Overconfident and Underprepared

The Disconnect Between Millennials and Their Money

National Endowment for Financial Education

About this
Executive Summary

This summary presents key findings from *Financial Capability Among Young Adults*, a study by Annamaria Lusardi, academic director of the Global Financial Literacy Excellence Center and Denit Trust Chair of Economics and Accountancy at The George Washington University School of Business; and Carlo de Bassa Scheresberg, senior research associate at the Global Financial Literacy Excellence Center.

The full report, available at www.nefe.org, was prepared in June 2015 to document new research funded by the National Endowment for Financial Education® (NEFE®) to analyze financial capability among young adults using data from the 2012 National Financial Capability Study.

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Millennials and Their Money:

Assessing the Balance Sheet

There are two sides to every balance sheet, and a look at Millennials and their money shows a stark divide. Millennials are highly engaged in their financial lives and own a variety of assets. Their optimism is buoyant and their confidence is steady.

But, Millennials also are heavily indebted and often borrow against their assets. Reported dissatisfaction with their financial situations reveals a disconnect between Millennials' expectations and their realities.

And, as this NEFE-funded study shows, alarmingly low levels of financial capability don't match the high levels of financial responsibility taken on by young adults.

As Millennials arrive at key points in their long-term financial decision making, it is becoming increasingly apparent that their financial position is more fragile than expected. A gap exists between the financial responsibilities assigned to young adults and the knowledge and capacity needed to effectively manage those responsibilities. This gap will only continue to widen until financial capability — of which financial literacy is a key determinant — becomes a priority among young adults and those who intervene on their behalf.

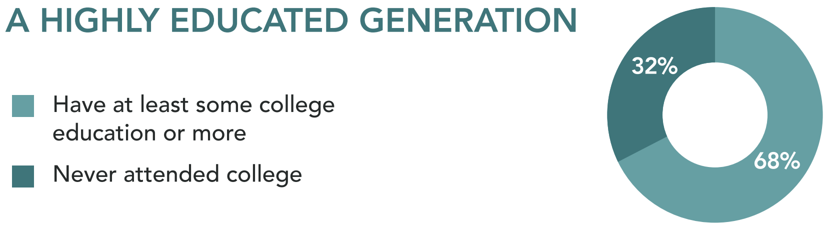
Who are Millennials?

Every generation influences the economy but Millennials — encompassed by some 70 million to 80 million individuals born between the late 1970s and mid-1990s — are positioned to exert special impact. They are larger in number, more ethnically diverse and more educated than previous generations. Their role in the U.S. workplace is influential and growing. Soon, in the United States and abroad, Millennials will make up the largest share of the labor market. It is projected that by 2025, three out of every four workers globally will be Millennials. In this way, they are poised to play a pivotal role in the country's social and economic development.

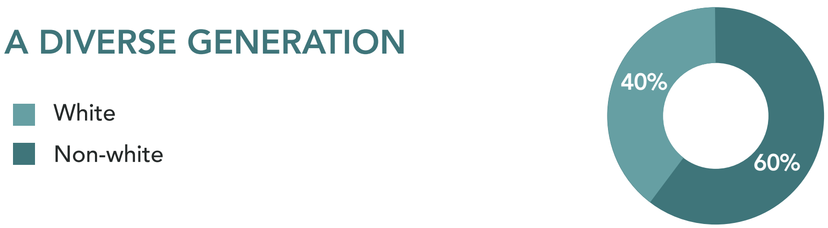
When compared to previous generations, minorities are more broadly represented among Millennials' most educated, high-achieving members, and 11 percent of all Millennials have at least one immigrant parent. Additionally, Millennials are on track to be the most educated generation in American history: within the group of 25- to 29-year-olds alone, one-third has earned at least a bachelor's degree.

Millennials, too, are known for an unrelenting confidence in their own abilities — likely born from growing up in an era that placed unprecedented value on children, personal development and self-esteem. This confidence and sense of achievement spills into their financial lives, even though many were never trained how to make the complex personal finance decisions facing them now and in the future.

A HIGHLY EDUCATED GENERATION



A DIVERSE GENERATION



What They Own:

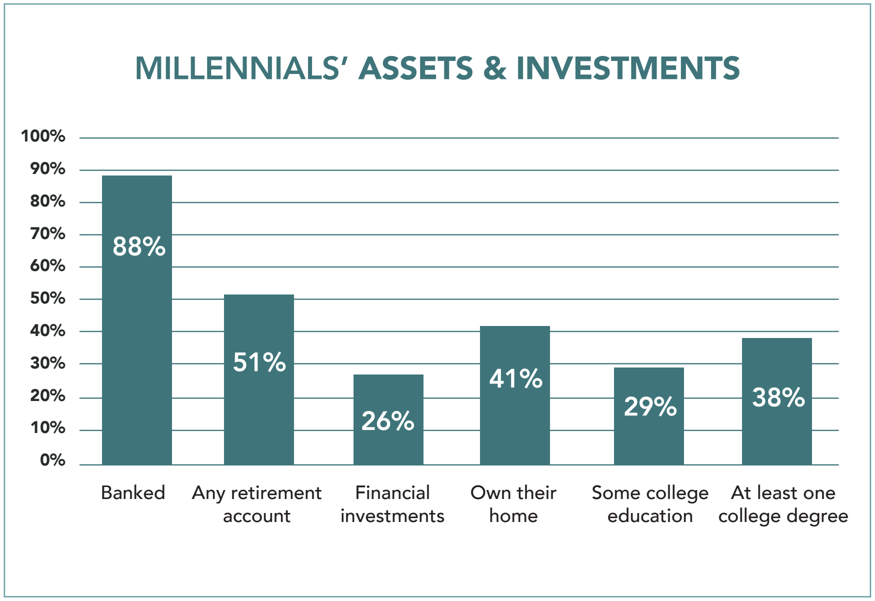
Millennials and Their Assets

Key Findings:

- Millennials overwhelmingly are banked (88 percent).
- More than half have some sort of retirement account.
- Over 40 percent own their homes.
- Over one-fourth have investments in stocks, bonds or mutual funds.
- Millennials are heavily invested in higher education: Nearly 40 percent have a college degree.

