THE ROLE OF FINANCIAL LITERACY IN FINANCIAL DECISIONS AND RETIREMENT PREPAREDNESS AMONG SENIORS AND OLDER ADULTS

Presentation to the Financial Literacy and Well-being Forum on November 24, 2015

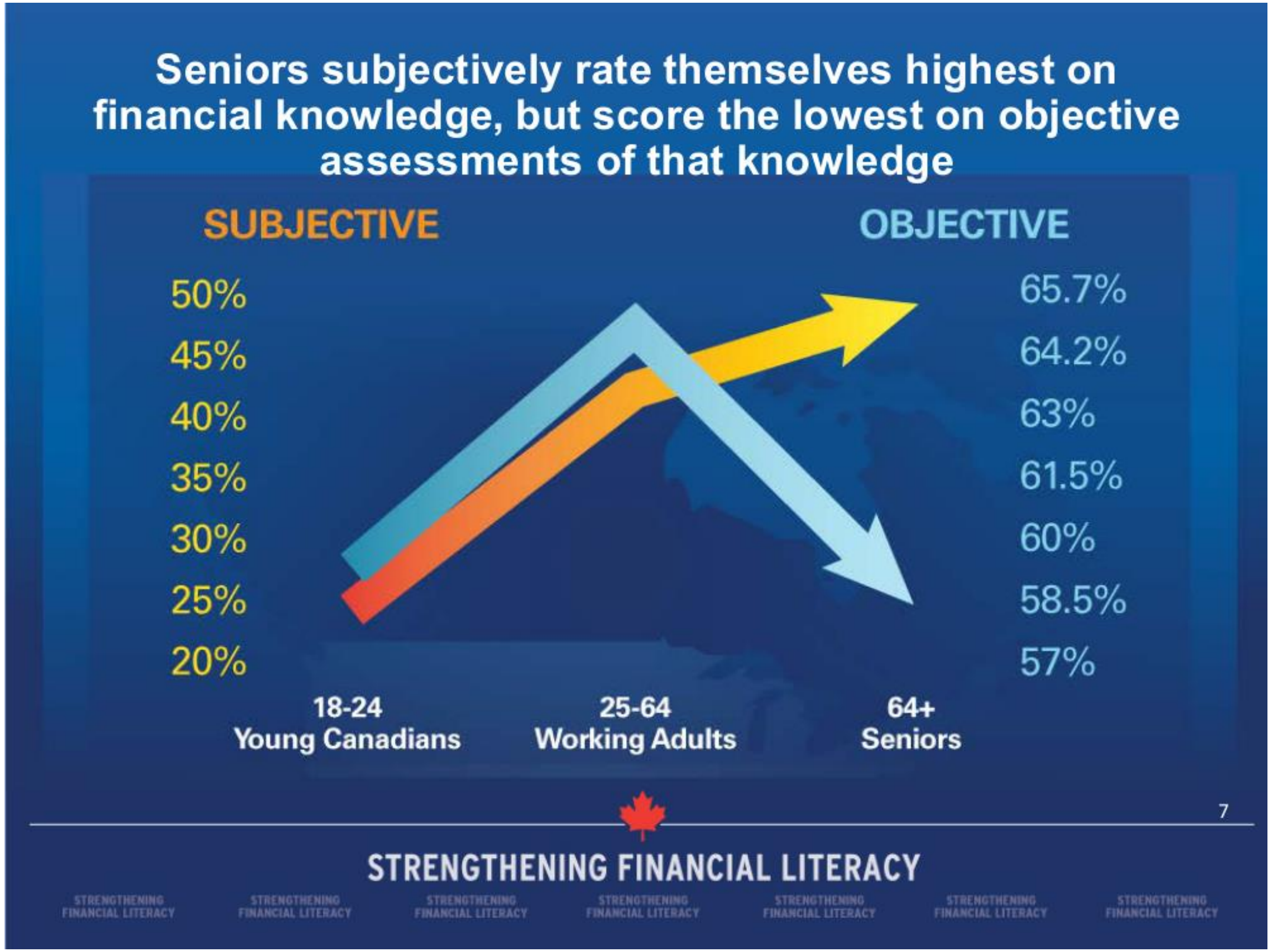
By Taylor Shek-wai Hui

SRDC SRSA
Social Research and Demonstration Corporation
Société de recherche sociale appliquée

INTRODUCTION

Background

Compared to youth and prime age adults, seniors have a larger a gap between their perception and the reality of their financial knowledge (Rooney, 2014).



