The role of financial literacy in financial decisions and retirement preparedness among seniors and near-seniors

Taylor Shek-wai Hui, Cam Nguyen, Boris Palameta, David Gyarmati

May 2016

Executive Summary

For the Financial Consumer Agency of Canada

SRDC SRSA

The Social Research and Demonstration Corporation (SRDC) is a non-profit research organization, created specifically to develop, field test, and rigorously evaluate new programs. SRDC's two-part mission is to help policy-makers and practitioners identify policies and programs that improve the well-being of all Canadians, with a special concern for the effects on the disadvantaged, and to raise the standards of evidence that are used in assessing these policies.

Since its establishment in December 1991, SRDC has completed over 250 projects and studies for various federal and provincial departments, municipalities, as well as other public and non-profit organizations. SRDC has offices located in Ottawa, Toronto, and Vancouver, and satellite offices in Calgary and Winnipeg.

For information on SRDC publications, contact

Social Research and Demonstration Corporation
55 Murray Street, Suite 400
Ottawa, Ontario K1N 5M3
613-237-4311 | 1-866-896-7732
info@srdc.org | www.srdc.org

Vancouver Office
789 West Pender Street, Suite 440
Vancouver, British Columbia V6C 1H2
604-601-4070 | 604-601-4080

Toronto Office
481 University Avenue, Suite 705
Toronto, Ontario M5G 2E9
416-593-0445 | 647-725-6293

Executive summary

It has become increasingly important for Canadians to equip themselves with sufficient knowledge, skills, and confidence to manage their personal finances before and during retirement. As highlighted in the National Strategy for Financial Literacy,[1] Canadians are living longer and leading more active lives than ever before. It is estimated that the average Canadian currently approaching retirement age can expect to live until the age of 86. People who retire at the age of 65, will have to live on their pensions and savings for an average of 21 years, and possibly longer. With the decline in coverage of workers through employer-sponsored pension plans, Canadians face an increasing personal responsibility to plan for their own retirement. In spite of this, one in three Canadian adults is not financially preparing for retirement, according to findings from the 2014 Canadian Financial Capability Survey. Furthermore, when compared to youth and prime age adults, seniors score the lowest on objective assessments of financial knowledge, yet they rate their financial confidence as the highest of any age group. This study seeks to determine the impact that this difference between financial knowledge and financial confidence has on seniors and their ability to meet their financial needs in retirement.

This study makes use of microdata from the 2014 Canadian Financial Capability Survey to examine financial knowledge and financial confidence among seniors (aged 65 and over) and near-seniors (aged 55 to 64). The study considers how knowledge and confidence are related to three domains of financial behaviour that are critical for retirement preparedness: money and debt management, future planning and savings, and best financial practices and protection measures. The study also compares individuals' financial knowledge levels with their financial confidence assessments. People are classified as either under-confident, confident or over-confident, according to their financial confidence relative to their financial knowledge.

The results of the quantitative analysis suggest that financial confidence has important effects on retirement preparedness among seniors and near-seniors. This goes beyond the simplistic view equating cautiousness with low confidence or recklessness with over-confidence. Our analysis shows that the effects of financial confidence vary according to the levels of financial knowledge.

- **High knowledge alone is not enough to lead to financially desirable behaviours:** Among the high-knowledge population of seniors and near-seniors, a lack of financial confidence can hinder good practices in personal finance. At the same time, high financial confidence can help to compensate for a lack of financial knowledge.
- **Confidence seems to direct seniors and near-seniors with low knowledge toward financially desirable behaviours in several key domains:** Highly confident individuals who are less knowledgeable are doing well in managing their debt, keeping up with their bills, checking their bank accounts frequently, having some savings or assets, having multiple insurance products, and being better prepared for unexpected changes in financial needs.
- **Overconfidence can lead seniors and near-seniors with high knowledge to make poorer financial decisions in some areas:** Those who are financially knowledgeable but over-confident are less likely to be able to keep up with bills or pay for large unexpected expenses. They are also more

[1] Financial Consumer Agency of Canada (2014). National Strategy for Financial Literacy Phase 1: Strengthening Seniors' Financial Literacy. Ottawa, ON.

likely to take on consumer debt than their counterparts whose level of confidence is aligned with their knowledge.

- **Under-confident seniors and near-seniors are at a higher risk of poor financial outcomes:** Under-confident seniors and near-seniors are generally worse off than those who are confident or over-confident, in all three behavioural domains examined: money and debt management, future planning and savings, and protection measures.

Overall, the findings suggest that financial education programs and initiatives need to enhance not only objective knowledge but also financial confidence in seniors and near-seniors. When designing and targeting programs to enhance financial capability, it is important to consider not only seniors' and near-seniors' cognitive ability, but also their changing financial confidence in key skill domains.

With respect to current money and debt management, the findings suggest that **programs to improve budgeting may be better targeted to under-confident seniors and near-seniors with low knowledge**. For debt management more specifically, some over-confident groups with higher levels of financial knowledge may also benefit from educational programs to improve their handling of debt and their awareness of high-cost credit usage.

When we consider financial planning for the future, the findings suggest that under-confident seniors and near-seniors are systematically at risk of insufficient planning and saving. **Educational and support programs need to focus on improving confidence as a means of developing good planning and saving habits.** The results also indicate that additional effort may be needed to promote insurance-based products among the under-confident groups with financial knowledge in particular, as these groups appear to be under-insured.

As for ensuring best financial practices and protection measures, **efforts should be focused on increasing seniors' and near-seniors' objective financial knowledge, as well as their financial confidence in financial decision-making.** Financial confidence appears to compensate for many deficits in objectively assessed knowledge with respect to adopting best financial practices and protecting one's interests. This is particularly important for seniors and near-seniors who may not have high levels of financial knowledge as compared with other groups of Canadians.

More generally, the findings suggest that **financial literacy programs should incorporate critical activities to raise participants' awareness of their own skills**, which can include various forms of pre- and post-learning assessments. This can provide feedback mechanisms that, for the under-confident, can bolster financial confidence and, for the over-confident, can help set realistic expectations based on their actual skills, financial behaviours, and retirement preparedness. In addition to program design, the research has implications for the targeting and promotion of financial education programs. Promotional and marketing activities may be more effective in reaching and motivating enrolment among seniors and near-seniors if they are tailored to incorporate differences in confidence levels.