Despite being at an early stage of their working lives, many Millennials are economically active and make or have made significant financial decisions, such as buying a house or choosing investment allocations. Data show that most Millennials own and place a high value on a range of financial and educational assets.

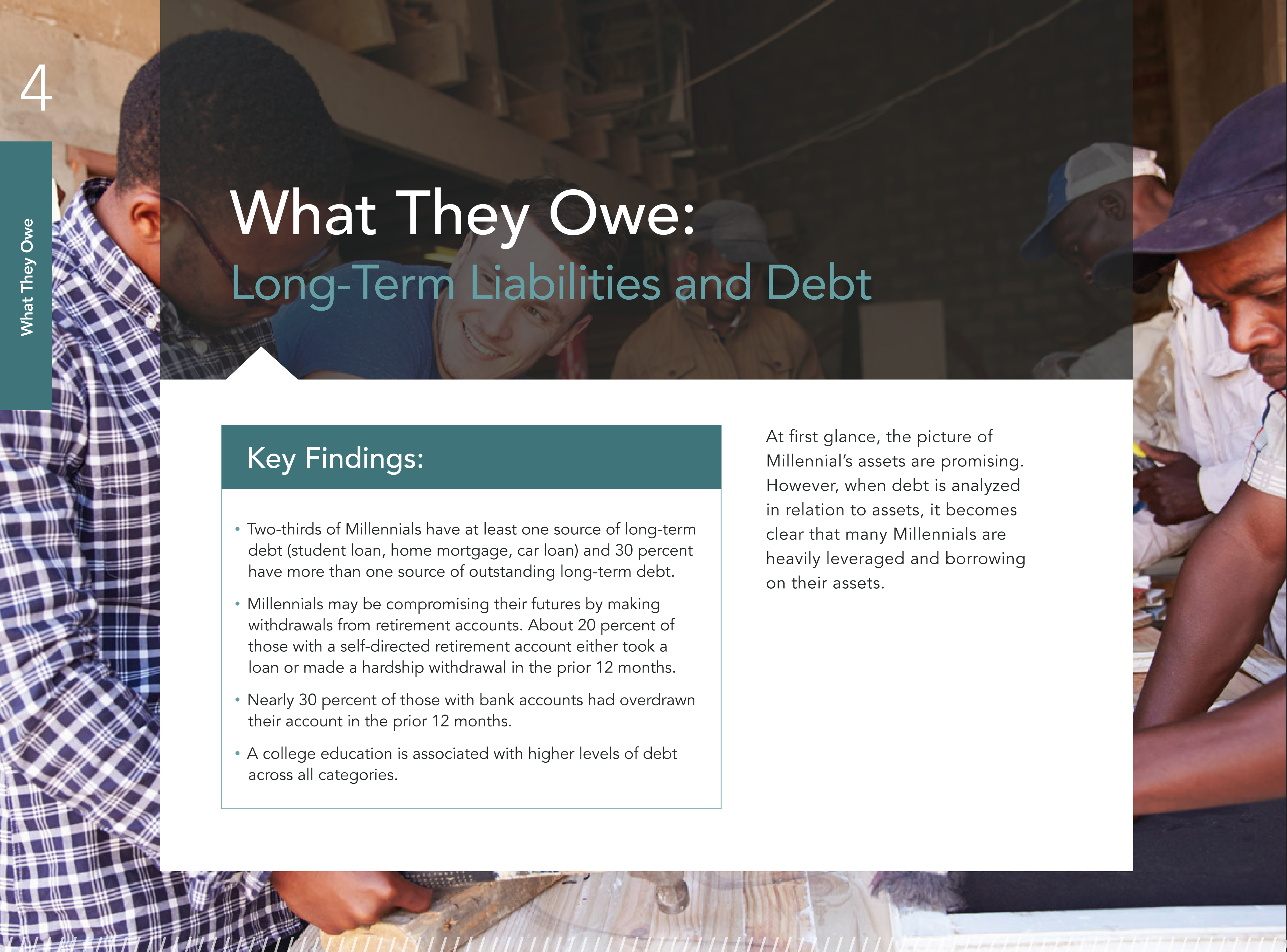
The vast majority of Millennials have either a checking account or a savings account at a bank or credit union. Moreover, 51 percent of respondents report having a retirement account (employer-based or independent) and one-fourth of respondents have investments in stocks, bonds or mutual funds. Additionally, 40 percent of respondents own their homes, and nearly 10 percent own additional real estate, such as second homes, investment properties or farms.



Of the study sample, 68 percent have attended college. Overall, 38 percent have an undergraduate degree or higher, 29 percent have some college education but not a college degree, and 22 percent have a high school diploma.

Education is an important distinguisher for this generation. Millennials with a college degree tend to have significantly higher levels of income. They also are much more likely than other respondents to hold a full-time job, an indicator that they will have more assets.

However, the asset side of the balance sheet provides only a partial representation of Millennial's personal finances. For a more accurate picture of Millennials' financial position, debt must be analyzed in relation to assets.



What They Owe:
Long-Term Liabilities and Debt

Key Findings:

- Two-thirds of Millennials have at least one source of long-term debt (student loan, home mortgage, car loan) and 30 percent have more than one source of outstanding long-term debt.
- Millennials may be compromising their futures by making withdrawals from retirement accounts. About 20 percent of those with a self-directed retirement account either took a loan or made a hardship withdrawal in the prior 12 months.
- Nearly 30 percent of those with bank accounts had overdrawn their account in the prior 12 months.
- A college education is associated with higher levels of debt across all categories.

