Debt and Debt Management among Older Adults

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15th Annual Joint Meeting of the Retirement Research Consortium

August 1-2, 2013
Washington, D.C.

The research was supported by a grant from the US Social Security Administration (SSA) as part of the Retirement Research Consortium (RRC). Support was also provided by the Pension Research Council/Boettner Center of the Wharton School at the University of Pennsylvania. We thank Carlo de Bassa, Ana Gazmuri, Yong Yu for research assistance. The findings and conclusions are solely those of the authors and do not represent the views of SSA, any agency of the Federal Government, the Michigan Retirement Research Center, or any other institutions with which the authors are affiliated. © Lusardi and Mitchell.

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Abstract

Complex financial markets are increasingly accessible to consumers as new products and financial services arrive to market. Nonetheless, many of these products are complex and difficult to grasp, especially for financially unsophisticated individuals. Of particular interest in the present economic environment is access to credit. This project analyzes older individuals' debt and debt management using data from the Health and Retirement Study (HRS) and the National Financial Capability Study (NFCS). Specifically, we examine three different cohorts (individuals age 56–61) in different time periods, 1992, 2002 and 2008, in the HRS to evaluate cross-cohort changes in debt over time. We also evaluate the impact of the financial crisis drawing on more recent data from the National Financial Capability Study (NFCS), where we also have detailed information on how families manage their debt. Our goal is to assess how wealth and debt among older persons has evolved over time, along with the potential consequences for retirement security.

Introduction

Recent research has shown that many individuals lack the financial knowhow to manage the complex new financial products increasingly available in the financial marketplace.[1] 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 goals in the present paper are to evaluate empirically what determines older individuals' debt and debt management practices, and whether (and how) these have changed significantly over time. Accordingly, 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 draw conclusions about the determinants then assess how debt among older persons has evolved, and we discuss the potential consequences of our findings regarding the role of debt on the verge of retirement.[2]

Our focus on debt is important for several reasons. First, debt generally rises at interest rates higher than those which can be earned on safe saving accounts. For this reason, debt management is critical for those seeking to manage their retirement assets. Second, access to credit has markedly increased during the last 20 or so years. Not only do families have greater opportunities to borrow to buy a home and access home equity lines of credit, while down payments needed to buy a home have fallen. 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. Finally, in many states, alternative financial services have proliferated including payday loans, pawn shops, auto title loans, tax refund loans, and rent-to-own shops (Lusardi and Bassa Scheresberg, 2013).

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[1] See for instance Lusardi and Mitchell (2007, 2008, 2011a, b, c, forthcoming) and Lusardi, Mitchell, and Curto (2010, 2012).
[2] Our prior work examined saving and asset building among those 50+ (Lusardi and Mitchell, 2007, 2011a).

Third, 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. Early macroeconomic analyses of firms taking up large amounts of debt (Bernanke and Campbell, 1988) can also be applied to households, as we shall show. 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.

Prior Literature

Many have expressed concern that Americans approaching retirement face worrisome levels of debt.[1] The evidence seems to confirm such concerns: over half (55%) of the American population age 55–64 carries a home mortgage, and about the same fraction (50%) has credit card debt (Bucks et al., 2009). Moreover, according to the same study, debt remains widespread until late in the life cycle. Thus among people age 65–74, almost half had mortgages or other loans on their primary residences, over a third held credit card debt, a quarter had installment loans; in this age group, two-thirds held some form of debt. Furthermore, managing debt and other financial matters is problematic for many in the older population (FINRA, 2006, 2007). For instance, research has revealed a U-shaped age pattern of quality of financial decision-making regarding 10 financial areas including credit card balance transfers; home equity loans and lines of credit; auto loans; credit card interest rates; mortgages; small-business credit cards; credit card late-payment fees; credit card over-limit fees; and credit card cash-advance fees (Agarwal et al. 2009). Fees and interest paid are lowest in the early 50s and rise thereafter; moreover, older individuals pay some of the highest costs for these services.

Of late there has also been an increase in the proportion of older Americans filing for bankruptcy. Pottow (2012) concluded that the age 65+ demographic is the fastest-growing in terms of bankruptcy filings, which were 2% in 1991 and rose to more than three times that rate by 2007. Credit card interest and fees were the most-cited reason for bankruptcy filings by such older people, with two-thirds of them providing these reasons. Evidence from the 2009 National Financial Capability Study and the TNS Debt Survey

[1] For a few recent examples see AARP (2013), Cho (2012), Pham (2011) and Securian (2013).

showed that people age 55+ hold widespread credit card debt and pay a great deal in fees for late payments and exceeding the credit limits – when they should be at the peak of their wealth accumulation process (Lusardi, 2011; Lusardi and Tufano, 2009a,b).

Moreover, these studies also find a link between debt management and financial literacy; with those least financially literate tend incur high fees and use high-cost borrowing. The least financially knowledgeable also reported that their debt loads were excessive and they were often unable to judge their debt positions. This group is also more likely to borrow from their 401(k) and pension accounts (Lu et al. 2010, Utkus and Young, 2011) and use high-cost methods of borrowing such as payday loans (Lusardi, 2010).

In our research, 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. 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.