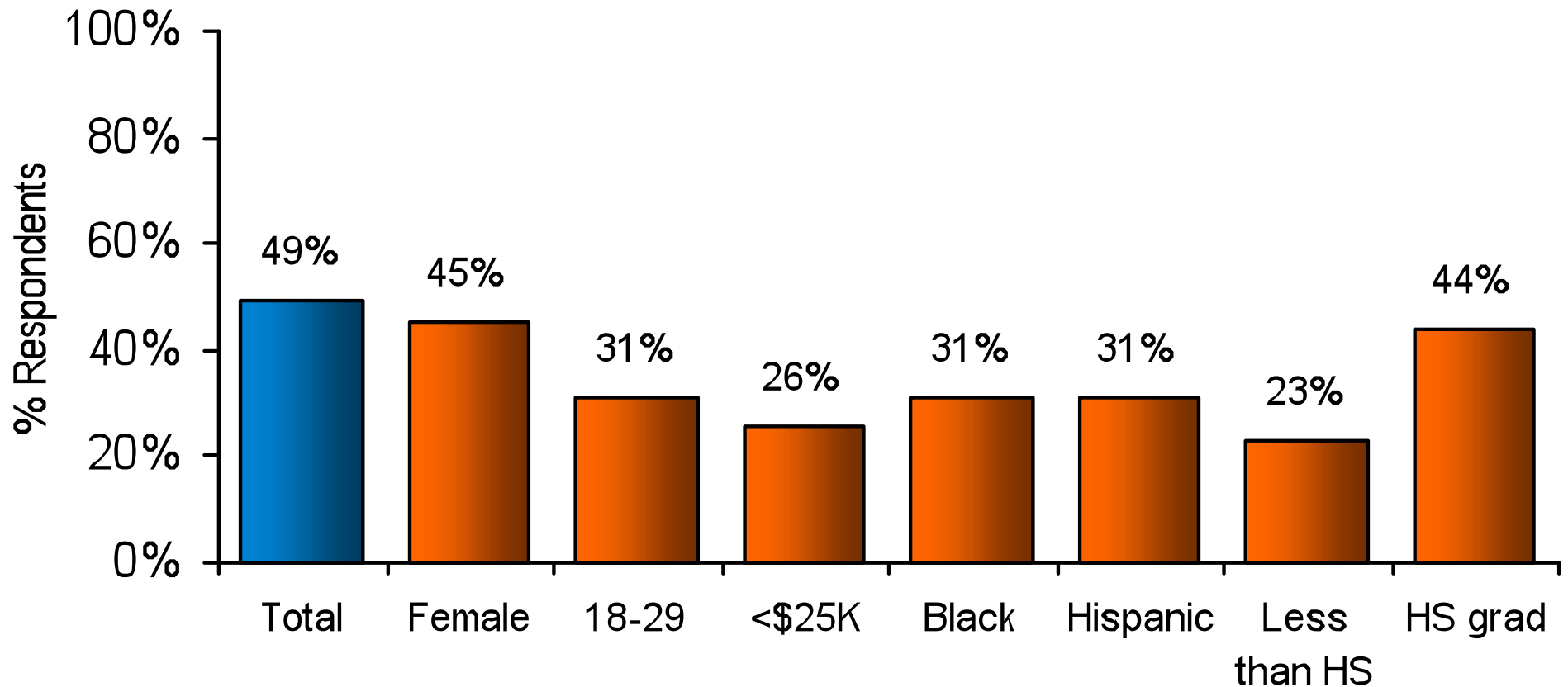


When asked if they could come up with \$2,000 in 30 days, 46% of Americans said no.

Source: TNS Global Economic Crisis Survey

Those Most at Risk Are Least Prepared for Emergencies...

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



High-cost borrowing

Many Americans use high-cost borrowing—23% have used one of these methods in the past 5 years:

- Pay-day loans
- Pawn shops
- Tax refund advances
- Auto title loans
- Rent-to-own



Credit Cards

In the past 12 months...	Total	18-29	30-44	45-59	60+
I always paid credit cards in full	54%	51%	45%	44%	75%
In some months, I carried over a balance and was charged interest	51%	46%	62%	58%	33%
In some months, I paid the minimum payment only	29%	41%	35%	31%	11%
In some months, I was charged a fee for late payment	23%	24%	27%	29%	11%
In some months, I was charged a fee for exceeding my credit line	8%	14%	8%	9%	2%
In some months, I used the cards for a cash advance	8%	11%	10%	8%	5%

12% of respondents who do not pay in full each month do not know the interest rate on their credit card.