At first glance, the picture of Millennial's assets are promising. However, when debt is analyzed in relation to assets, it becomes clear that many Millennials are heavily leveraged and borrowing on their assets.

BORROWING ON ASSETS

85% Have a checking account

Overdraw their checking account occasionally **29%**

41% Own a home

Of those, **72%** Have a mortgage on their home

36% Have an auto loan

38% Have a college degree

Of those, **55%** Have an outstanding student loan

Have a self-directed retirement account **36%**

17% Took a loan from their retirement account in the 12 months prior to the survey

Made a hardship withdrawal from their retirement account in the 12 months prior to the survey **14%**

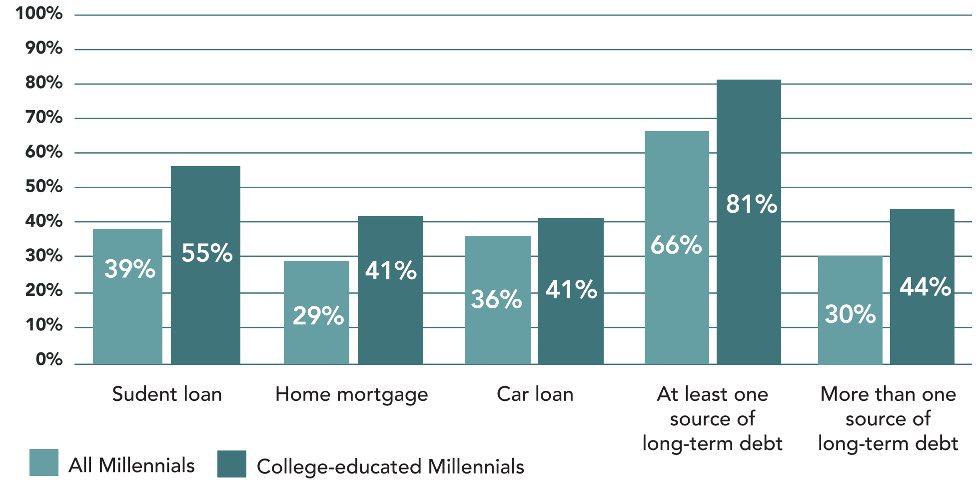
22% Either took a loan or made a hardship withdrawal

Note: Percentages are calculated over the total sample of Millennials. The number of observations is 5,525. Statistics relative to borrowing are conditional on having the associated asset.

Forty percent of Millennials own homes and more than 70 percent have taken on mortgages to finance those purchases. Many are underwater on their mortgages or late with mortgage payments. Thirty-six percent of Millennials carry auto loans. More than one-third have unpaid medical bills.

The higher level of education among Millennials is linked to debt: Nearly four in ten respondents have student loan debt. Between 2007 and 2010, student loans significantly increased as a proportion of young household debt, rising from 34 percent to 40 percent.

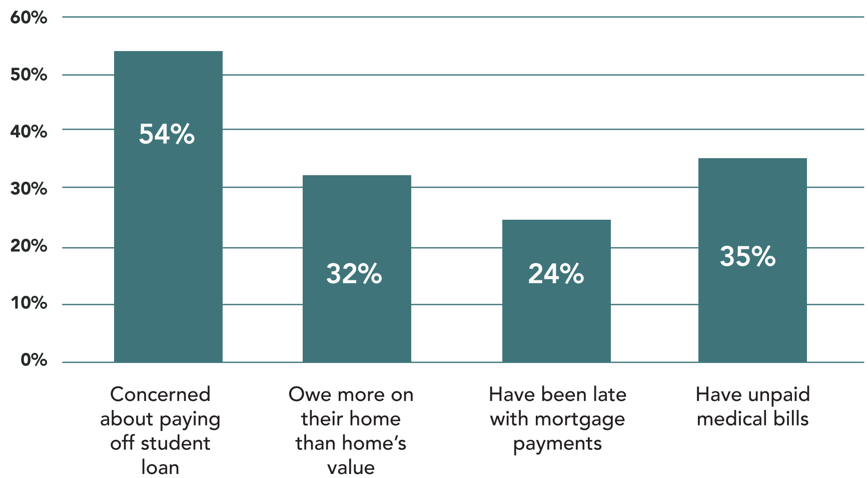
SOURCES OF LONG-TERM DEBT



Note: In the figure, statistics relative to the different types of loans are not conditional on having the associated asset.

All Millennials are heavily leveraged with long-term debt, but a college education is associated with even higher levels of debt across all categories.

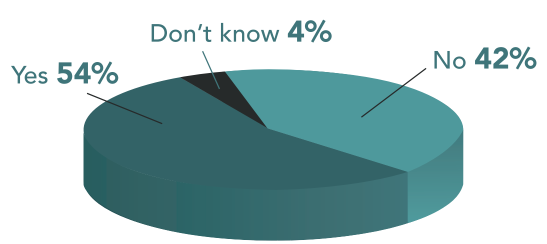
INDICATORS OF FINANCIAL DISTRESS



Note: Percentages are calculated over the relevant subsamples except for the statistics on medical debt, which is calculated over the full sample.

