

THE LINK BETWEEN SELF-CONFIDENCE AND FINANCIAL OUTCOMES AMONG WORKING-AGED CANADIANS WITH DIFFERENT LEVELS OF FINANCIAL KNOWLEDGE

Presentation to the Financial Literacy and Well-being Forum on November 24, 2015

By Boris Palameta

INTRODUCTION

Financial Knowledge vs. Financial Practice

Implicit assumption that knowledge leads to good practices

Financial education interventions most often focused on enhancing knowledge

But simply acquiring knowledge does not mean it will be used effectively

Interventions designed to improve financial knowledge have little impact on financial outcomes

People often have good intentions but fail to enact desired behavior

Cognitive bias: systematic errors in decision making

People may behave contrary to their knowledge and intentions (self-control issues)

E.g. *Present bias* - empirically linked with higher debt accumulation, lower likelihood of saving, and among those who do save longer delays in starting to save and lower levels of savings

Financial self-confidence as a predictor of outcomes

Most studies define and measure financial literacy narrowly – objective assessments of financial knowledge

When *psychological traits* are measured, they explain as much or more of the variability in financial outcomes as objective measures do

Financial self-confidence may be an indicator of effective practice

Evidence of empirical links between low self-confidence, procrastination/present bias, and poor financial outcomes

But also links between overly high self-confidence (relative to knowledge) and poor financial outcomes, especially in the area of saving and investment

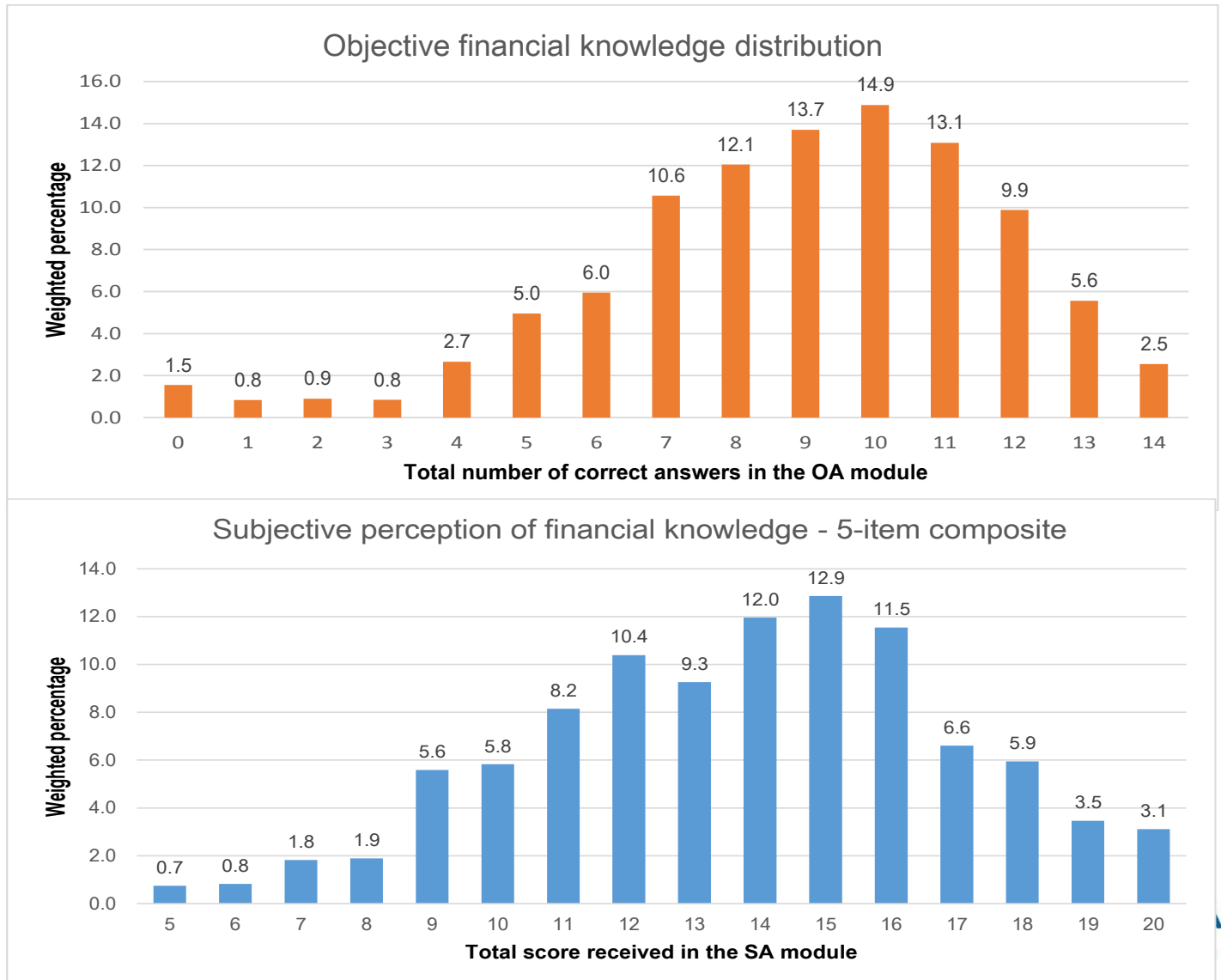
Are discrepancies between financial knowledge and confidence linked with poor outcomes?

High knowledge/low confidence – related to poor financial practice, procrastination/self-control issues?

Is **high confidence** undermined by **low knowledge** in areas that require sophisticated decision making such as investment and saving?

CFCS: Objective (Knowledge) and Subjective (Confidence) Assessments, among those aged 25 to 64

- CFCS contains
 - 14 questions - objective assessment of financial knowledge (total score = 0-14);
 - 5 questions - self-assessment of financial knowledge and abilities
 - (4-point scale; total score = 5-20)
- Correlation between objective and subjective assessments is weak ($r = 0.16$).
- Large discrepancies between knowledge and confidence are relatively common



FINANCIAL OUTCOMES AND METHODOLOGY

Financial outcomes – CFCS measures

1. Making ends meet and keeping track - Managing money and debt
 - Never late two or more months on a bill payment
 - No problem keeping up with bills and other financial commitments
 - No debt other than mortgage or student loans
 - Having a household budget, and usually or always staying within budget
 - Frequency of checking bank balance

2. Planning and saving
 - Receiving investment income
 - Number of insurance products
 - Shopping around for insurance (not all policies with one company)
 - Among those who intend to buy a home, likelihood of having saved 20% or more
 - Good idea of how much money is needed to maintain desired standard of living when retired
 - Confidence that retirement income will provide desired standard of living
 - Financially preparing for retirement
 - Among those preparing, RRSP as a source of revenue
 - Among those preparing, workplace pension as a source of revenue