Potential issues:

- Risk of fraud;
- Under-estimate investment risks;
- Running out of retirement savings.

Study Objectives

Objectives:

- To understand the characteristics of those who are “over-confident” among seniors (65+) and older adults (55-64)
- To understand the financial behaviours and outcomes that are associated with financial knowledge and confidence among seniors and older adults.
- To shed light on the needs of seniors and older adults in order to design effective intervention strategies.

This is a quantitative analysis using Statistics Canada’s public use microdata file of the Canadian Financial Capability Survey 2014.

METHODS

Working Definitions of "Over-confidence" and "Under-confidence"

- CFCS contains
    - 14 questions of objective assessment of financial knowledge (total score: 0-14);
    - 5 questions of self-assessment one's financial knowledge (4-point scale)
- However, there is no absolute linkage between objective and subjective assessments.
- Relative indicator by ranking(quartile):
    - Over-confidence: one's self-assessment ranks higher than the ranking of objective assessment
    - Under-confidence: one's self-assessment ranks lower than the ranking of objective assessment

		Objective assessment score quartile			
		First	Second	Third	Top
Subjective assessment score quartile	Top	Over-confident	Over-confident	Over-confident	Just confident
	Third	Over-confident	Over-confident	Just confident	Under-confident
	Second	Over-confident	Just confident	Under-confident	Under-confident
	First	Just confident	Under-confident	Under-confident	Under-confident

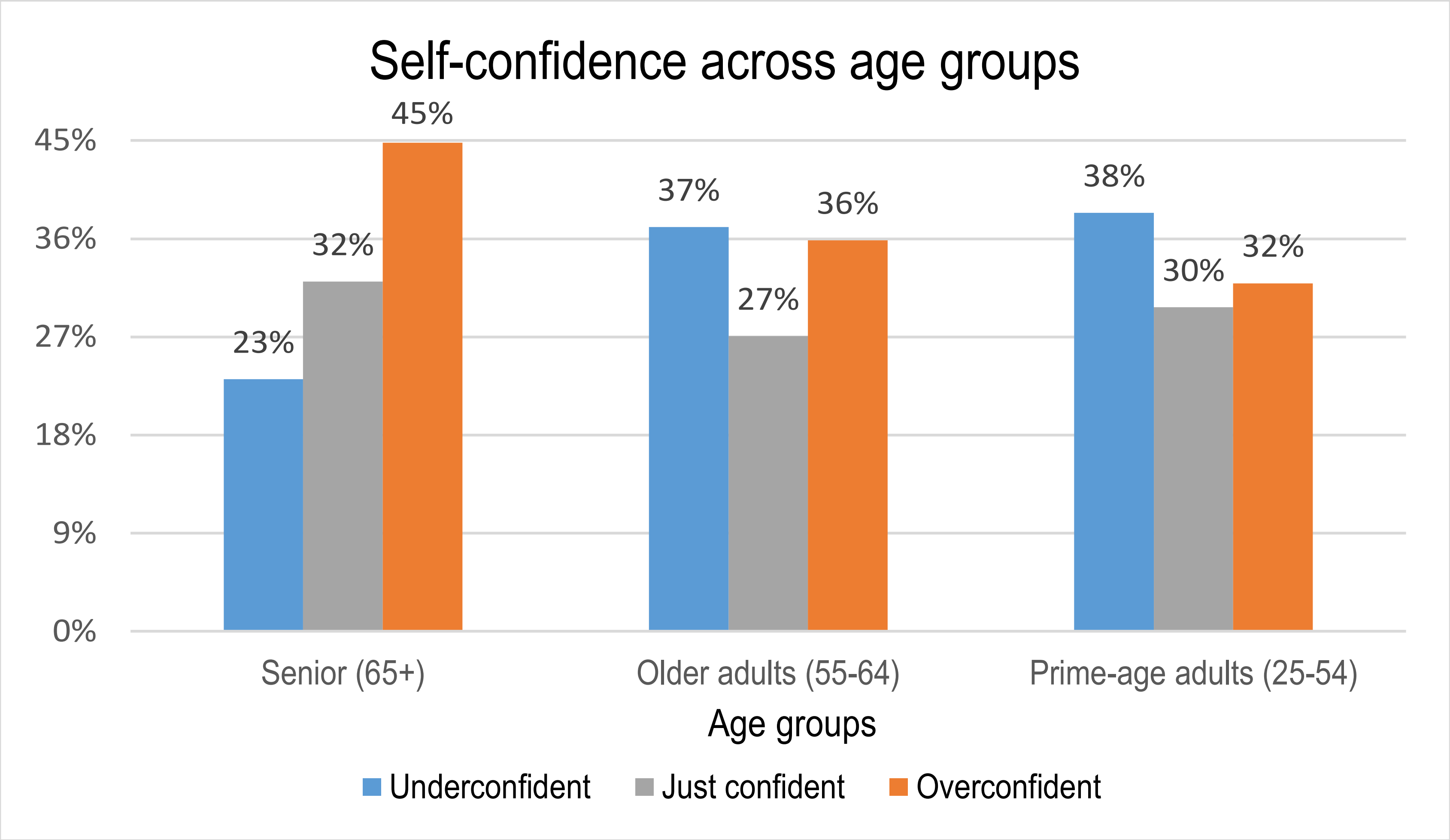
SRDC SRSA
Social Research and Demonstration Corporation
Société de recherche sociale appliquée