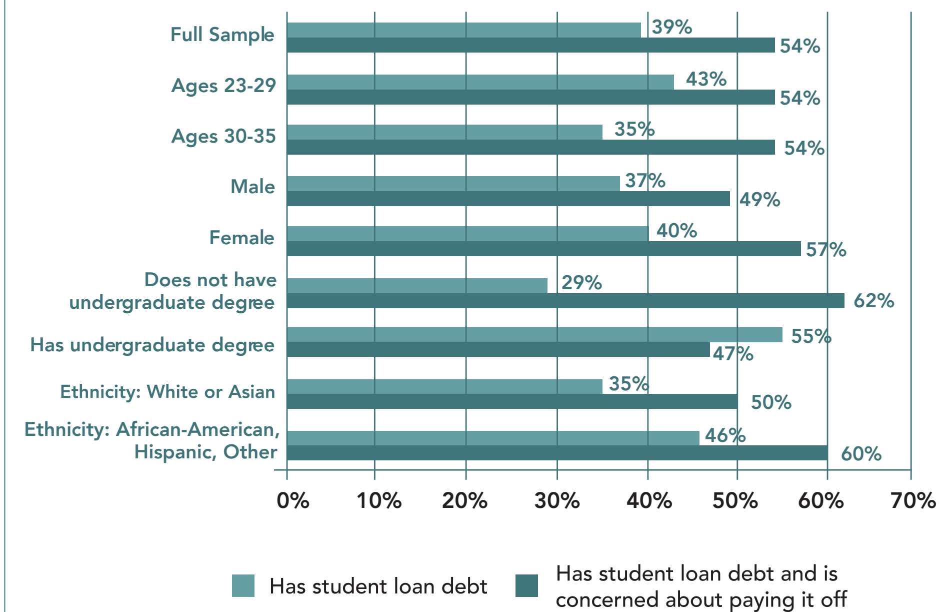
The long-term liabilities associated with their assets have left Millennials deeply in debt. Not only are they struggling to keep up with payments, but many worry about being able to pay off debt. This is true even among high-income households.

CONCERNED THEY MIGHT NOT BE ABLE TO PAY OFF THEIR STUDENT LOAN DEBT



Student debt is common across demographic characteristics. Fifty-five percent of college-educated respondents carry student loans and 54 percent of those are concerned about the ability to pay off student loans. Thirty-four percent of Millennials with annual household income above $75,000 doubt they will be able to repay their student loans.

STUDENT LOAN DEBT BY DEMOGRAPHICS



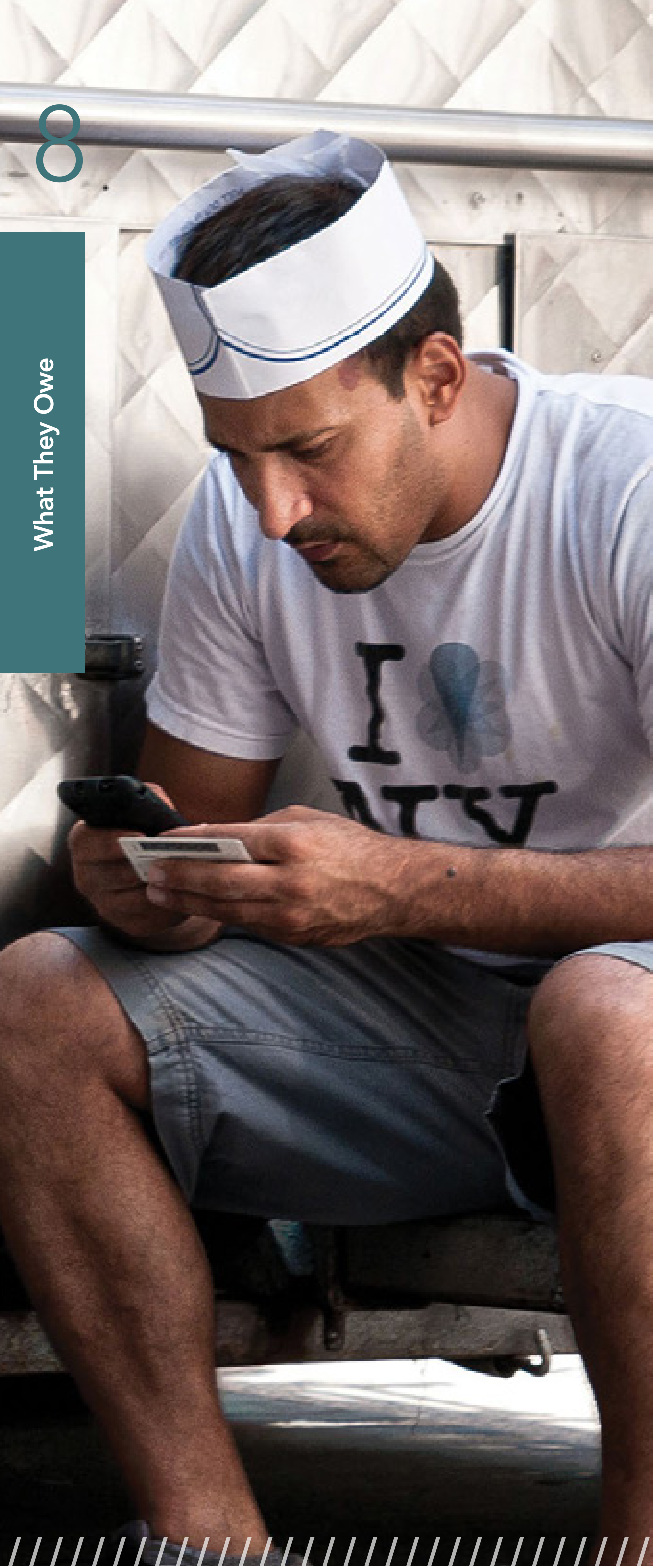
What They Owe:
Short-Term Liabilities

Key Findings:

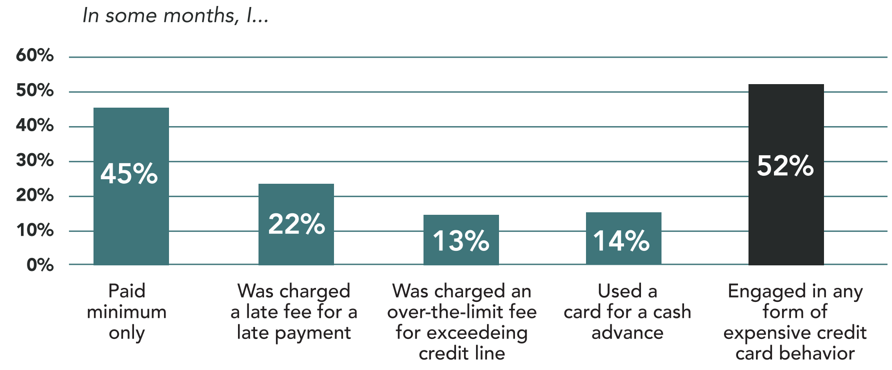
- Millennials use credit cards extensively: Nearly 70 percent have at least one.
- More than half of cardholders have engaged in potentially expensive credit card behaviors.
- More than half of cardholders carried over a balance and were charged interest.
- Despite their high education levels, 42 percent of Millennials use alternative financial services (AFS).
- Even among those with bank accounts, 39 percent have used an AFS product.

Short-term debt also is prevalent for Millennials: Expensive credit card use and alternative financial services are widespread.

Nearly seven in ten respondents have at least one credit card, and among these cardholders, more than half engaged in expensive behaviors in the twelve months prior to the survey such as paying only the minimum amount, using credit cards for cash advances, and incurring fees due to late payments or exceeding their credit lines. Likewise, more than half of cardholders carry over a balance and were charged interest. Women, African-Americans and Hispanics are more likely to engage in expensive credit card behaviors.



CREDIT CARD USE



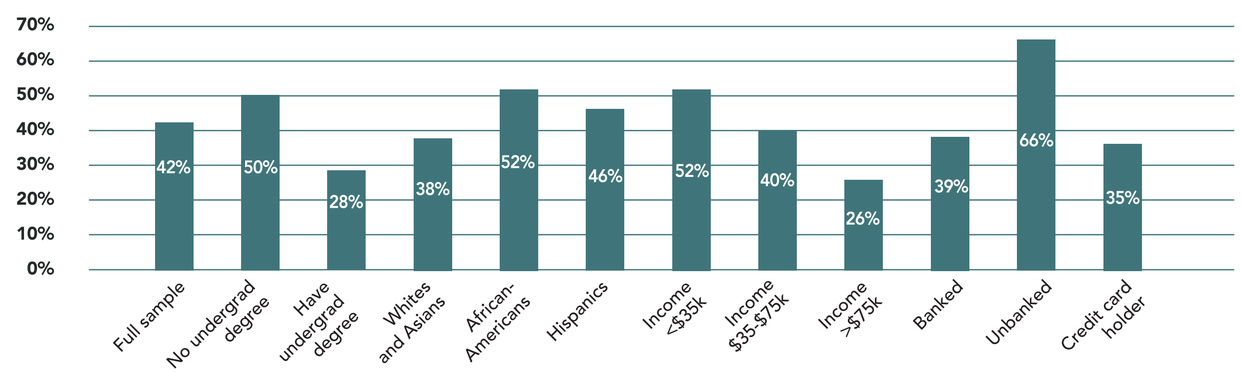
Over half of Millennials who have a credit card engage in some form of expensive credit card behavior that can trigger interest payments and unneccessary fees. Women, African-Americans and Hispanics were even more likely to choose these behaviors, although the tendency was widespread across all demographic categories.

Despite high education levels among Millennials, the use of alternative financial services (AFS) such as payday loans, pawnshops, auto title loans, tax refund advances and rent-to-own products is high. This is troublesome due to the steep fees they carry — in some cases, these products charge interest rates of over 400 percent.

Forty-two percent of respondents had used AFS at least once during the previous five years, demonstrating that AFS use is not a fringe behavior limited to a small segment of Millennials. Furthermore, many respondents indicated using non-bank services on a recurrent basis: 19 percent reported using payday loans in the previous five years, and of those 19 percent, more than one-third used them three or more times.

AFS use is higher among the less educated, the unbanked, African-Americans, Hispanics and lower-income respondents. However, even respondents with college degrees, traditional bank accounts and access to credit cards show significant rates of AFS use. Even among those with bank accounts, 39 percent have used an AFS product.

ALTERNATIVE FINANCIAL SERVICES USE AMONG MILLENNIALS



Unmet Expectations:
Debt Loads and Financial Satisfaction

Key Findings:

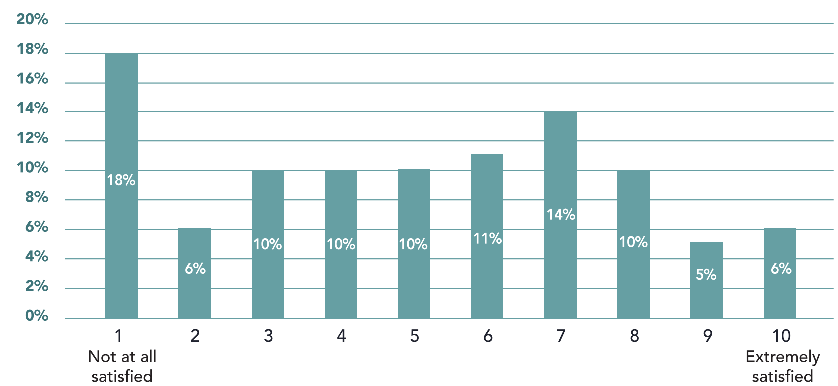
- Over half of Millennials feel they have too much debt.
- Many Millennials are not satisfied with their current financial condition.