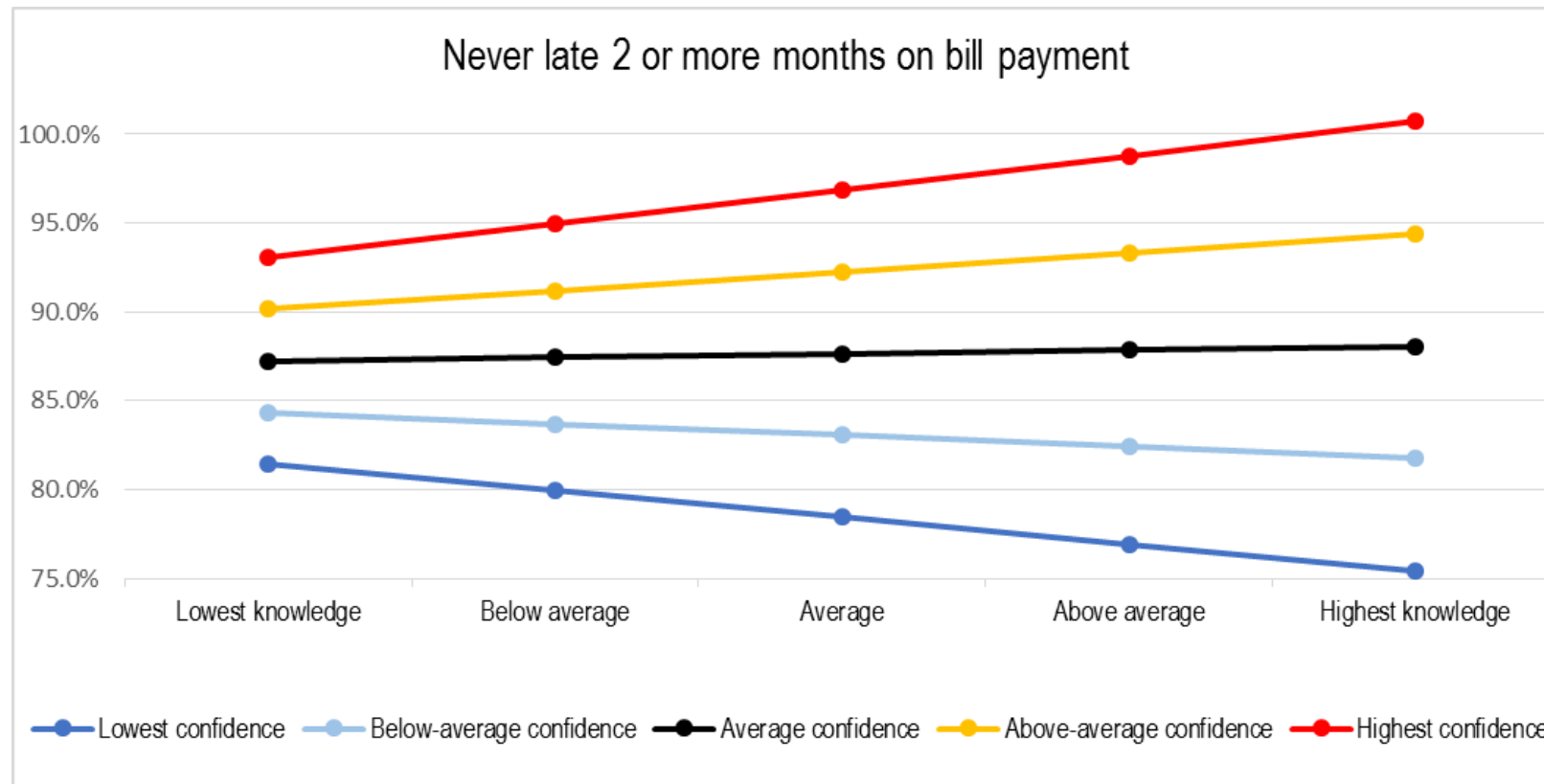
3. Advice
 - Using paid financial advice on retirement planning

- Examine to what extent each of the preceding financial outcomes are linked to financial knowledge and self-confidence, among 25 to 64 year olds.
- Because each of these outcomes can also be linked with demographic characteristics, control for each of these characteristics by using ***multivariate regressions***.
 - To what extent are outcomes linked to knowledge and confidence, with *demographics held constant*?
 - Does the effect of confidence depend on the level of knowledge?
 - E.g. Are high levels of confidence associated with good outcomes among the knowledgeable, but poor outcomes among the unknowledgeable (overconfidence)?
 - Does the effect of knowledge depend on the level of confidence?
 - E.g. Are high levels of knowledge associated with good outcomes among those who are confident, but poor outcomes among the less confident (underconfidence)?

