

Study: Financial Literacy vs. Financial Well-Being And Credit-Constrained Canadians

Loans Canada's survey probed theories on financial literacy and their effect on financial performance by sampling 1665 Canadians seeking alternative forms of credit. We found that **77% of respondents have checked their credit in the last six months**. According to data found in the 2019 Canadian Financial Capability Survey (CFCS), "Those who checked [their credit report] more recently are more likely to consider themselves to have a bad or very bad credit rating." In keeping with this fact, we found that **59% of our respondents have a credit score that they would describe as low**.

Findings showed **67% of those surveyed had a high level of confidence in their ability to make financially sound decisions**. Conversely, data showed respondents didn't display good financial behaviour in terms of budgeting, saving, or tracking their spending. Moreover, the data suggested that people who considered themselves financially literate were carrying higher levels of debt and were **loan stacking** at a higher rate than people who didn't claim to be financially knowledgeable.

Financial literacy is known to be the key to better financial decisions. When respondents were asked if they follow the behaviours that financially knowledgeable consumers would follow, these were their answers.

Financial Literacy and Behaviour

In general, we can all agree that being financially literate means you are well equipped with the information you need to manage your money – particularly when it comes to saving, spending, and borrowing. Yet, the respondents who claim to be financially knowledgeable (67%) aren't saving for emergencies, tracking their spending, or paying off their credit cards in full.

Financial Habits of Credit-Constrained Canadians



67%

Do not pay
credit cards in full



72%

Do not save
for emergencies



43%

Do not track
spending

66% of our respondents also do not have a monthly budget they stick to. A budget is an essential tool that can be used to manage income, track expenses, meet savings goals, and paying down debt. According to the 2019 Canadian Financial Capability Survey (CFCS) commissioned by the Financial Consumer Agency of Canada, budgeters had a higher level of financial well-being because they were better able to manage bill payments, debt, and cash flow than those who did not have a budget. Moreover, budgeters were more likely to have emergency funds and be able to cover unexpected expenses; an asset that many credit-constrained Canadians don't have.

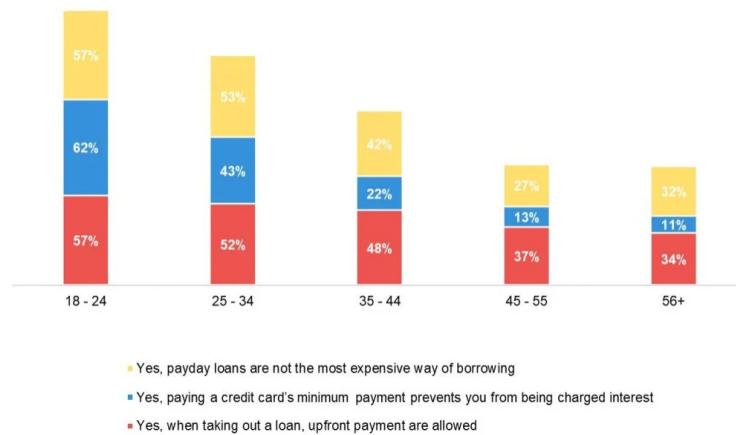
66%

of credit-constrained
Canadians don't have
a monthly budget that
they stick to.



Furthermore, when tested on their knowledge of basic personal finance concepts, the responses to the three questions below illustrate the gap between confidence in financial literacy and actual know-how:

Financial Literacy By Age Group



Of those claiming financial literacy, we gained the following insights:

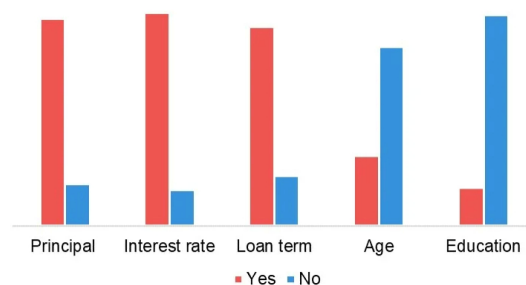
- 40% of respondents did not know that a payday loan is the most expensive way to borrow
- 30% did not know that paying a credit card's minimum payment meant you still had to pay interest
- 44% thought **upfront payments** were legal when taking out a loan.

These results show that many may think they have enough financial knowledge to make good credit decisions, but in reality, many still have a lot to learn. This is especially notable because the majority of respondents are those most vulnerable to the consequences of not having a complete understanding of the cost of borrowing and the credit system as a whole.