Objective and Subjective Assessments of Financial Knowledge

- In the adult population, three quarters are capable of answering questions correctly on the daily handling of money (basic financial knowledge).
- The identification questions beyond the first quartile are beyond basic financial knowledge.
- Subjective assessment follows a similar pattern.

Objective Assessment Items		First	Second	Third	Top	Subjective Assessment	
OA_12	Which can hurt your credit rating					SA_3	Making ends meet
OA_14	Which will help lower the cost of a house						
OA_5	Who would need the greatest amount of life insurance						
OA_4	T/F - Easily compare the cost of any brand						
OA_13	What affects amount of interest paid on a loan						
OA_6	If had savings account which statement on interest is correct						
OA_11	Which statement not correct about ATM cards					SA_2	Keeping track of money
OA_8	Safest place for university money						
OA_1	Savings provide same buying power at retirement					SA_4	Shopping around to get the best financial product
OA_7	Who would have problems during periods of high inflation					SA_5	Staying informed on financial issues
OA_9	Which investment best protects savings if sudden increase in inflation						
OA_2	A credit report - Comprehension					SA_1	Level of financial knowledge
OA_10	Which circumstances would it be beneficial to borrow money						
OA_3	Who insures stocks in the stock market						

Objective and Subjective Assessments of Financial Knowledge, by age



THE CHARACTERISTICS OF OVER-CONFIDENT AND UNDER-CONFIDENT SENIORS AND OLDER ADULTS

Comparing individual characteristics by self-confidence groups

- There is no single individual characteristic that can predict over- or under-confidence.
- There are some small variations:
  - Senior and older women were slightly more likely to be classified as over-confident because of their lower scores in the objective assessment.
  - Over-confident group had more people with relatively lower income and lower educational attainment.
  - Stage of life might matter:
    - larger household vs smaller households;
    - retired vs working.

* - pattern not observed among prime age adults 25-54.

Under-confident		Over-confident
Not widowed*		Women*
Households with 3 or more people*		Households with 1 or 2 people*
Resides in Western or Pacific Canada		Quebec
Household income above $80,000		Household income below $55,000*
Canadian Born		Educational Attainment: College, trade, vocational or technical school
Employed or Self-employed		Retired

SRDC SRSA
Social Research and Demonstration Corporation
Société de recherche sociale appliquée

FINANCIAL BEHAVIOURS

Financial behaviours – background (1)

Questions in CFCS do not always offer a clear interpretation of “desirable” or “good” financial behaviour. Three types of financial behaviour proxy indicators are derived:

1. Managing money and debt
    - Requested credit report
    - Usage of household budget and always staying within budget
    - Check bank balance at least once a week
    - Keeping up with bills and financial commitments without a problem
    - Debt other than mortgage or student loans (the lower the better)

2. Planning and saving for the future
    - No asset or savings (the lower the better)
    - Have 0 or 1 insurance (the lower the better)
    - Able to pay $5,000 unexpected expenditure
    - (Among those not yet retired): Financially prepared for retirement
    - (Among those not yet retired): Confident that the standard of living during retirement meets expectation.