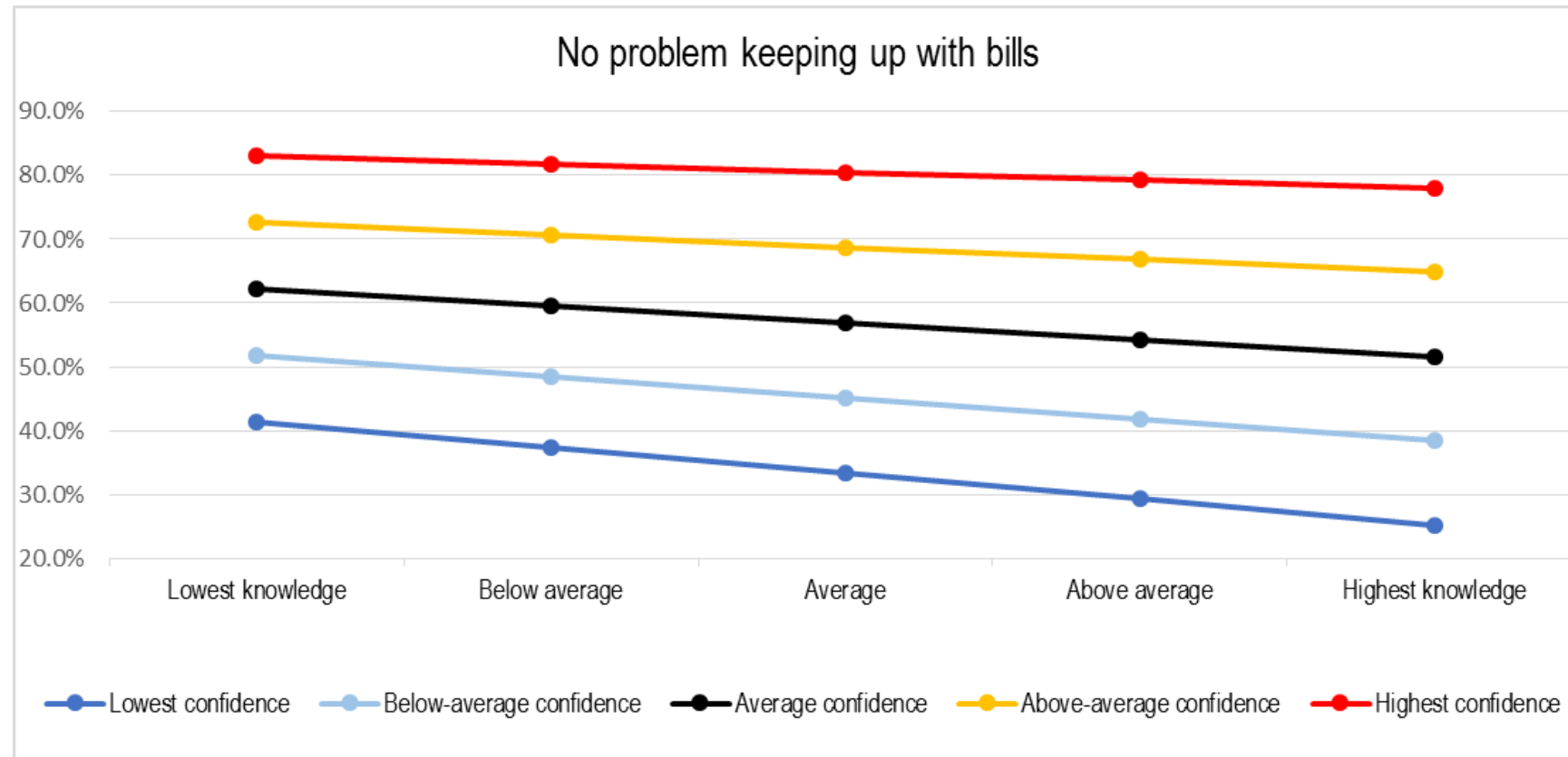
RESULTS

Managing money and debt

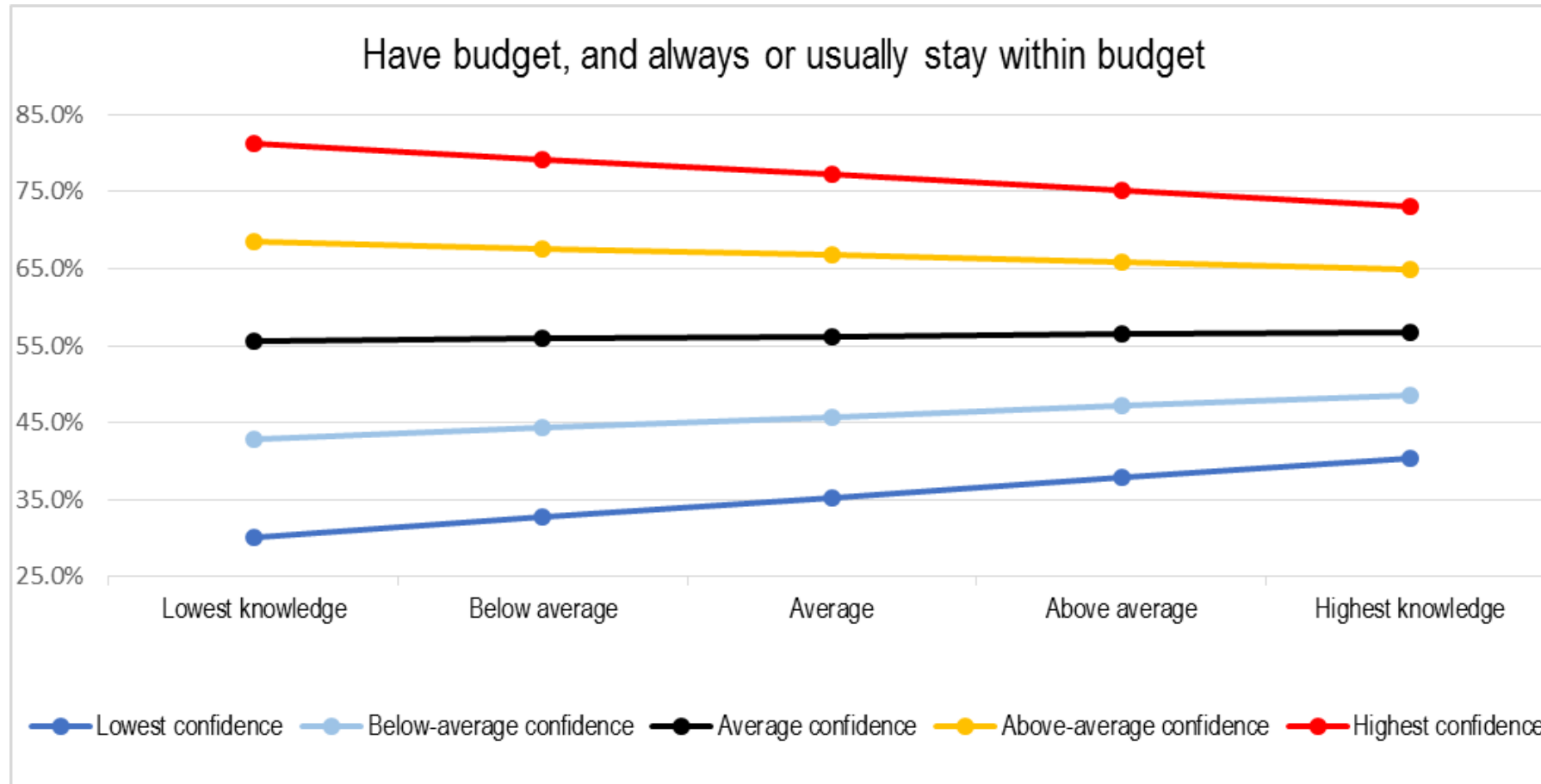
- Confidence is generally a more important predictor than knowledge for these outcomes
- Poor outcomes for the less confident, even those with high levels of knowledge



Managing money and debt (2)

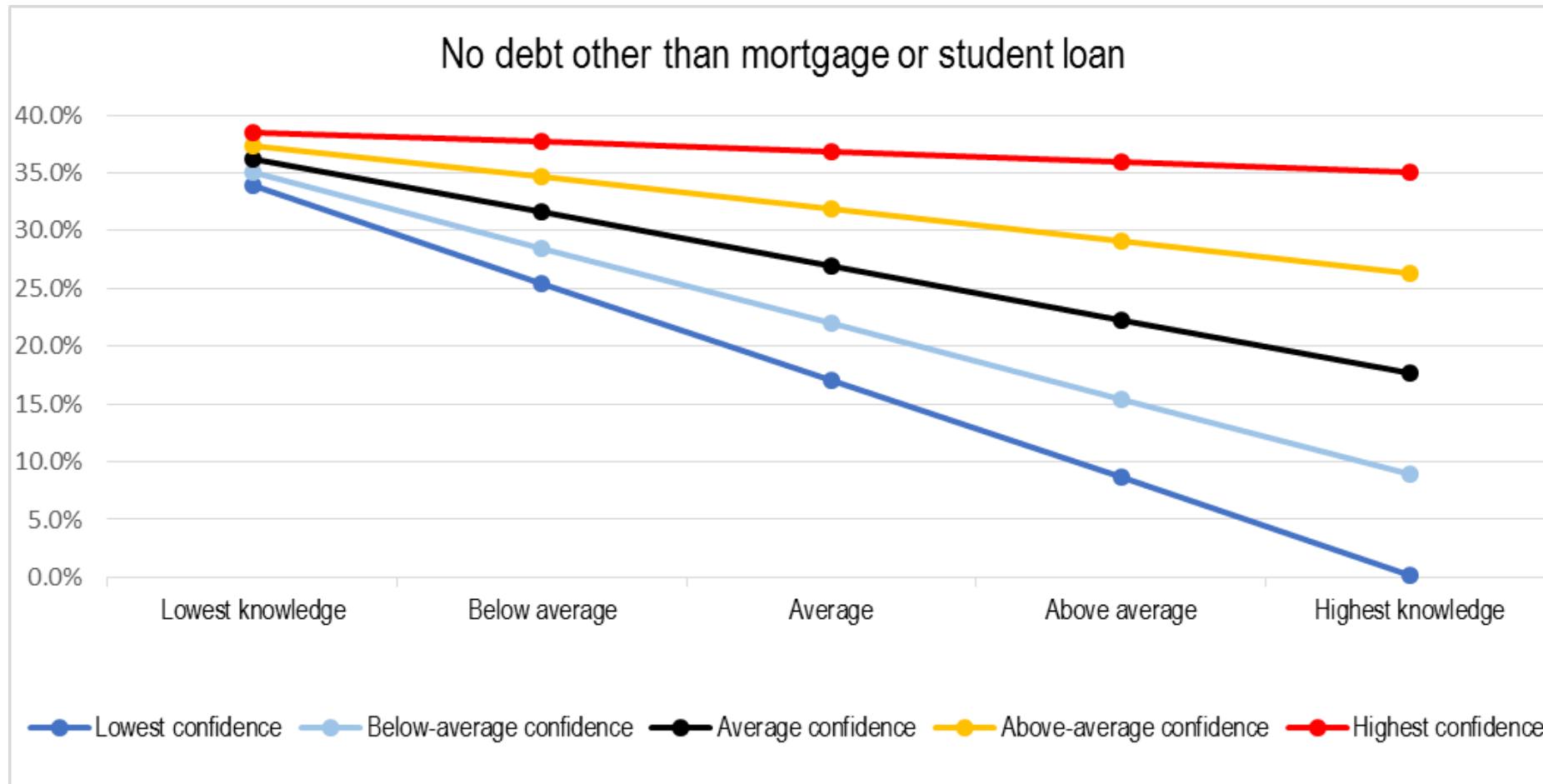


Managing money and debt (3)