How Millennials feel about their finances is significant. Their responses to attitudinal questions reveal expectations of where they should be financially in comparison to their actual experience.

Fifty-three percent of respondents feel they have too much debt, and when asked if they are satisfied with their financial condition, only one in five says yes.

SATISFACTION WITH CURRENT PERSONAL FINANCIAL CONDITION

Overall, thinking of your assets, debts and savings, how satisfied are you with your current personal financial condition?

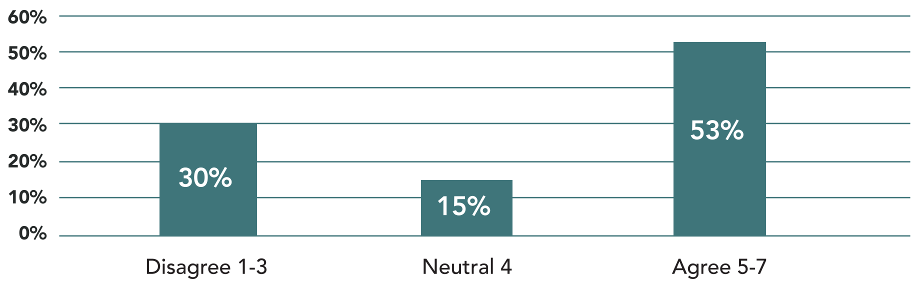


Note: Percentages calculated over the total sample of 5,525 observations. Percentages do not add up to 100 percent because "don't know" and "prefer not to say" answers are excluded.

Interestingly, satisfaction with one's current financial condition tends to be higher among respondents with long-term debt (perhaps because this debt often is due to education). Satisfaction was much lower among those with short-term debt, those with expensive credit card behavior, and those who borrow through AFS products. Satisfaction also is inversely related to over-indebtedness. Only 16 percent of those who agreed with the statement "I have too much debt" also said they were financially satisfied.

PERCEIVED **OVER-INDEBTEDNESS**

On a scale from 1-7, where 1 means strongly disagree and 7 means strongly agree, how strongly do you agree or disagree with the following statement? "I have too much debt right now."



Millennials are overburdened by debt. In addition, few — only one in five — are satisfied with their financial condition. These sentiments are weakest among those with short-term debt.

Note: Chart does not sum to 100 percent because "don't know" and "prefer not to answer" responses are not reported.

Financial Fragility:
What if Something Goes Wrong?

Key Findings:

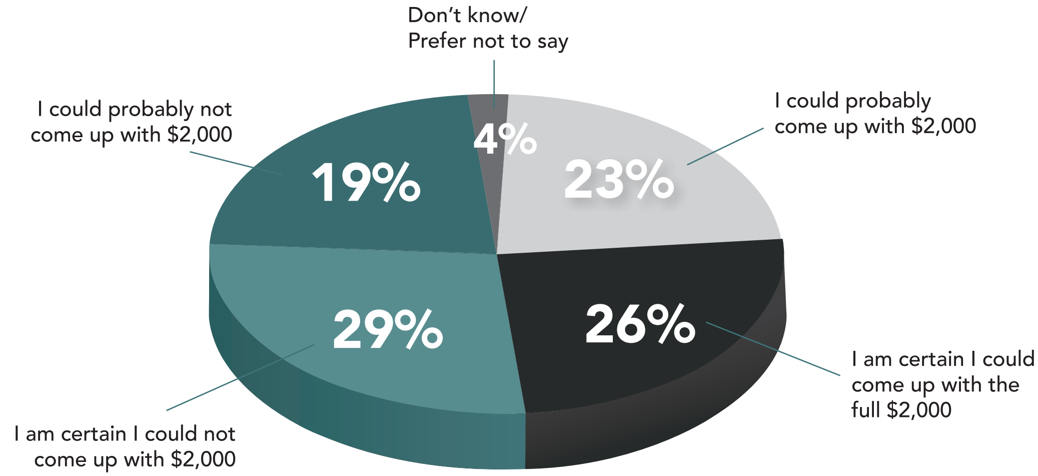
- Millennials are unprepared to handle sudden economic shocks.
- Even among those with retirement accounts, emergency funds are rare.

Millennials are financially fragile. Data show that many Millennials do not have emergency or "rainy day" funds, despite (and perhaps because of) the prevalence of economic shocks during this generation's lifetime.

Fewer than one-third (32 percent) have set aside funds to cover three months of expenses in the event of job loss, serious illness, economic downturn or other unexpected shock. Those who do not save for the long run also do not save for the short run. Among respondents without retirement plans, only 19 percent report having emergency funds.

Moreover, many Millennials are unprepared to deal with midsize, unexpected income shocks. When asked if they could come up with $2,000 if an unexpected need arose within the next month, nearly half (48 percent) responded that they probably or certainly could not come up with the funds.

HOW CONFIDENT ARE YOU THAT YOU CAN COME UP WITH $2,000 IF AN UNEXPECTED NEED AROSE WITHIN THE NEXT MONTH?



Many Millennials do not have adequate funds to deal with an unexpected short-term need.

The ability to cover expenses in the event of an unexpected economic shock varies across subgroups. Having a full-time job is one of the most important indicators of financial stability: While 35 percent of those who have a full-time job report they certainly could come up with $2,000 in one month, only 17 percent of those who do not have a full-time job report they are certain about their ability to come up with such funds. Moreover, respondents at higher levels of education show much lower levels of financial fragility. Thirty-six percent of college-educated Millennials and 52 percent of post-graduates are certain about their ability to come up with $2,000 in one month.

Household income also is an important determinant, with 55 percent of those earning above $75,000 per year, 26 percent of those earning between $35,000 and $75,000 per year, and 12 percent of those earning below $35,000 per year being certain that they could come up with $2,000 if needed.