We also noticed that as age increased the questions were more likely to be answered correctly, which suggests that older respondents are more financially knowledgeable compared to their younger counterparts. However, the results as a whole demonstrate the difference between confidence in financial literacy and actual knowledge on the matter. Still, an opportunity exists: it is clear that working to educate younger individuals on the topic of financial literacy could certainly be a great way to tackle this issue in the long run.

Cost of a Loan

Understanding the **cost of a loan** can help Canadians make better borrowing decisions, choose the best lending product for their situation, and ultimately save money. The three main components that affect the total cost of a loan are amount borrowed (principal), interest rate, and loan term. When we questioned the respondents about what factors directly affect the cost of a loan, the results seemed to be positive as seen in the figure below.



However, a deeper look at the results showed that only 44% of people actually answered all questions correctly.

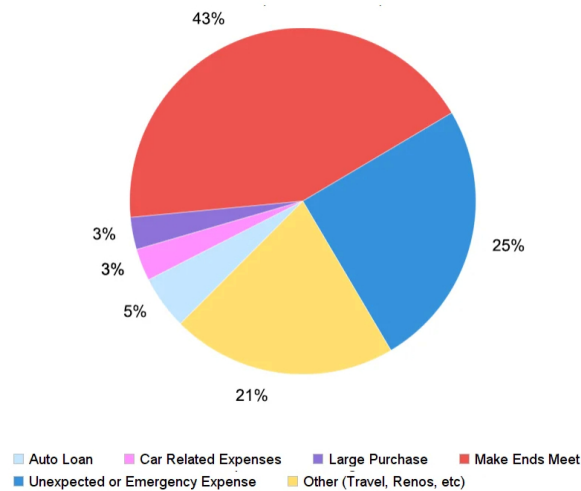
Meaning **more than half (56%) of respondents are unsure of all the factors that affect the cost of a loan**. This suggests that many respondents may be taking on loans or incurring debt without understanding the full cost of borrowing.

Loan Stacking

Simply put, loan stacking occurs when a borrower takes on a new personal loan before a previous one is paid off. Usually, this means borrowing from multiple providers. More often than not, consumers choose loan stacking because they feel as though they have no other option.

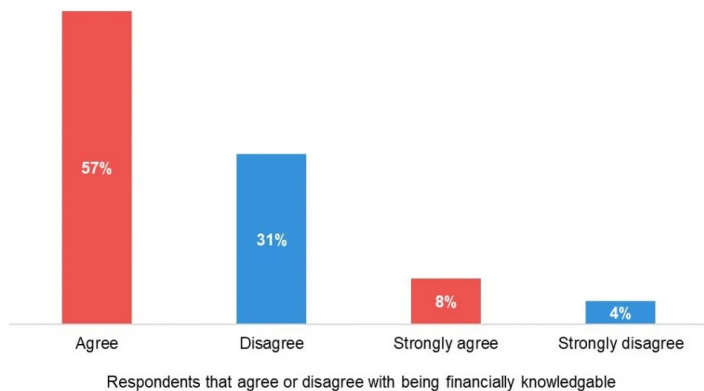
Job loss, medical emergencies, car issues, rising interest rates: these are just some of the challenges Canadians deal with on a daily basis, yet they are not always financially prepared for them. **Our survey found that 78% of respondents are not saving for emergencies.** Furthermore, **emergency costs** was the second most common answer respondents provided as the reason behind stacking loans.

Reasons Respondents Loan Stack



In fact, 46% of respondents claimed to have stacked loans, with emergencies (25%) and making ends meets (43%) being the main reasons for their actions.

In addition, we learned that individuals who considered themselves to be financially literate were also more likely to loan stack than those who did not make this claim.



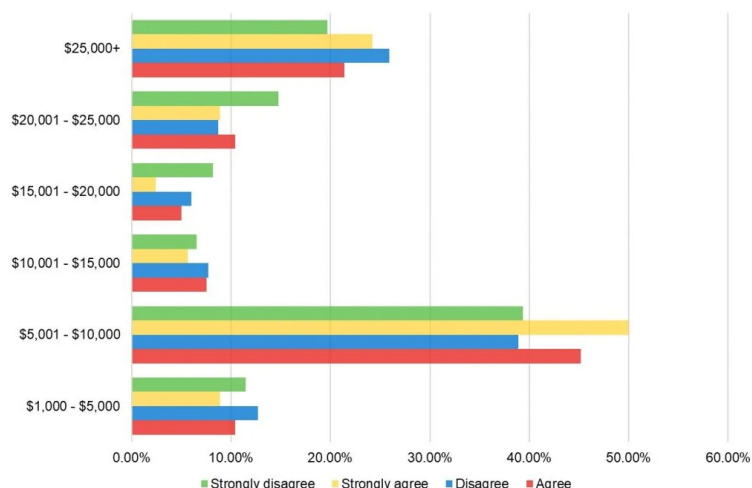
The graph above shows the percentage of respondents who loan stack compared to respondents' levels of agreement when asked about their knowledge in financial literacy