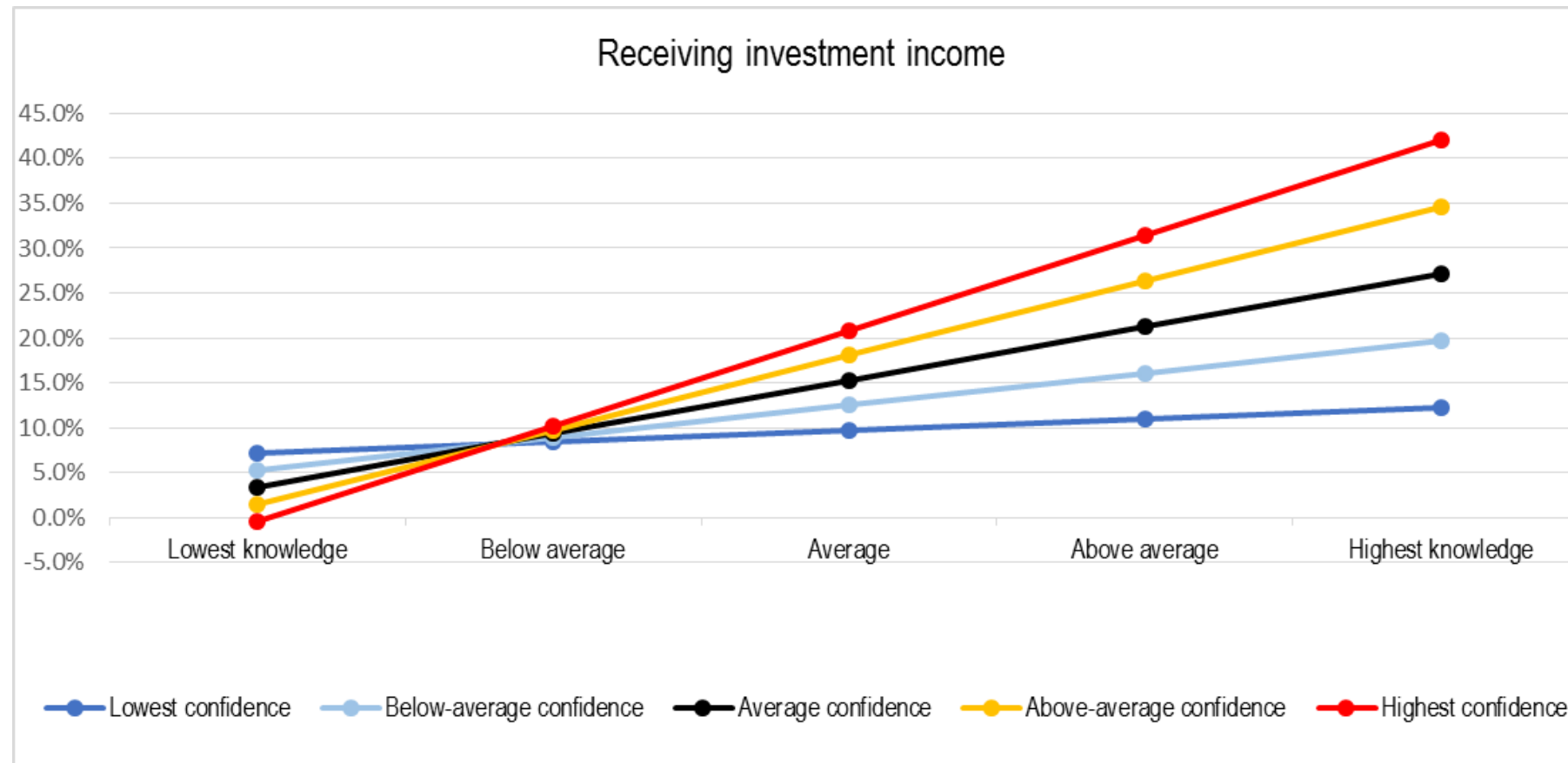
Managing money and debt (4)

Especially poor outcomes for those with high levels of knowledge, but low confidence

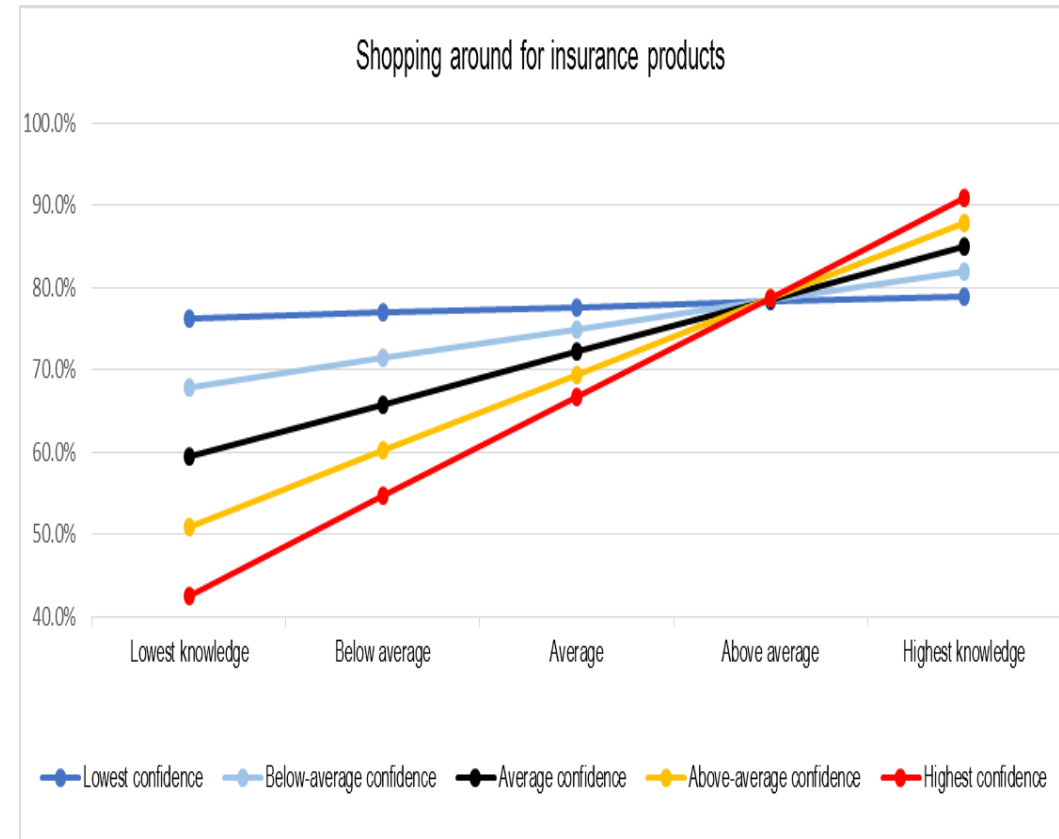
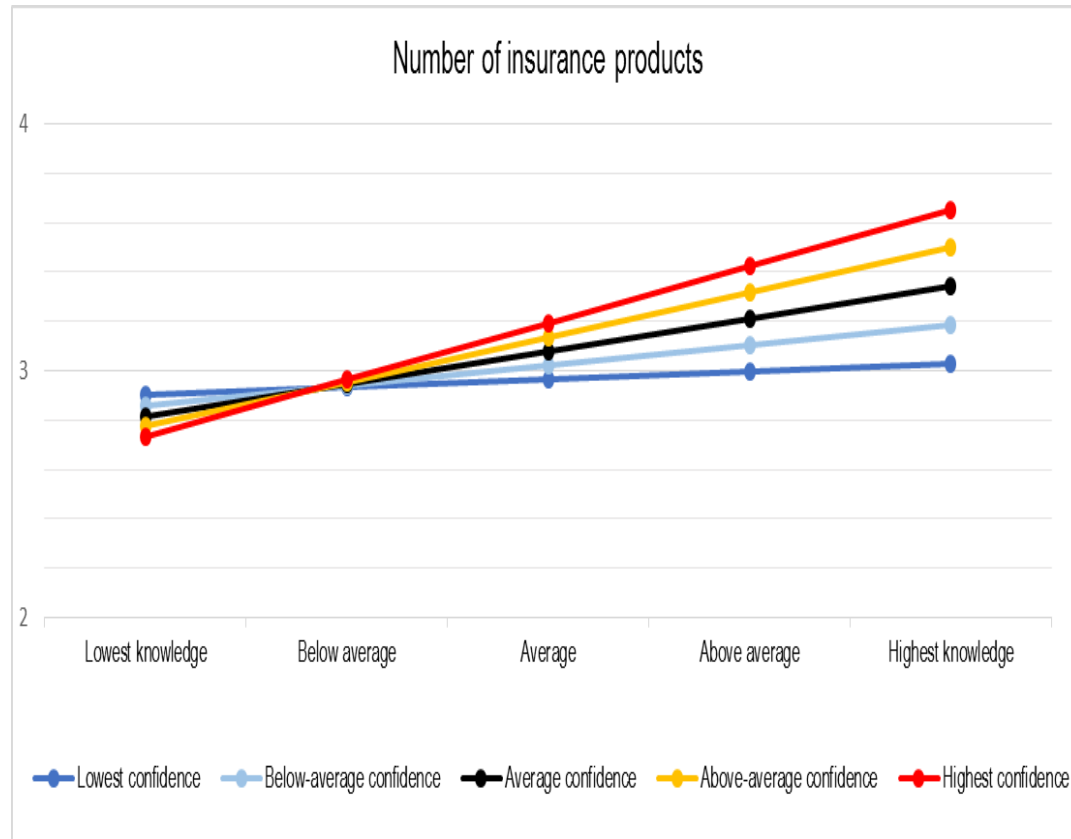