Managing Financial Products

Risky mortgage-lending played a role in the financial crisis. The data show many homeowners are under-informed about what types of mortgages they were carrying.

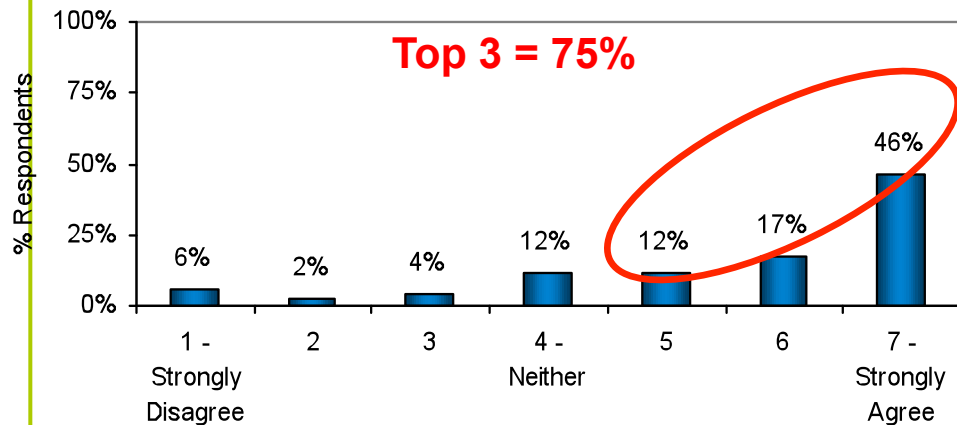
Homeowners that stated	Total	<\$25K	\$25-\$75K	>\$75K
Have a mortgage	61%	31%	61%	77%
Have line of credit	21%	11%	20%	27%

When asked whether they have a mortgage that is either an interest-only mortgage or has an interest-only option, **20%** responded they **did not know**.

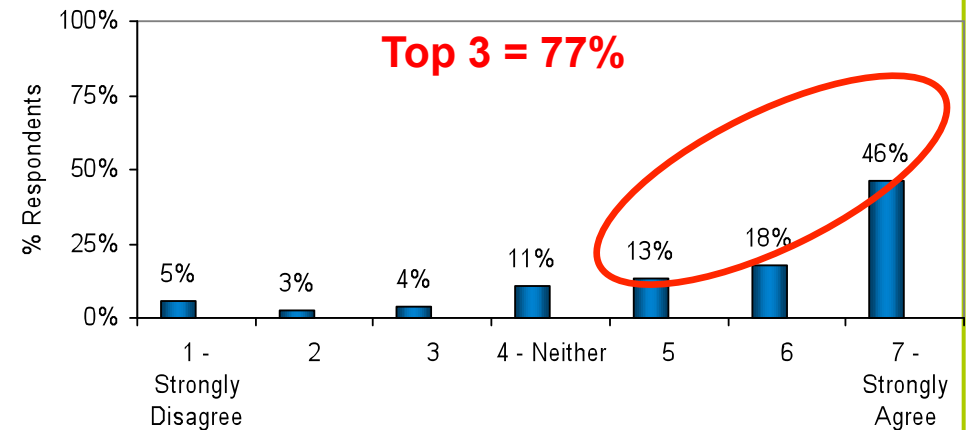
Moreover, **10%** of mortgage borrowers **did not know the interest rate** they are paying on their mortgage.

