Developing Financial Capability Over the Life Course

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June 3, 2013
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Financial Capability Over the Life Course

1. Defining Capability
2. Stages of the Life Course
3. Recommendations for Practice
‘Financial Capability’

**Shifting** financial decision making to individuals

- Knowledge, Skills, Behaviors, Attitudes
- Life Course
- Financial Access
- Adaptability & Confidence
- Goal: Economic Well-being
Financial Capability Model

Program → Knowledge

Experience → Skills

Personality → Attitude

Behavior
www.usfinancialcapability.org - clickable map

- 55 percent living paycheck-to-paycheck
- 60 percent do not have a rainy day fund to cover three months of unanticipated financial emergencies.
- On average 3/5 financial literacy questions correctly

...2012 Data Just Released...
Re-Frame: Understanding Decisions in Context

- Goal = financial security

- Choices = tradeoffs
  - Savings may not be goal; paying bills, debts, paying for ‘needs’
    - e.g. Emergency savings = cash in pinch or spending on ‘social mobility’
Payday Loans

Fast Friendly Service

$50. to

$500.

Payday Loans

No Credit Checks

Same day service
### Compared to What?

<table>
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<tr>
<th>14-Day Term</th>
<th>FEE</th>
<th>APR</th>
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<tbody>
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<td>Overdraft Protection &amp; Non Sufficient Funds (NSF) Fee</td>
<td>$28.95</td>
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<td>Overdraft Protection Fee</td>
<td>$27.00</td>
<td>579.71%</td>
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<td>Credit Card Late Fee: 1st Time Late</td>
<td>$25.00</td>
<td>536.76%</td>
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<tr>
<td>Credit Card Late Fee: 2nd Time Late</td>
<td>$35.00</td>
<td>751.48%</td>
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<tr>
<td>Utility Late/Reconnect Fee</td>
<td>$46.00</td>
<td>987.65%</td>
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<tr>
<td>Payday Loan</td>
<td>$15.00</td>
<td>322.06%</td>
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</table>
Life Course ‘Stages’

1. Youth
2. Young Adults
3. Families
4. Near Retirement
5. Out of Workforce
School Age Children

Kids Themselves

- Allowance (be consistent)
- Savings—in school and/or in home
- Basic Concepts: opportunity cost/tradeoffs

Parents

- Education Savings (529 plans as example)
- Family Budget
- Include in Decisions—observe you doing your ‘homework’
Rules of Thumb I for Youth (Parents/Teachers)

1. School-partnerships: financial institutions, community organizations
2. Family & financial discussions—need not be taboo, but not easy
3. Focus on tradeoffs not hard and fast rules
4. Investing in human capital as primary goal
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Post Secondary Schooling to Early 30s

- **School-work blend**: Building earning power
- **Financial Services**: Transitions to independence
- **Spending**: Managing Short and longer term
- **Health Insurance**: Being uninsured is risky financial choice
- **Debt**: Access to debt is good and important but must be well-managed
18 to 30 Year Olds: School to Work

Education & Student Loans

- Returns to college are strong
- Federal/subsidized students loans are still a good deal
- Working in school can slow you down

Getting Going

- Credit Management Matters...even for dating
- The Employee Benefits Maze
  - Health care: covered, but increasingly complex
  - Retirement Savings: start early even if small
    - * Automate!
How Recent College Graduates Stack Up

Note: Sample includes U.S. citizens aged 23 and 24 in 2010 who were not enrolled in school. Weekly earnings is averaged over this entire population, including those without work.
Source: CPS Merged Outgoing Rotation Group 2010.

http://www.brookings.edu/
Know your options:
- Standard Repayment
- Graduated Repayment
- Extended Repayment
- Income-Based Repayment (IBR)
  - Income-Contingent (ICR) (Direct)
- Income-Sensitive Repayment (FFEL)
- Alternative Repayment Plans (Direct)

http://www.studentloanborrowerassistance.org/
Check Your Credit Report Campaign
“5 minutes 3 times per year”
2/2, 6/6, 10/10

http://fyi.uwex.edu/creditreport/

- 15.9 out of 200+ million consumers use AnnualCreditReport.com annually (CFPB, 2012)
- 5% of records have errors that could have negative consequence (FTC, 2013)

- February 2\textsuperscript{nd} (2/2): (Experian)
- June 6\textsuperscript{th} (6/6): (Equifax)
- October 10\textsuperscript{th} (10/10): (TransUnion)
Rules of Thumb II for Young Adults

1. Invest in Yourself: consider costs of delay
2. Manage student loans: consolidation, IBR, deferment
3. Check Your Credit 3xs per year: [http://fyi.uwex.edu/creditreport/](http://fyi.uwex.edu/creditreport/)
4. Retirement Funds—maximize employer matches
   - Make it automatic
   - Watch for fees (on financial products of all types)
5. #1 risk? You cannot work. Need (term) life insurance & Disability
<table>
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<th>Chapter</th>
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<td>1</td>
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30-50 Year Old Families

Housing

- Rent vs. Own
- Buying a home for lifestyle not investment

Saving for Retirement

- Keep it Simple

Beware: Sold not sought

- There is no free lunch
A House is a Home

- Historically, ownership is a means for building wealth
- 1998-2006: expansion
  - Home equity used for consumption
- 2008 unemployment & home values fall
  - 4 million foreclosures later...
Focus on Fees

EFFECT OF A 1% DIFFERENCE IN HIGHER ANNUAL FEES ON A $20,000 401(k) BALANCE INVESTED OVER 20 YEARS.

