Consumer Literacy & Credit Worthiness

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Promises and Pitfalls: As Consumer Finance Options Multiply, Who is Being Served and At What Cost?

Overview of Purpose & Policy Objectives

Purpose:

We want to better understand consumer literacy and credit worthiness. (Determinants? Policy instruments?)

- Rely on unique data: survey information on finances, attitudes, experiences and behaviors & credit information from credit files --12,140 respondents aged 20 to 40, with household incomes under $75,000

Policy Questions Addressed:

1. Does consumer literacy impact credit worthiness?
2. Does consumer literacy impact financial behavior? If so, can improved literacy improve behavior?
3. Do financial behaviors impact the likelihood of having impaired credit? If so, will interventions that change behavior change credit worthiness?

Model of Credit Worthiness

- Source of Knowledge
- Parental Influence
- Income & Variability
- Home Ownership
- Employment
- Credit Counseling
- After School Job
- Education/Loan
- Gender/Age/Children
- Marital Status
- Race

Financial Knowledge (Consumer Literacy)
Self-Assessed & Objective

Additional Variables:
- Self Assessed Knowledge
- Objective Knowledge
- Attitudes
- Locus of Control
- Ability to Cope
- Financial Safety Net
- Feelings
- Income/Net Worth
- Ex-Spouse Effects

Financial Behavior (Self Control)
- Budgeting and Saving
- Ability to Control Finances

Financial Outcomes (Credit worthiness)
- Negative Events
- Financial Stress and Strain

Additional Variables:
- Behavior
- Bad Events
- School of Hard Knocks
- Divorce Impacts
- Management of Finances
- Agreement about Finances

Key Results

- Consumer Financial Knowledge:
  - Learning experiences, formal education & counseling impact financial knowledge
  - Credit card usage/payment patterns, income & net worth & having a financial safety net also impact knowledge
- Financial Behavior
  - The key explanatory variable for behavior is financial knowledge.
  - The set of psychological factors also had an expected large impact on financial behavior (a respondent behaves "better" if more optimistic, taking fewer risks, not worrying too much about money, and being able to cope)
  - Income relative to parents and the existence of a safety net are more important than actual income, net worth or home ownership
- Credit Outcomes
  - The key predictor for credit outcomes is financial behavior.
  - Also important: income (variability) measures, spousal behavior

Conclusions

Using a very unique data set designed to help us understand the interactions between literacy and credit worthiness, we have been able to find support for the following:

- Consumer literacy matters!
- Behavior is not explained simply by rationale economic behavior – other influences seem to matter (psychological factors, locus of control, parental and spousal influences)
- Credit outcomes can change and increased knowledge (and awareness of that knowledge) can lead to better financial behavior and improved credit outcomes.