Highly Positive Self-Perceptions

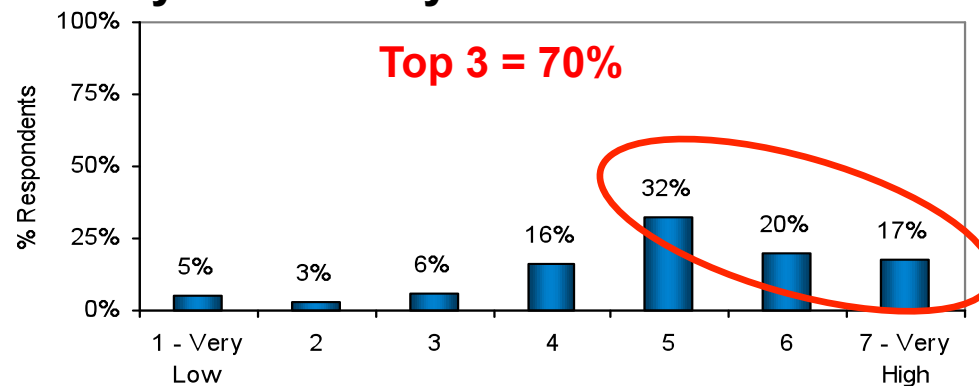
I am good at dealing with day-to-day financial matters.



I am pretty good at math.

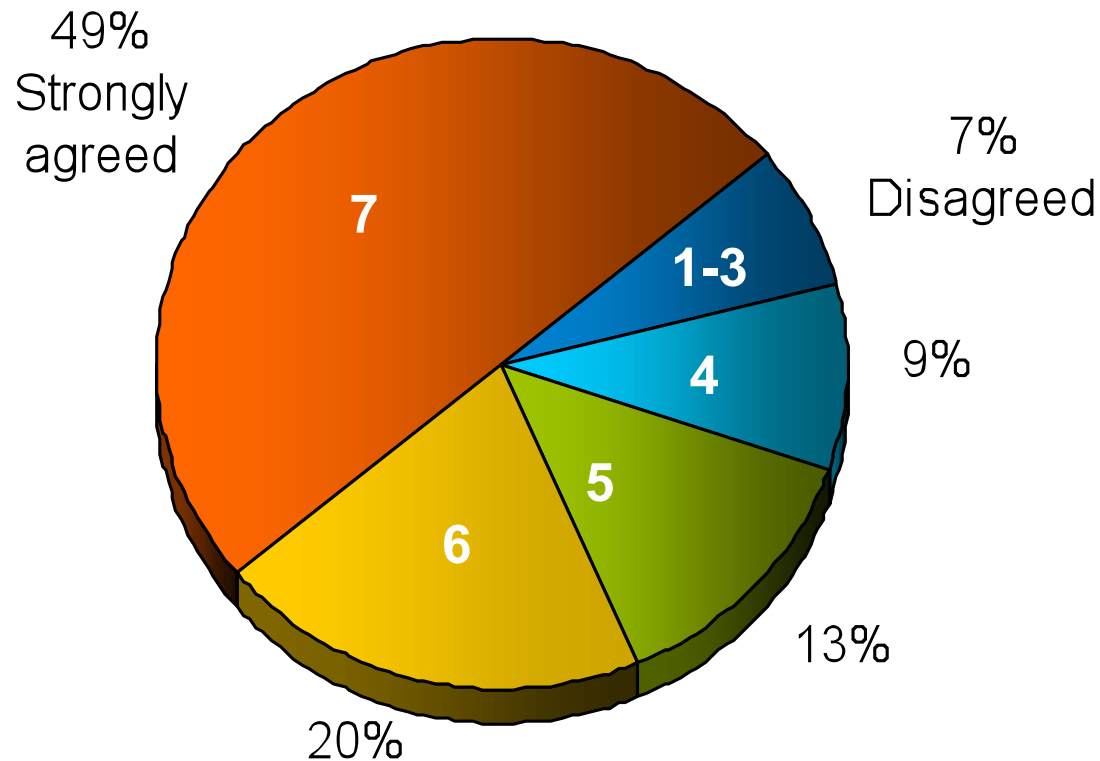


How would you assess your overall financial knowledge?