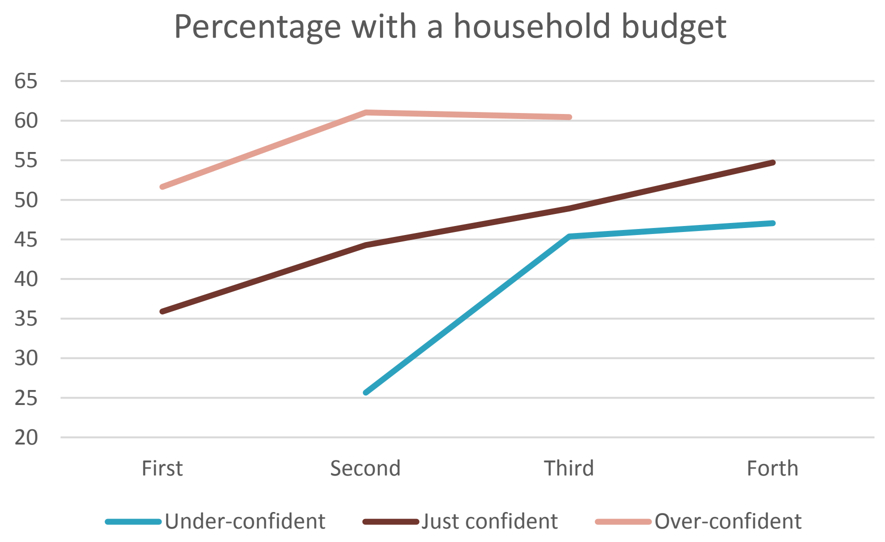
Financial behaviours – background (2)

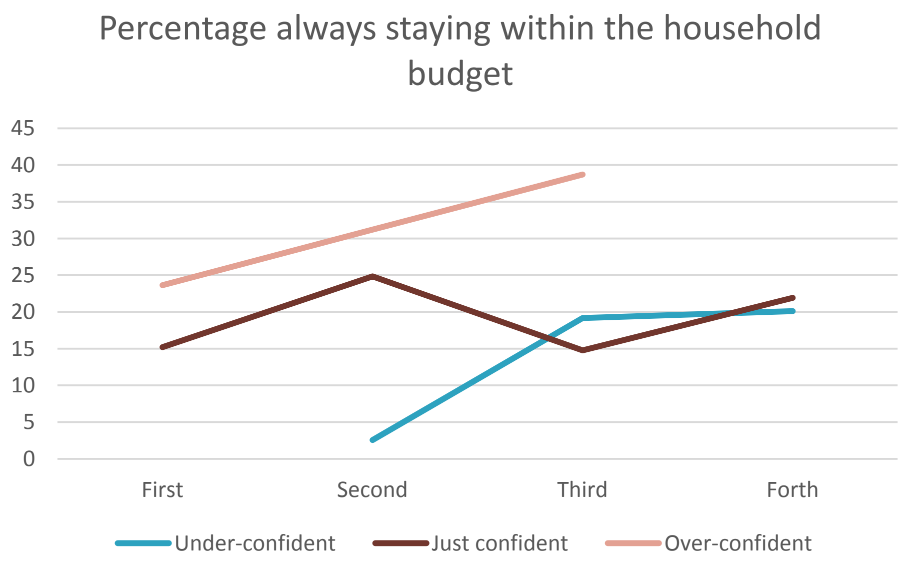
3. Protection against fraud
    - Used financial advices
    - Used professional financial advices
    - Have a will
    - Have arrangement in terms of powers of attorney

Examination of the level of these indicators by financial knowledge and self-confidence can reveal whether “over-confident” seniors and older adults do worse or better.

To control for confounding characteristics, the following indicators’ level have been adjusted for individual characteristics (gender, age group, immigrant status, educational attainment, home ownership and mortgage status, household income level, and value of financial asset) through regressions.

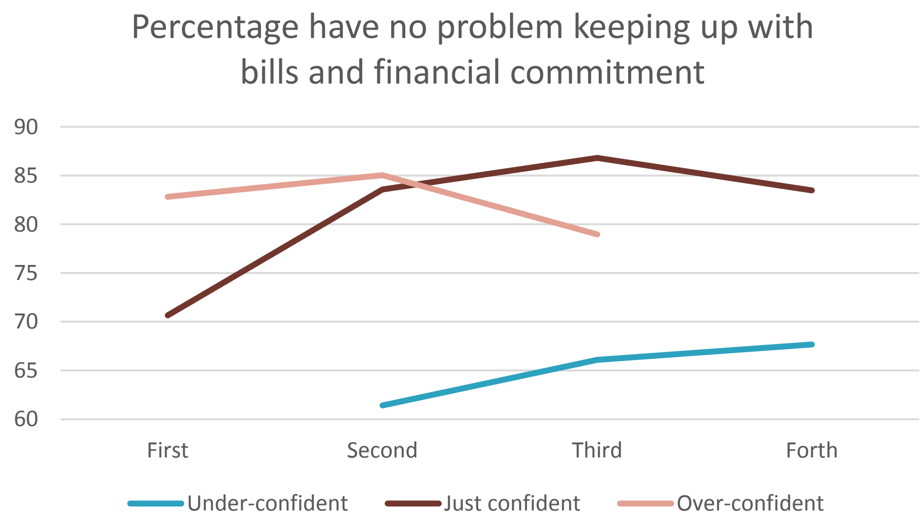
Managing money and debt by financial knowledge and confidence (1)