Accumulated account balance with 0.5% charge for fees

Accumulated account balance with 1.5% charge for fees

17% Difference in asset value

Source: Government Accountability Office.

http://www.gao.gov/
Passive Investing: Hands Off is Better

- Very unlikely to beat market consistently
- A few funds or investments will beat the average, but rarely will that happen every year

<table>
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<th>Number of Funds</th>
<th>5 years</th>
<th>10 years</th>
<th>20 years</th>
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</thead>
<tbody>
<tr>
<td>3 funds</td>
<td>17%</td>
<td>9%</td>
<td>3%</td>
</tr>
<tr>
<td>5 funds(^1)</td>
<td>14%</td>
<td>8%</td>
<td>2%</td>
</tr>
<tr>
<td>10 funds</td>
<td>9%</td>
<td>6%</td>
<td>1%</td>
</tr>
</tbody>
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\(^1\)average number of funds held by typical investor
Why Play the Retirement Lottery?
Rules of Thumb III for Working Families

1. Buy a home (not a real estate investment you happen to live in)
2. Mortgages—shop around and refinance strategically
3. 401k funds (a)—focus on expense ratios and fees (not returns)
4. 401k funds (b)—use simple, broad market index funds
5. Save for kid’s college—it sends a signal
6. Just say ‘no’ to financial sales people.
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Transitions and Planning

- How long will you work? What does work mean?
- How healthy are you?
- What will your life be like in retirement?
Social Security Payments are a Form of Annuity

- Inflation adjusted payments for life
  - Core of retirement for many people
- Most people claim as soon as possible...
  - **Don’t** unless you have no other options
- Social Security Survivor benefits also valuable for spouse

**Use tools at:** [http://www.ssa.gov/](http://www.ssa.gov/)
Understanding Claiming Options

http://crr.bc.edu/special-projects/books/the-social-security-claiming-guide/
Social Security Benefits:
The Longer You Wait, The More You Get

Source: Center for Retirement Research at Boston College.

http://squaredawayblog.bc.edu/
Rules of Thumb IV for Nearing Retirement

1. Boost savings rate as other expenses decline
2. Manage health care costs & coverage
3. Stay healthy, but prepare for not being healthy
4. Give a lot of thought to Social Security claiming choices (with spouse)
5. Remember: work may continue. Retirement becoming less of an ‘event.’
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Retirement is not about money

- Replacement rate fallacy
  - You may not need as much as you think
  - Health care is the wild card
- Expectations, health & well-being are complex!
  - Living too long is a real risk
  - ‘Costs’ of maintaining complicated investments
  - Simplify, especially as we age
- Keeping trusts, wills, estates ‘fresh’
- Preventing Financial Fraud & Elder Abuse
Plan for Loss in Cognitive Functioning

Ability to make financial decisions?

- 30% of people in their 80s show cognitive impairment
- 20% of people in 80s show evidence of dementia

That’s 50%. 50-50 chance you will lose cognitive acumen.

http://dash.harvard.edu/handle/1/4554335
Rules of Thumb V for Seniors

1. Organize documents
   - Will
   - DPA: Durable Power of Attorney
   - Living will
   - Health care proxy

2. Simplify & Consolidate

3. Manage ‘Longevity Risk’
   - Annuity contracts: Yes, but read fine print

4. Talk to your spouse and family about managing finances regularly

![Thumb up emoji]
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Keeping Up in Modern Consumer Financial Market

- Accelerated use of technology
- Prepaid debit cards
- Electronic payments
- SmartPhone Wallet
- Instant liquidity
Financial Capability Strategies

Information Models
- Disclosures
- Print/Web
- Interactive Web
- Workshops
- One:One

Advice Models
- Technical expert (credentialed)
- Transactional guide (may have sales focus)
- Counseling (acute problem solving)

Mechanism Models
- Defaults
- Automatic Deposit
- Product constraints
Role of Education

Workshops, Seminars, Brochures, Websites etc.

- Reduce the cost of acquiring information
  - If people make better choices with more information
- Evidence of effects of financial literacy education are weak at best\(^2\)

- But, be careful about ‘right’ outcomes

\(^2\) http://ssc.wisc.edu/~jmcollin/JCA_published.pdf
More Information = More Debt Use

Pre-post Debt Levels: Financial Education v. Controls

- Control: Pre = $10,000, Post = $15,000
- Treatment: Pre = $10,000, Post = $15,000

Implications for Practice

More Information = More Debt Use

Multilevel Approaches

- Community-based orgs
- Helping professionals
- Partnerships with the financial sector

Social Ecological Model

PUBLIC POLICY
COMMUNITY
ORGANIZATIONAL
INTERPERSONAL
INDIVIDUAL
Be Realistic: Financial Interventions Have Limits

Limits of technical sciences...

Monitoring, Nutrition, Food Access, Counseling
Teachable Moments
- Life events
- Transitions

Not just a class; not just in school

Just in Time
- Decision making tools

Linking to financial product access
What About Behavioral Nudges?

Defaults

- Procrastination / Impatience

Inattention

- Reminders

Following the Crowd

- Social comparisons

- Pro: Can be very powerful
- Con: Indiscriminate

Still need to have the ability to make decisions
Emerging Strategies

- Peers, Couples, Generational
- Focus on Goals
- Translating into impacts on ‘future self’
- Leverage Peers (and peer networks)

**Examples:**

- Financial Coaching
- Emergency Savings
Focus on Well-Being

More than Finances

- Being a steward of all resources
- Stability—especially in housing
- Being able to response to shocks
- Mental and physical health
- Adaptability as contexts change
  - Stress
  - Confidence
  - Trust
Moving Forward

- Rules of thumb help...
  - ...but one size fits all solutions may not fit everyone
- Context matters
- A lot still to learn!
Learning More

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