Self-Perception versus Financial Behavior

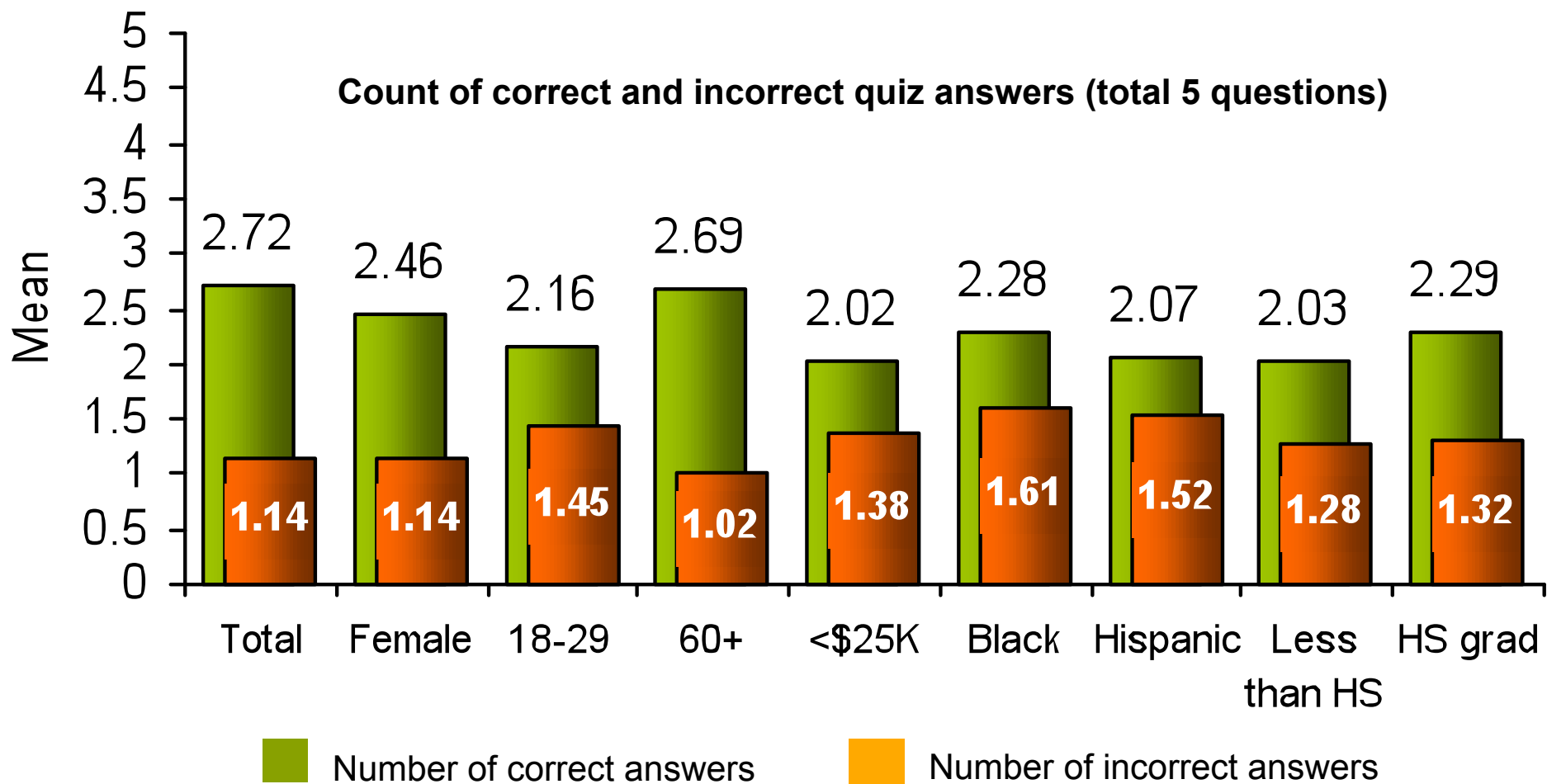
“I am good at dealing with day-to-day financial matters”
Respondents with credit cards and checking accounts



However, 24% who strongly agreed and 40% who agreed engaged in behaviors that generated fees or high costs.

Financial Literacy

Financial literacy has proven links to savings rates and wealth accumulation, but it varies between demographic groups



Summary

People are not well-equipped to make financial decisions

- **People are not well-informed about the terms of their financial contracts**
- **Many incur in behaviors that generate fees, interest payments, and other costs**
- **More than one in five Americans have used high-cost borrowing**
- **Lack of emergency savings makes Americans exposed to shocks**
- **Pervasive lack of financial knowledge and lack of awareness of financial illiteracy pose risk to both the individual and the economy**