Planning and saving

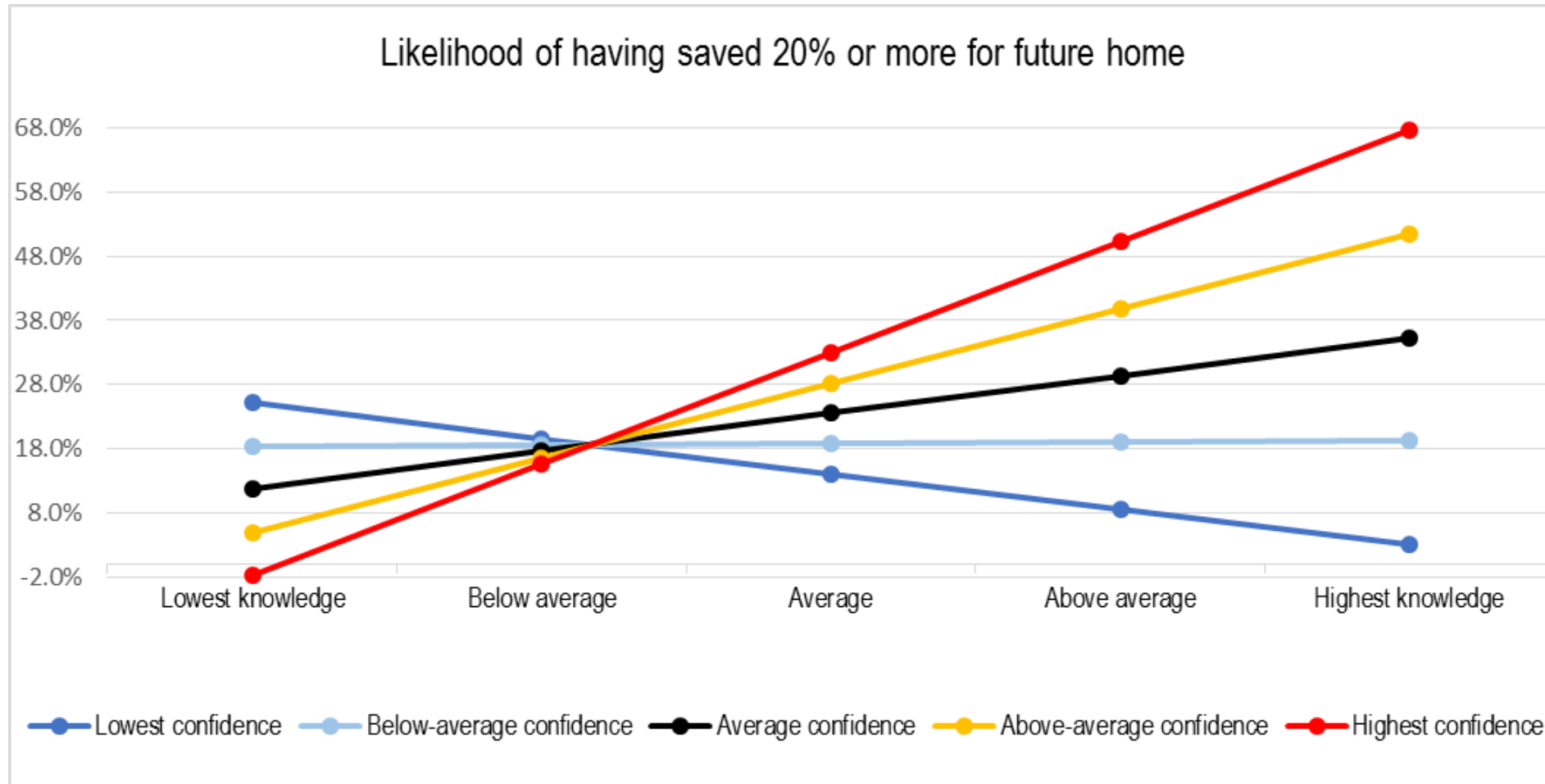
- Poor outcomes for the underconfident (those with high levels of knowledge but low confidence), but also for the overconfident (those with low levels of knowledge but high confidence)



