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Consumer Literacy & Credit Worthiness

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Prepared for:

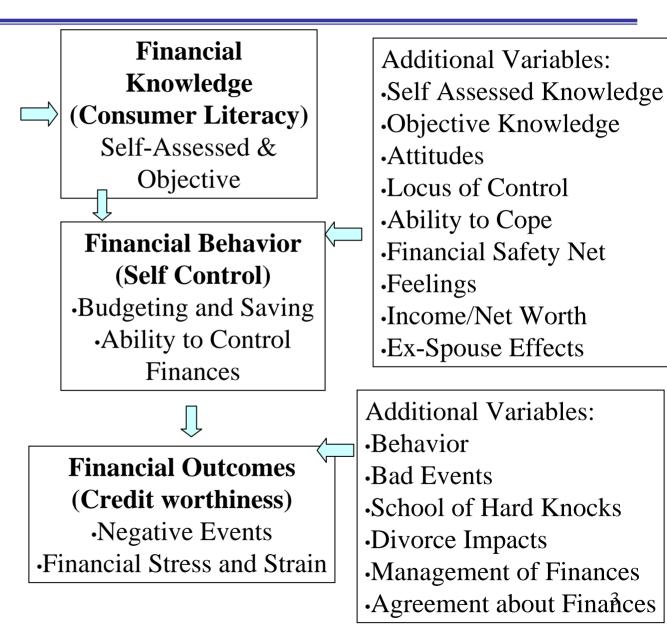
Federal Reserve System's Community Affairs Research Conference

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



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

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.