Financial Literacy:

What Millennials Don't Know Can Hurt Them

Key Findings:

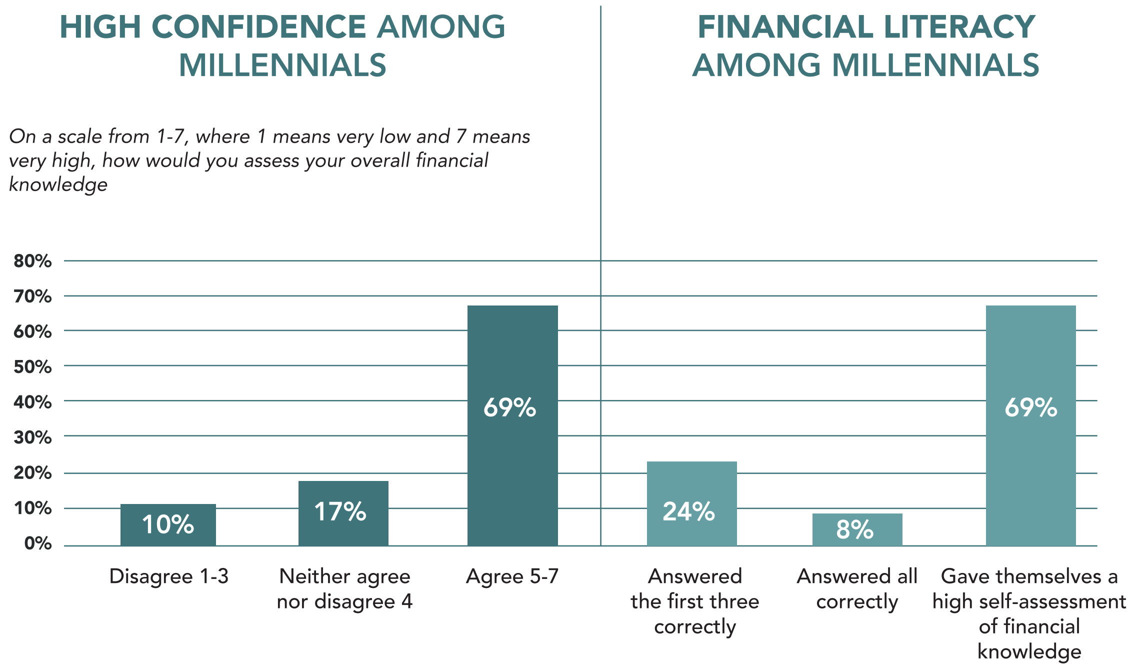
- Millennials are very confident about their financial knowledge and their financial management skills.
- This high confidence does not match actual financial literacy levels: Only one-quarter of respondents show basic financial literacy and only 8 percent show a high level of knowledge.
- Even though their financial literacy is low, Millennials do not seek advice from financial professionals.

While Millennials are very confident about their financial knowledge and their financial management skills, their high confidence does not match their actual financial literacy levels.

Financial literacy is a measure of the understanding of fundamental financial and economic concepts that underpin decision making. Being financially literate is particularly important for Millennials, who already are active investors and carry both short- and long-term debt.

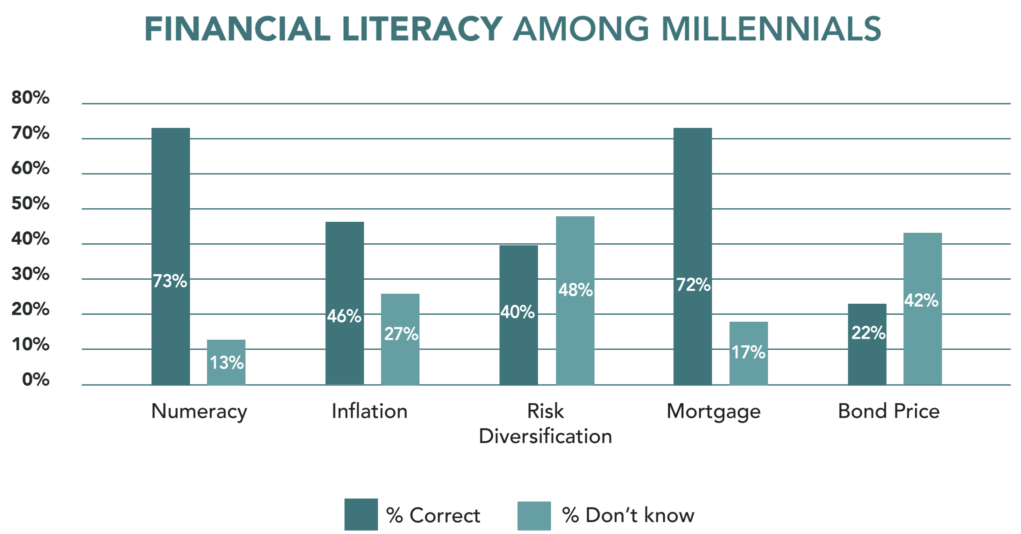
To measure financial literacy, respondents were given a set of five financial literacy questions meant to test their capacity to do calculations related to interest rates as well as test an understanding of inflation, risk diversification, stocks and mutual funds, interest payments on a mortgage, and the relationship between interest rates and bond prices.

Only one-quarter of respondents show basic financial literacy (measured by answering the first three of five questions correctly) and only 8 percent show a high level of knowledge (measured by answering all five questions correctly). Furthermore, many are inclined to answer "Don't know" to questions about financial concepts, which is an indicator of low financial literacy.



Millennials are very confident about their financial capability. The majority feels they have moderate to high financial knowledge. But this does not dovetail with the data, which overwhelmingly show that Millennials have low financial literacy, with only one in four demonstrating basic financial literacy.