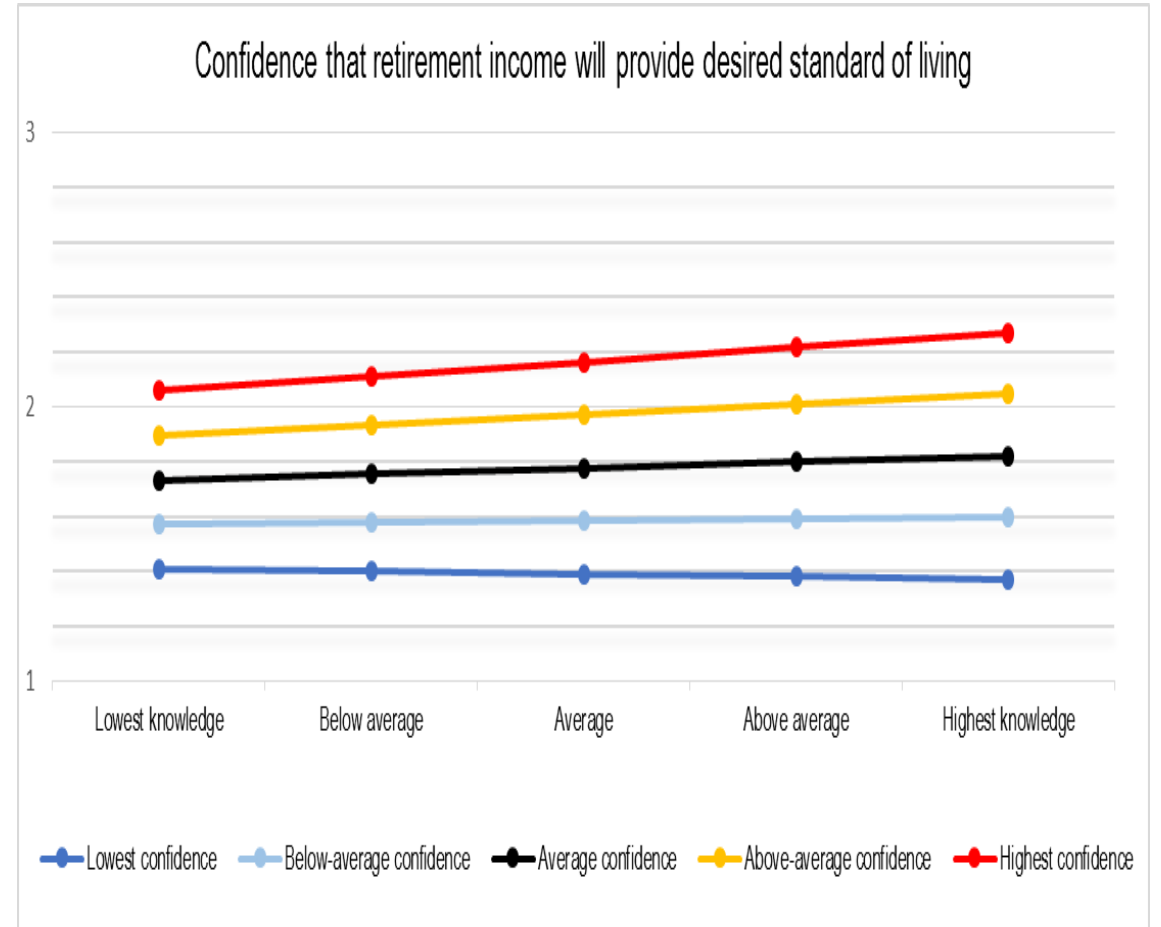
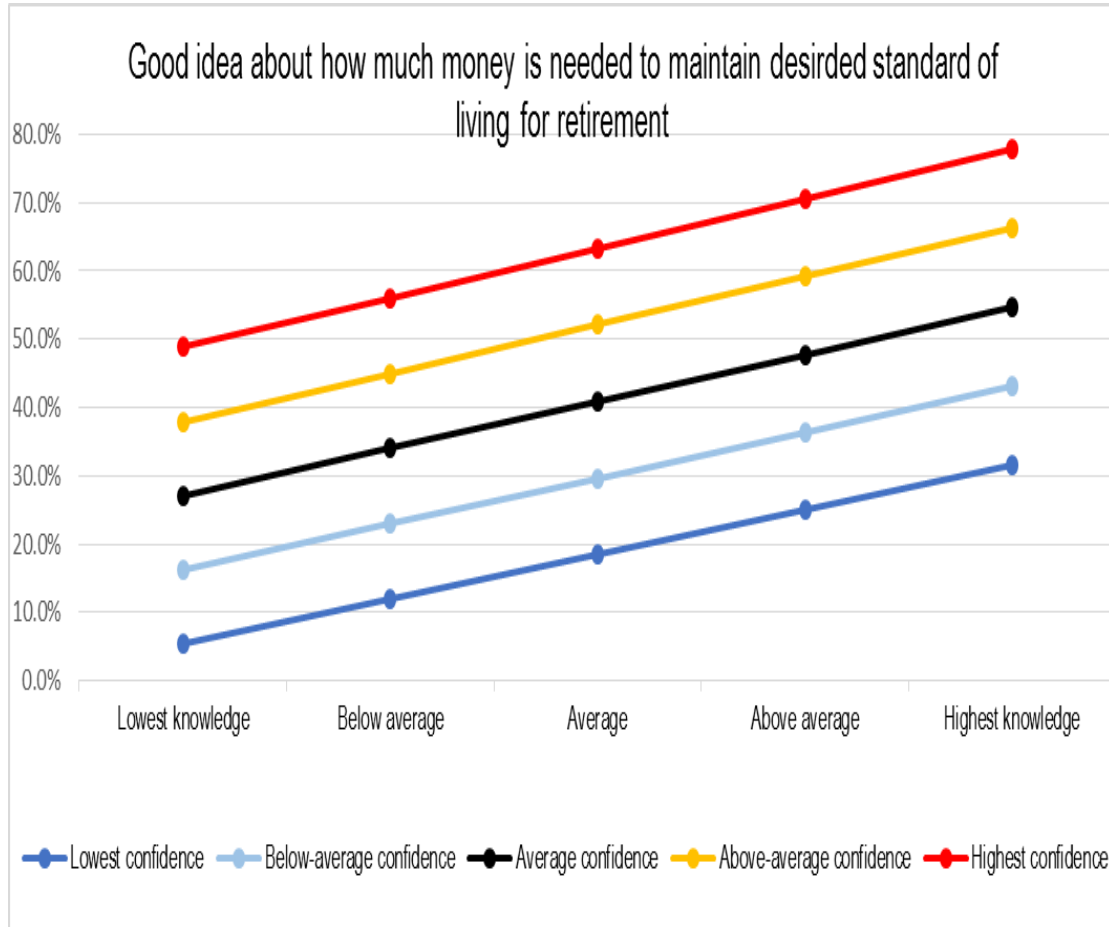
Planning and saving (2)



Planning and saving (3)