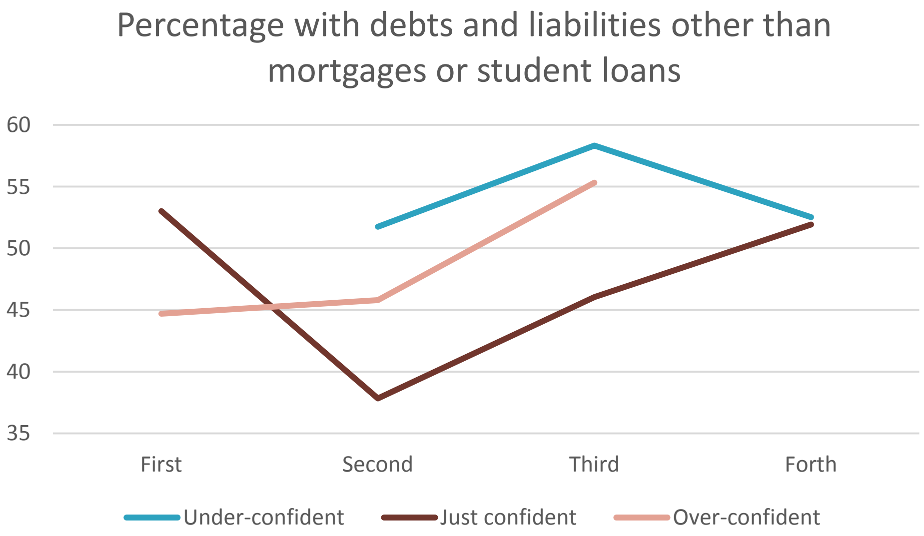




- Overall, for indicators of *managing money and debt*, desirable outcomes increase with financial knowledge
- However, for several key indicators, those in the over-confident group appear to do better, while those in the under-confident group do worse
- **Example – household budgeting**
  - Over-confident EXCEEDS just-confident (OC > JC) at ALL levels of financial knowledge
  - Under-confident is BELOW just-confident (UC < JC) but ONLY at LOWER quartiles of financial knowledge
- **Possible implications – program targeting**
  - Programs to improve budgeting may be better targeted at UNDER-confident groups with LOW knowledge
  - OVER-confident groups, even those with LOW knowledge, appear to do relatively well, in spite of lower skills

Managing money and debt by financial knowledge and confidence (2)