Note: Chart does not sum to 100 percent because "don't know" and "prefer not to answer" responses are not reported.



Even though their financial literacy is low, Millennials do not seek advice from financial professionals. In the five years before the survey, only 27 percent of Millennials had sought professional financial advice on savings and investments, and only 12 percent had sought professional advice on debt management.

In a troubling trend, respondents with higher financial literacy are more likely than those with lower financial literacy to have received professional financial advice, so those who need it most do not obtain it. Many Millennials don't trust financial professionals and think that professional advice is too expensive.

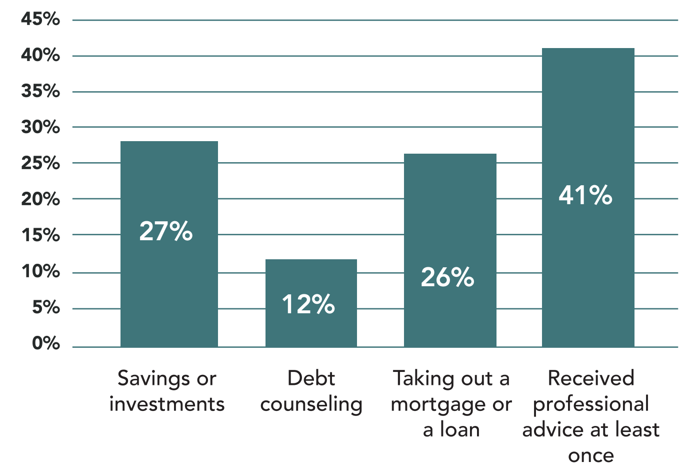
Determinants of Financial Capability

Key Findings:

- Key determinants of financial capability include financial literacy, general education and the ability to deal with income shocks.
- Only 22 percent of Millennials have received some form of financial education.

Using a multivariate analysis of financial behaviors and associated socio-demographic factors, the study indicates that key determinants of financial capability include financial literacy, education (some college or a degree) and the ability to deal with income shocks. However, data show that only 22 percent of Millennials have received some form of financial education.

USE OF FINANCIAL ADVICE FROM PROFESSIONALS



Note: Percentages calculated over the total sample of 5,525 observations

Implications and Recommendations

MORE THAN DEBT

NEFE believes it is time to stop defining Millennials solely by their student debt loads — or by any single debt yardstick. They deserve more than scary stories of debt gone wild. Their lives contain an interrelated combination of debt and assets.

This study is one of the first to present Millennials' finances holistically. Now we have more data in one place than ever before to examine the nuances of the financial condition of young adults in the United States.

Practitioners and instructors must begin their work understanding the personal balance sheets of their learners — both assets and liabilities — and helping their learners understand those balance sheets as well. This study provides six sets of checkpoints which financial capability providers can use to build a truly comprehensive picture of the state of one's finances. Solutions to individual pieces of Millennials' financial lives miss the opportunity to achieve holistic improvement. Use both sides of the balance sheet for best results.

RECOGNIZE GAPS AS OPPORTUNITIES

Being aware of gaps in Millennials' financial lives creates opportunities to teach, coach, encourage and assess positive behavioral change. For example:

- **We can capitalize on the high value Millennials place on asset-building to provide financial education and encourage positive behaviors.**
- **We can help Millennials assess their basic financial knowledge as a baseline for instruction tailored to their needs.**
- **We can examine the specifics of Millennials' finances to understand and improve the gap between their expectations and their realities.**
- **As a community we can share what works and experiment with new approaches (with evaluation of effectiveness).**

INCREASE FINANCIAL CAPABILITY

The research identifies key determinants of financial capability, including financial literacy, financial education and the ability to deal with income shocks. Of these, NEFE asserts that financial education is the base which lays the groundwork for the others. Therefore:

1 Ensure that financial education is effective: Make sure it includes NEFE's Five Key Factors:

a. Well-trained educator (and/or tested e-learning protocol)

b. Vetted/evaluated program materials

c. Timely instruction

d. Relevant subject matter

e. Evidence of impact (evaluation)

2 Make financial education available where Millennials are:

a. In their workplaces

b. In their communities

c. In higher education and trade and vocational institutions

d. Online, with access points via search and social media

3 Make financial education [and positive financial behaviors] appealing to Millennials by capitalizing on:

a. The high value they place on asset-building

b. Their confidence

c. Their already substantial engagement with financial products and services

d. Their desire for higher satisfaction with their financial condition

e. Their specific needs prior to and during financial events (e.g., taking out a car loan, signing up for a retirement savings plan)

Research to Action

Take the financial literacy test used in the study at **www.usfinancialcapability.org/quiz.php.**

QUESTIONS TO CONSIDER

1. How can we get Millennials to acknowledge their knowledge gaps while recalibrating their confidence so it isn't dangerous? How can we help them to see the disconnect without discouraging them?

2. Why are highly educated, banked Millennials turning to alternative financial services? Why do they accept high interest rates and fees?

3. How can we create a culture of unashamed information-seeking among young adults with low financial literacy? How can we provide access to knowledgeable professionals to help them?

4. What prevents young adults from building emergency savings?

5. What causes young adults to make withdrawals from their retirement accounts? What are effective ways to help them understand the future effects of their current decisions?

ABOUT THIS STUDY

This study analyzed data from the 2012 National Financial Capability Study (NFCS), a state-by-state online survey commissioned by the FINRA Investor Education Foundation of more than 25,000 respondents. Various indicators of financial capability are examined including making ends meet, planning ahead, managing financial products, financial knowledge and decision making. This analysis evaluates the financial capability of Millennials, focusing on 23- to 35-year-old individuals for a total of 5,525 observations.

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Partnering for Financial Well-Being

The National Endowment For Financial Education

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