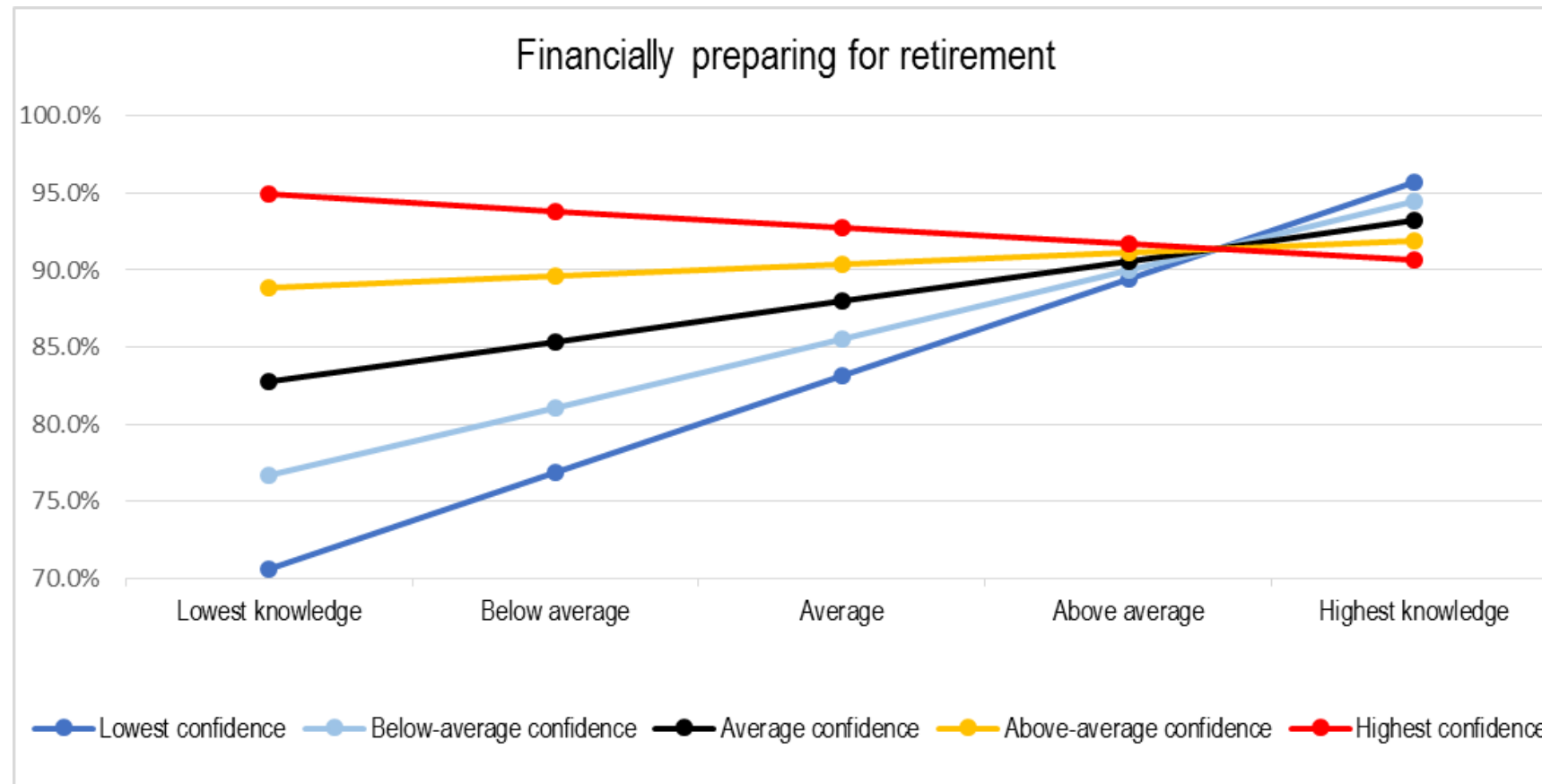


Retirement



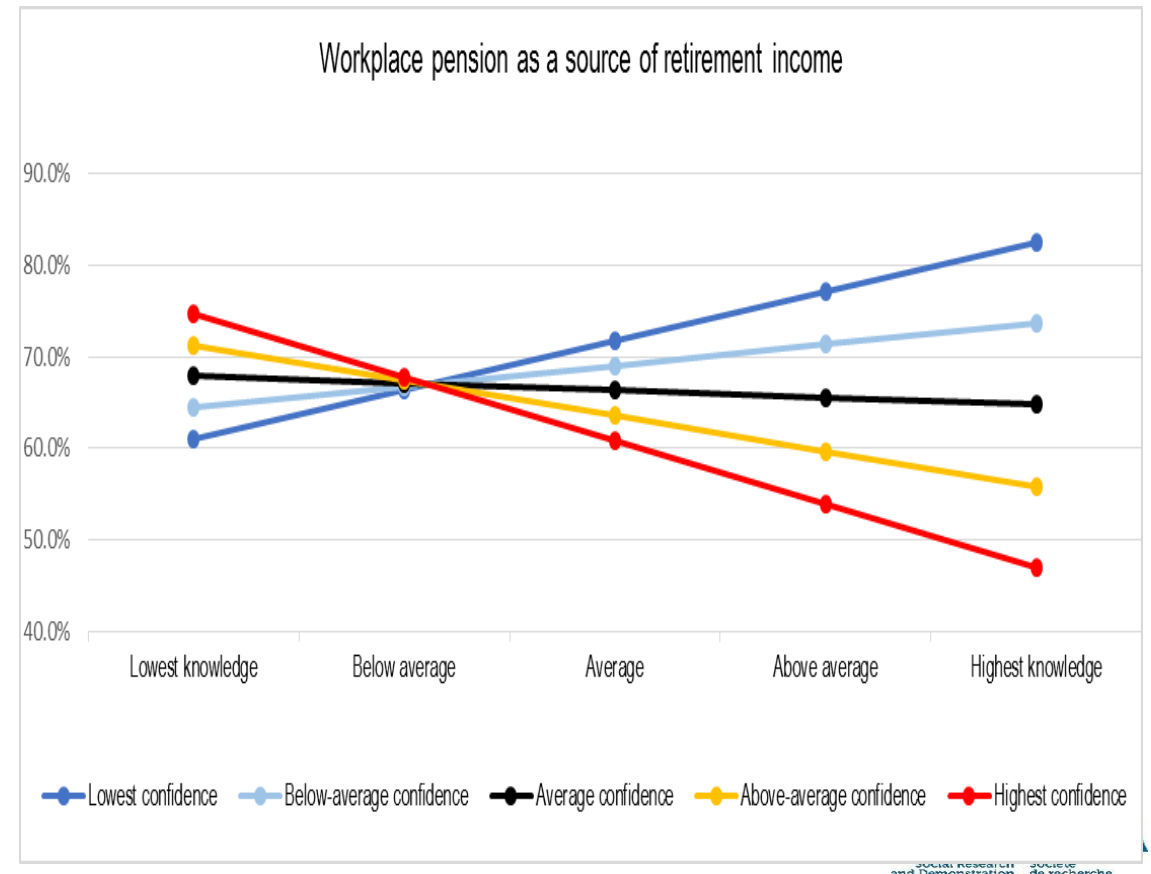
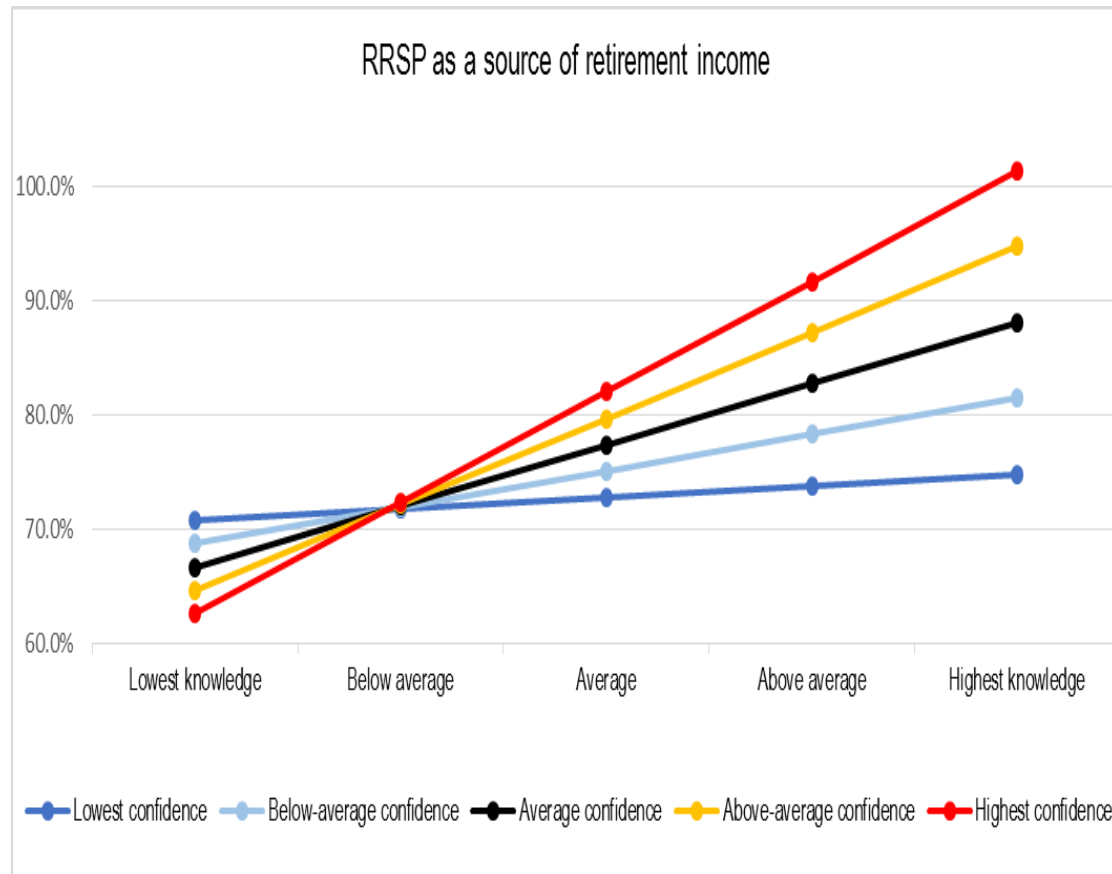
Retirement (2)