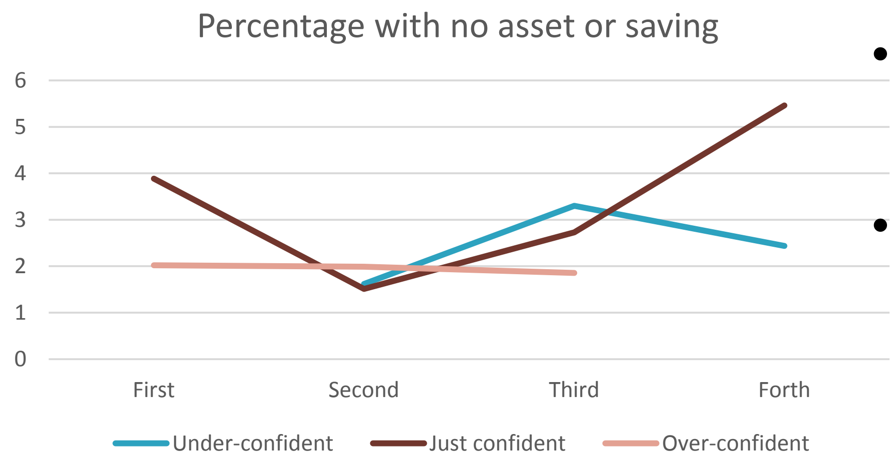


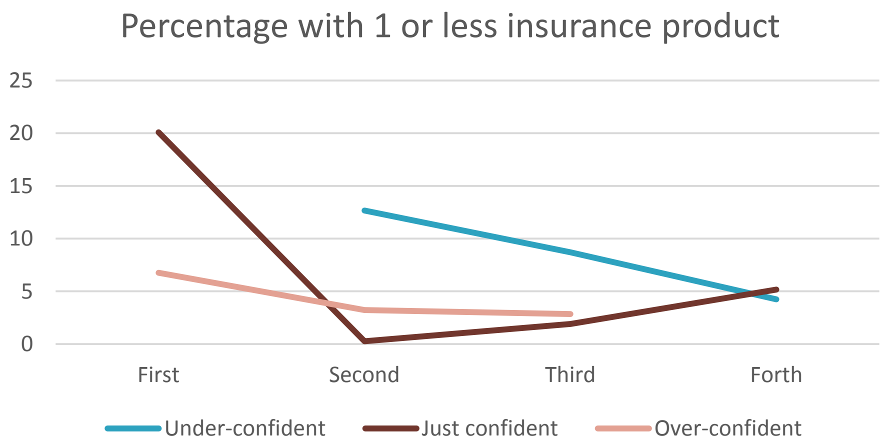
- This overall pattern for under-confident groups appears to hold for related indicators of managing money and debt
- However, over-confident groups at higher levels of objective financial knowledge, are NOT always doing better
- **Examples – keeping up with bills, debts/liabilities**
  - Over-confident better off than just-confident (OC > JC) but ONLY at the LOWEST quartile of objective knowledge
  - For instance, % with non-mortgage debt is 10 pp higher for over-confident groups at higher levels of knowledge
- **Possible implications – program targeting**
  - OVER-confident groups, even those with HIGHER levels of objective knowledge, might also benefit from programs, education, or supports in areas of debt management

FINANCIAL BEHAVIOUR

SRDC SRSA Social Research and Demonstration Corporation Société de recherche sociale appliquée

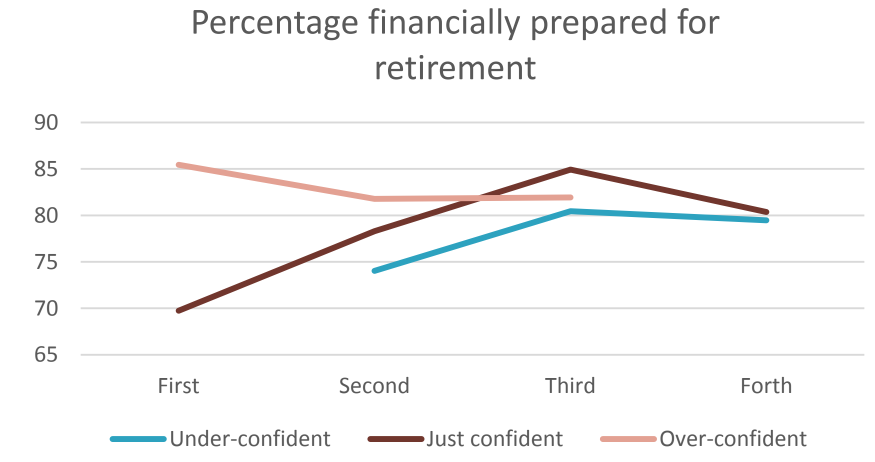
Planning and saving for the future by financial knowledge and confidence (1)

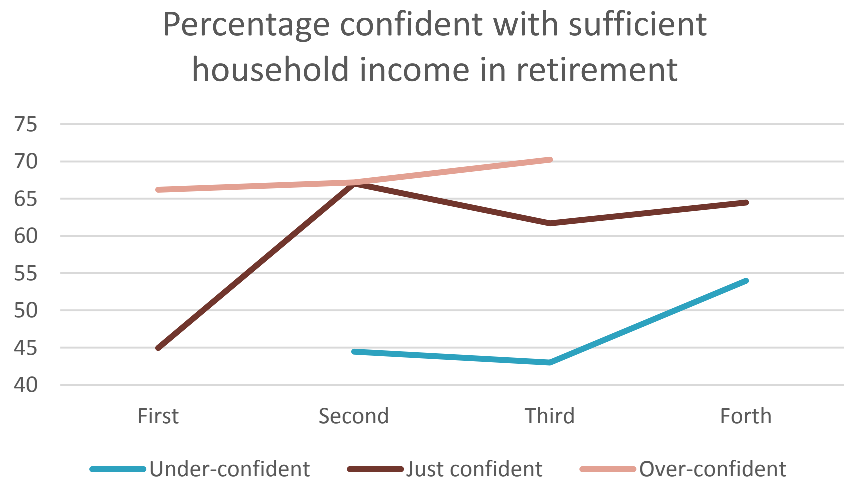




- With respect to planning and savings for the future, there are a mixed set of results depending on the indicator
- **Examples – savings behaviour, insurance products**
  - Consistent with earlier results, OVER-confident groups may be doing better than just-confident at the LOW end of objective financial knowledge
  - But surprisingly, UNDER-confident groups at the HIGHER end of objective financial knowledge perform equally or better with respect to savings on some indicators
  - However, UNDER-confident groups at the LOWER end less likely to own insurance products
- **Possible implications – education/promotion**
  - Educational/promotional programs for insurance-based products may need additional efforts to reach UNDER-confident groups with LOWER financial knowledge

