Statement of Olivia S. Mitchell

For the
Senate Special Committee on Aging

Hearing on

The Changing Face of Retirement Security in America

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Good afternoon, Senators, and thank you for inviting me to discuss the changing face of retirement security. My name is Olivia S. Mitchell,[1] and I am a Professor at the Wharton School and Director of the Pension Research Council at the University of Pennsylvania. As a researcher and a Baby Boomer, I commend you for taking up this important issue. This statement consists of my prepared testimony.

This is a challenging time to be growing older in America. Thirty years ago when my parents retired, they had a secure lifetime pension along with a generous retiree medical plan. Interest rates were high enough to secure them a steady income without spending down their nest eggs too quickly. They also had inflation-protected lifetime benefits from Social Security and Medicare, and they held no debt. And their four children whom they'd saved enough to educate could always be relied on for help.

By contrast, we Boomers face a much different future. We worry that Social Security and Medicare, as well as the Disability Insurance system, are fragile. Few of us have retiree medical coverage and traditional defined benefit pensions. Some of us with defined contribution pensions have not saved enough, nor are we converting our assets into longevity-protected income streams so as to avoid outliving our saving. Interest rates are so low that holding TIPS is a losing proposition. With longer lifespans in the offing, we very much need protection for long-term care costs, but the products aren't widely available or affordable. And many more Boomers are in debt than we have seen in generations. This rising indebtedness is the focus of my comments today.

Debt and Financial Fragility Higher Among Baby Boomers

In a recent report, I compared three cohorts of people aged 56-61 in 1992, 2002 and 2008, using the Health and Retirement Study (HRS). For each group on the verge of retirement, we measured *total debt* (the value of mortgages plus other residential loans, and other debt including credit

[1] These comments represent my own views and not those of any research supporters or coauthors.

card, medical, and such), and we also compared *debt to assets*. We also focused on Baby Boomer patterns of indebtedness and financial fragility using both the HRS and the FINRA National Financial Capability Study (NFCS).[2]

We came to two main conclusions about older Americans' debt levels:

1. Americans are more likely to arrive with debt at retirement now than in the past. For the earlier group in 1991, about 64% held debt, whereas over 70% of the Boomers did by 2008.
2. Not only did more people have debt, but the value of this debt also grew sharply. Median debt more than quadrupled from about $6,200 in 1992, to $28,300 in 2008 (in 2012 dollars). Also the quarter of the distribution holding the most debt owed about $50,000, but in the two later cohorts, this same subset of the population owed $100,000 and $117,300 respectively.

This is important because Boomers retiring in the next several years are more likely to carry this debt into retirement, compared to previous cohorts. Also, since debt payments typically rise faster than the interest rates that retirees can earn on their investments, they will likely be more vulnerable during retirement.

We also examined 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 Boomers, since almost a quarter (23%) had debt exceeding their total assets versus only 10% of the earliest cohort we examined.

Sources of Debt

A key reason that debt rose so rapidly for Boomers is that this group spent more on housing than earlier cohorts. As a result, Boomers are now more likely to have loans outstanding on their

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[2] This study was funded in part by the Social Security Administration through the Michigan Retirement Research Center (MRRC) and the Pension Research Council/Boettner Center at the Wharton School of the University of Pennsylvania; see Lusardi and Mitchell (2013).

primary residences, and their mortgage values have grown faster than the values of their homes.[3] Median home loans relative to assets rose from 6% to 25%, which implies that Boomers will need to service their home loans well into retirement. In other words, Boomers entering retirement are more leveraged due to housing than their earlier counterparts back in the 1990s, since they bought more expensive houses and financed them with larger mortgages.

Boomers are also much more likely to have debt equal to or greater than their liquid assets, meaning that they will likely have to sell off their less liquid assets (or borrow more) to meet their bills. Interestingly, some Boomers have both liquid assets and debt, suggesting that they may be overlooking ways to better manage their household finances.

Drilling down further using the 2012 NCFS, we found that in addition to mortgage debt, many Boomers have expensive financial habits: they do not pay off their credit card balances in full, they use their cards for cash advances, and they are charged fees for late payment or exceeding their credit limits. Medical bills are also a source of financial problems, mentioned by almost a quarter (23%). And in the five years prior to the survey, more than one-fifth of the Boomer group (age 56-61) said they had engaged in high-cost borrowing using alternative financial services (such as pawn shops, payday loans, rent-to-own stores, auto title loans, and tax refund loans). When asked to evaluate their indebtedness, 40% felt they had too much debt. Even more striking was the fact that only about a third (36%) said that they were unlikely to be able to come up with $2,000 in the next month, if an unexpected need arose. (This amount would be on the order of a medium-sized car repair or home repair bill.)

Factors Associated with Higher Debt Levels

Finally, we evaluated what factors appeared to be more or less protective against debt at older ages. To summarize our findings, the following factors stand out:

1. Higher income, better educated, and more financially literate Boomers were systematically less likely to hold high levels of debt and to be financially fragile.

[3] The probability of having a mortgage in this age group rose between 1992 and 2008 from 10% to 16%, an increase of 60% (Lusardi and Mitchell 2013).

2. Nonwhite, unmarried, and less healthy Boomers, along with those who had more children, were more vulnerable.
3. People who had a large unexpected drop in income the previous year were more likely to feel that debt was a major problem for them.

Why Boomer Debt Is of Concern

It is important to focus on debt among 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 household 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.

Policy Options

In the wake of the financial crisis and Great Recession, we now know that more can be done to protect Americans from the problems stemming from financial illiteracy.[4] In particular, we have learned that there is a strong positive link between financial literacy, planning, and wealth; those who are not financially savvy are more likely to have debt and lower savings.

While protective legislation may be useful when people lack the opportunity to make repeated financial decisions so as to learn from them, it can also be useful to better inform Americans when they face potentially expensive decisions such as buying a home, cashing out their 401(k) plans, or taking out credit card loans.

Boomers could also do better with more access to financial advice, which can generate potentially important rewards in the form of lower debt for those nearing retirement. They also

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[4] For recent reviews of this literature, see Lusardi and Mitchell (2014 forthcoming) and Mitchell and Smetters (2013 forthcoming).

need more information on the benefits of delaying retirement; indeed, many have already come to this conclusion on their own.[5] Finally, deferring Social Security claiming produces a much higher retirement income for many: for instance, delaying claiming benefits from age 62 to 70 can mean an additional 76% more in monthly payments.[6]

As we concluded in our recent review of financial knowledge and financial success, "the costs of raising financial literacy are likely to be substantial, [but] so too are the costs of being liquidity-constrained, over-indebted, and poor."[7]

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[5] Over one-third of workers in a recent survey indicated that they expected to retire later than age 65, up from 11% in 1991 (EBRI 2013).
[6] Detailed computations are provided in Shoven and Slavov (2013).
[7] Lusardi and Mitchell (2014 forthcoming).

Table 1. Measures of Financial Fragility on the Verge of Retirement in the National Financial Capability Study (NFCS)
Source: Derived from Lusardi and Mitchell (2013)

	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.