- Preparing financially for retirement
 - Those with high levels of confidence (regardless of knowledge)
 - Those with low levels of confidence, but high levels of knowledge

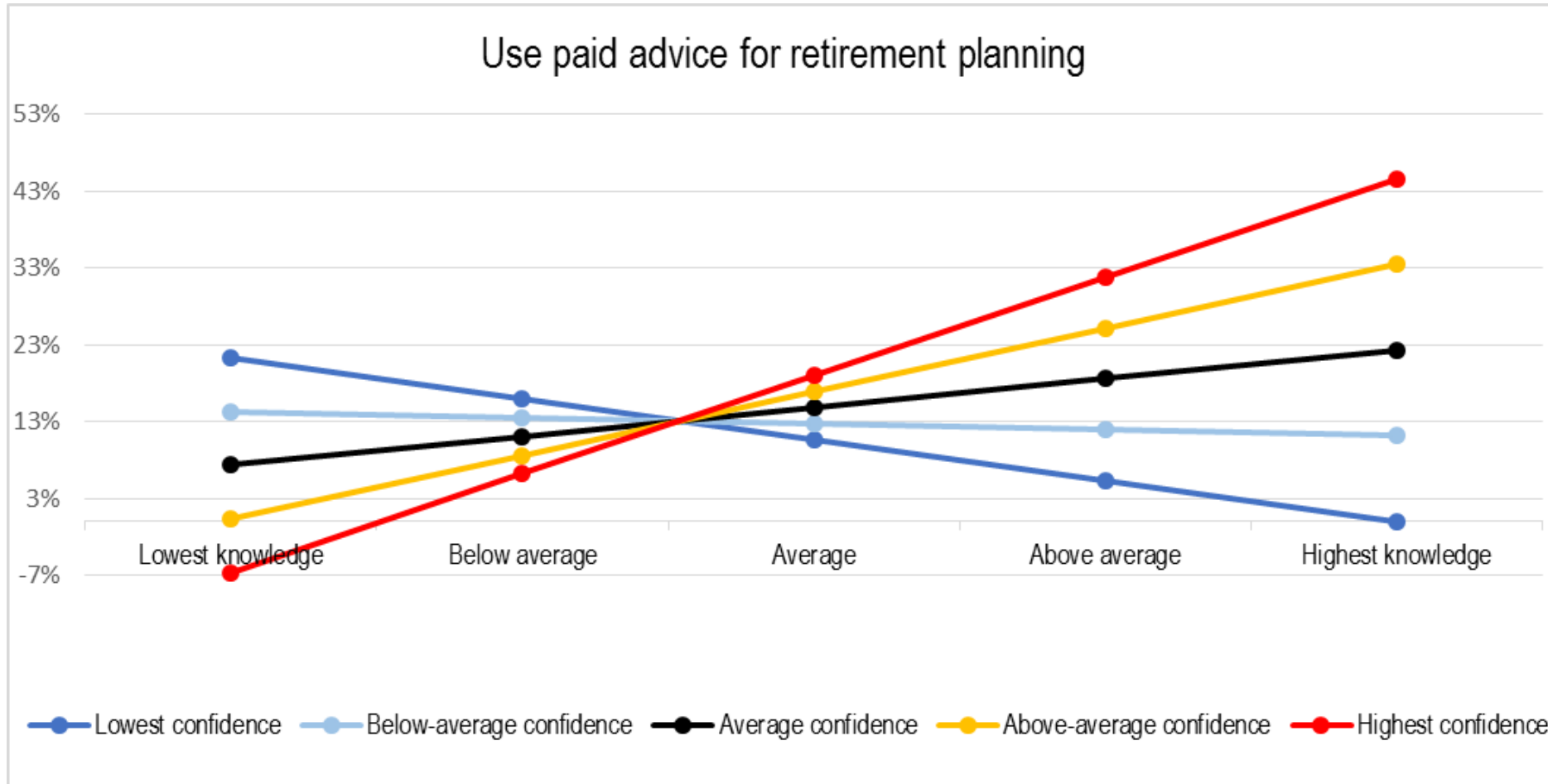


Retirement (3)

- But preparing in different ways
 - High knowledge/high confidence – RRSP's
 - Underconfident and overconfident – Workplace pensions



Retirement (4)



Retirement (5)

	RRSP assets \geq \$100,000 (among those reporting RRSP's)	Non-RRSP financial assets incl. pensions \geq \$100,000 (among those reporting non-RRSP financial assets)
High knowledge/high confidence	52%	40%
High knowledge/low confidence	37%	22%
Low knowledge/high confidence	26%	27%
Low knowledge/low confidence	19%	17%

SUMMARY

Summary - Money and Debt Management

- A sizable proportion of those with high levels of knowledge nonetheless experience relatively poor outcomes in the areas of day to day money and debt management
 - Low confidence may be an indicator of awareness of poor financial practices
 - Lack of self-control, prone to cognitive bias despite “knowing better”?
- A sizable proportion of those with low levels of knowledge nonetheless experience relatively good outcomes in the areas of day to day money and debt management
 - High confidence may be an indicator of good day-to-day practice
 - Knowledge measure may not be as variable in these areas – more variability in investment and savings related questions

Summary – Planning and Saving

- Poor outcomes on several indicators for both high knowledge/low confidence and low knowledge/high confidence
 - Procrastination/present bias despite a good base of knowledge among the underconfident?
 - High confidence may not extend to good planning and saving practices when not coupled with knowledge
- Most groups indicate financial preparation for retirement
 - But **high knowledge/high confidence** people are doing much more
 - making use of RRSP's, using paid financial advice, saving larger amounts
 - **High knowledge/low confidence** don't think they are doing enough
 - but don't supplement pensions with RRSP's or get professional advice
 - **Low knowledge/high confidence** more likely to think they are doing fine
 - Though their financial asset levels appear to be no higher than the underconfident, and they are just as unlikely to supplement pensions with RRSP's or seek paid advice

Implications for Research and Program Design

- Intervention strategies need to go beyond a narrow focus on building financial knowledge
- Cognitive bias in decision making may be the ‘hidden factor’ undermining both day-to-day money/debt management and longer-term saving among even highly knowledgeable people.
 - Use direct measures of key cognitive biases to confirm the link with both low confidence and poor financial outcomes
 - Identifying people with different kinds of need (Low knowledge? Low self-control? Both?) can help inform intervention design
- Overconfidence may be associated with complacency in investment and saving decisions
 - Need better and more direct measures of investment and saving behaviour to investigate the possible detrimental effects of overconfidence
 - Targeted knowledge interventions