

OLDER ADULT DEBT AND FINANCIAL FRAILTY

ANNAMARIA LUSARDI AND OLIVIA S. MITCHELL *

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Many individuals lack the financial know-how to manage the complex new financial products increasingly available in the financial marketplace. How people borrow and manage debt has become of increasing policymaker concern, given recent evidence on Americans' overindebtedness. As a consequence, some have suggested that older persons today are much more likely to enter retirement age in debt compared to decades past. Our new paper seeks to empirically evaluate the factors associated with older individuals' debt and debt management practices, and whether (and how) these patterns have changed significantly over time.

Motivation

We focus on debt for several reasons. First, debt generally rises at interest rates higher than those which can be earned generally on assets. For this reason, debt management is critical for those seeking to manage their retirement assets. Second, not only do families have greater opportunities to borrow to buy a home and access home equity lines of credit, but also they need lower down payments in order to buy a home. Additionally, as sub-prime mortgages proliferated, credit became increasingly accessible to consumers with low credit scores, little income, and few assets. Consumer credit, such as credit card borrowing, has also become more accessible, and this type of unsecured borrowing has increased over time. Third, in many states, alternative financial services have proliferated, including payday loans, pawn shops, auto title loans, tax refund loans, and rent-to-own shops. Fourth, a focus on debt may help to identify financially fragile families who may be sensitive to shocks and not be able to afford a comfortable retirement. Last, the recent financial and economic crisis was largely driven by borrowing behavior, so understanding debt may be informative to help avoid a repeat of past errors.

Methods and Results

We evaluate older individuals' debt patterns using the Health and Retirement Study (HRS) and the National Financial Capability Study (NFCS). Using the 2009 and 2012 National Financial Capability Study (NFCS), we explore detailed information on how families manage their debt. Using the HRS, we also compare three different cohorts of people on the verge of retirement (age 56-61) at three different time periods: 1992, 2002 and 2008. We assess how debt among older persons has evolved, and we discuss the potential consequences of our findings regarding indebtedness on the verge of retirement.

We contribute to the literature with two sets of empirical analyses. First, using the HRS, we compare three different cohorts of people on the verge of retirement (age 56-61) at three different time periods: 1992, 2002 and 2008. The HRS analysis provides an evaluation of cross-cohort changes in debt over time. Second, we examine older individuals' debt patterns using the 2009 and 2012 National Financial Capability Study (NFCS), focusing on how older households manage their debt and on financial fragility.

Our results indicate that more recent cohorts have, indeed, taken on more debt and face more financial insecurity, mostly due to having purchased more expensive homes with smaller down payments. In addition, Baby Boomers are more likely to have engaged in the use of expensive alternative financial services. Factors reducing exposure to debt include having higher income, more education, and greater financial literacy. Factors associated with greater financial

* *Olivia S. Mitchell* is the International Foundation of Employee Benefit Plans Professor of Insurance and Risk Management at the Wharton School, University of Pennsylvania. *Annamaria Lusardi* is Denit Trust Distinguished Scholar in Economics and Accountancy at the George Washington University School of Business. This Research Brief is based on MRRC Working Paper 2013-291.

fragility include having had more children, poor health, and unexpected large income declines. Thus, shocks do play a role in the accumulation of debt close to retirement. But it is not enough to have resources, people also need the capacity to manage those resources if they are to stay out of debt as they head into retirement.

We also examine patterns of financial fragility, measured several ways including whether people had debt to asset ratios of over 50% (see Table 1). Again, things look more problematic for the Baby Boomers, since almost a quarter (23%) had debt exceeding their total assets versus only 10% of the earliest cohort we examined.

Implications

Most theoretical models of household portfolios have tended to focus on household portfolio patterns without devoting much attention to debt patterns. The present research indicates that analysts and policymakers in the future may be interested in formulations that incorporate debt and debt management practices into the factors driving retirement security. The fact that there is often a wedge between interest rates charged on debt versus returns that people can earn on their saving is generally not taken into account. Moreover, extant models tend to overlook the fact that interest rates charged to individuals are not fixed but can be shaped by peoples’ behavior. Our paper thus motivates additional research on key aspects of debt and debt management for future policy analysis.

Why Boomer Debt Is of Concern

It is important to focus on debt among Baby Boomers for at least three reasons. 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 such as payday loans, pawn shops, auto title loans, tax refund loans, and rent-to-own shops. Third, it appears that the prevalence of financially fragile and indebted households has risen over time. Our analysis of debt patterns seeks to help us avoid a repeat of past errors and assist those on the doorstep of retirement to focus specifically on debt management.

Table 1. Measures of Financial Fragility on the Verge of Retirement in the National Financial Capability Study (NFCS)

Financial Fragility Measures	Age 56-61
Underwater with home value*	17.0%
Credit card fees, at least one type*	31.4%
Loan from retirement accounts*	7.0%
Hardship withdrawal from retirement accounts*	5.7%
Unpaid medical bills	23.4%
High-cost borrowing	21.2%
Too much debt	39.9%
Could not come up with \$2,000	35.5%

* Values conditional on holding the asset or debt. Statistics on hardship withdrawal and loan and retirement account reported if have a retirement account. Source: Derived from Lusardi and Mitchell (2013)

University of Michigan Retirement Research Center
Institute for Social Research 426 Thompson Street Room 3026
Ann Arbor, MI 48104-2321 Phone: (734) 615-0422 Fax: (734) 615-2180
mrrcumich@umich.edu www.mrrc.isr.umich.edu

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