Planning and saving for the future by financial knowledge and confidence (2)

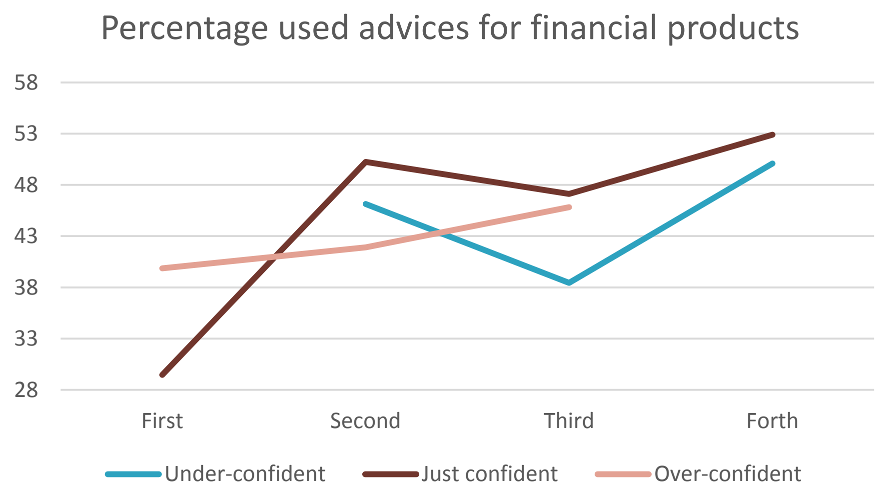


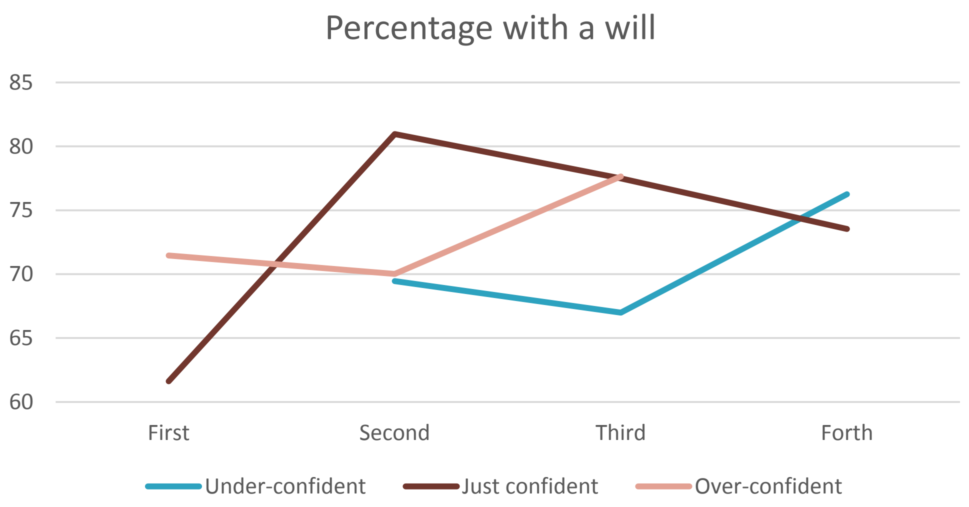


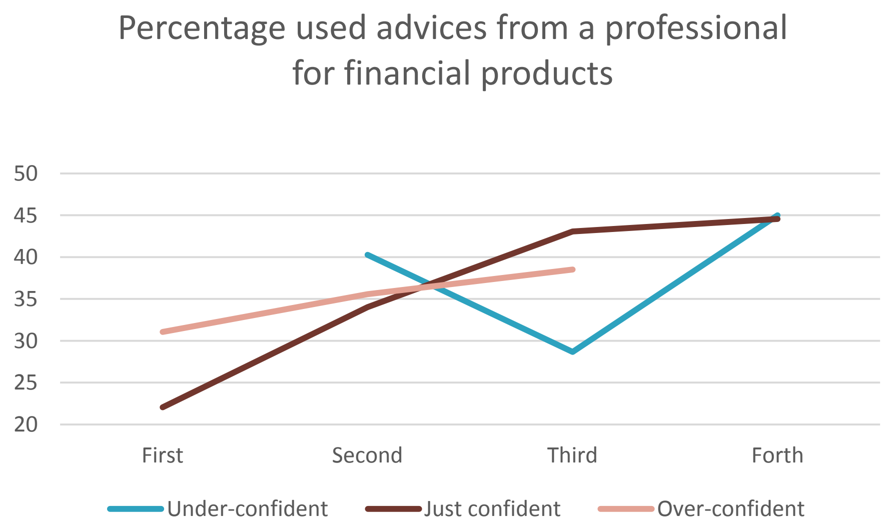
Examples – retirement preparedness

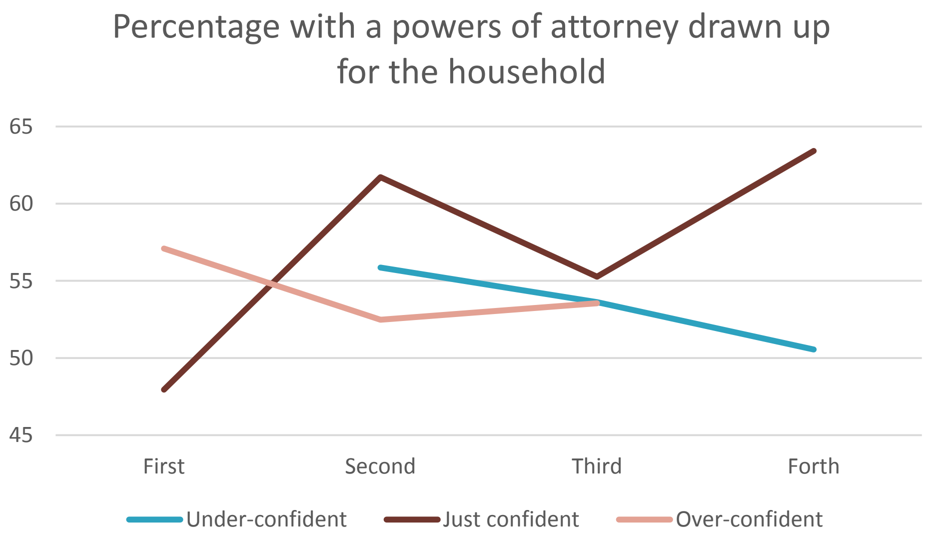
- Preparedness for retirement, among those who had not retired, increases with financial knowledge.
- Again, confidence in one's financial knowledge coincides with one's preparedness for retirement.
- Regardless, a substantial proportion (over 30%) were not confident their household income would be sufficient to meet their expected standard of living after retirement.
- Not surprisingly, under-confident groups report being less prepared at all levels of objective knowledge – with as much as 20 percentage points fewer reporting confidence

Protection against fraud by financial knowledge and confidence









Social Research and Demonstration Corporation
Société de recherche sociale appliquée

CONCLUDING REMARKS

Summary

- Seniors and older adults who rated their financial knowledge more than they have demonstrated in the test of the CFCS were less educated with a lower household income
- Among seniors and older adults, best practices in managing money and debt, planning and saving for future, as well as protection against fraud were associated with financial knowledge as well as one's confidence in one's financial knowledge
- Raising seniors' self-confidence in financial literacy appears to be as important as raising financial knowledge, given that those who had lower self-confidence tend to adopt fewer best practices of financial behaviour
- Over-confidence in financial literacy also appears to play a key role in some financial behaviours and outcomes of seniors
- These results may have important implications for the design and targeting of programs, particularly those that support budgeting, debt management, and savings

Food for thought

- SRDC's experimental evaluation of *learn*$ave did not find any impact on saving or financial management behaviour for classroom style financial management training provided to low income participants (who had less financial knowledge). Participants reflected that they did not think the content were useful.
- Recent studies in public funded training demonstrated that targeting the needs of participants are crucial in determining efficacy of the training.
- Which is more useful to seniors and older adults?
    - The knowledge of "which investment best protects savings if sudden increase in inflation" when Bank of Canada has successfully targeted inflation within a stable 2% band?
    - The knowhow of "comprehending a credit report" when one's capability of borrowing against future income is disappearing?
    - A strategy to budget for household spending and always staying within budget?
    - Have the confidence of consulting reliable professional advice to ensure sufficient income for retirement?