It appears that individuals who have a high level of confidence in their financial decisions are still making the same mistakes as those who don't claim they are financially literate.

Debt

As you may have expected people who loan stack have higher levels of debt than people who do not. However, surprisingly, our study

found that people who considered themselves financially literate have similar or higher levels of debt in comparison to people who don't claim they are financially literate. For example, in the graph below, respondents who agree or strongly agree they are financially knowledgeable were more likely to have debt levels between \$5,001 – \$10,000 than those who disagreed.



The graph above shows debt levels compared to respondents' levels of agreement when asked about their knowledge in financial literacy

In general, over 50% of respondents carried high-interest forms of debt like **payday loans** and credit cards. Listed are the three main debt forms credit-constrained Canadians carry:

Types of Debt Carried by Credit-Constrained Canadians



Credit Cards
55%



Payday Loans
45%



Personal Loans
39%

Credit Cards

Financial literacy is important when making financial decisions, but as seen, many are unaware of their own limitations when it comes to making sound financial decisions. This lack of awareness can lead to mistakes. For example, not realizing the importance of paying your credit card bill in full every month.

32%

of credit-constrained Canadians who don't pay off their credit card bills in full believe that paying the minimum payment prevents them from being charged interest.



when only making the minimum payment, it's not unexpected that 59% of respondents have a low credit score.

Paying your credit card, or rather making bill payments in general, is one of the most important steps in building a healthy credit score. Not paying your credit card off in full every month can lead to a higher credit utilization ratio which impacts credit negatively.

68% of those polled reported having at least one maxed-out credit card. The higher your credit card balance, and therefore the higher your utilization ratio, the more likely you are to have to max out your credit card in the event of an unexpected expense.

Moreover, not paying your credit card in full means you'll have to pay more on interest later which can lead to greater amounts of debt, making it harder to repay.

With **67% of respondents not paying off their credit cards in full** and **30% of those not realizing they'll have to pay interest**

68%

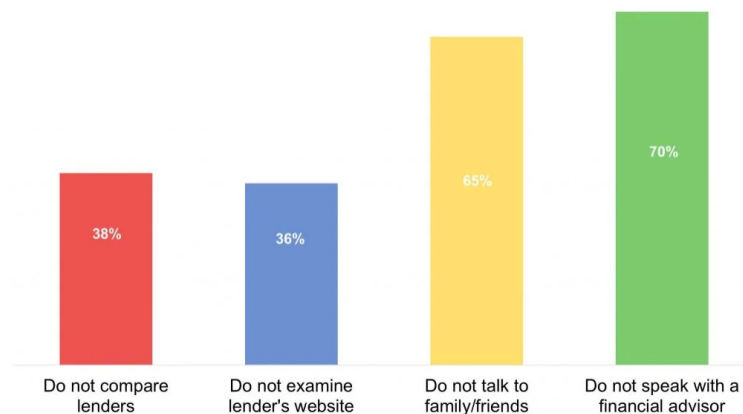
Research

Research is an integral part of the decision-making process, particularly when it comes to decisions about borrowing. Yet, there are still consumers who aren't doing their due diligence before applying for a loan. Our survey found:

or credit-constrained Canadians who use credit cards on a regular basis have at least one maxed-out card.



Percentage of Respondents Who Are Not Conducting Appropriate Research Before Borrowing



38% of those surveyed never or rarely compare lenders before applying for a loan. Comparing lenders and their offerings is the best way to guarantee finding the most competitive and most appropriate lending product. This is especially important for credit-constrained Canadians who would benefit from more competitive financing terms or lower monthly payments.

60% of respondents never or rarely call a lender before applying for a loan. Calling a lender can help legitimize the institution you're dealing with. It can also help explain any questions or concerns a borrow might have, and help expose hidden or undisclosed fees.

70% of respondents never or rarely seek expert financial advice prior to taking out a loan.

Similarly, **65% of respondents don't consult with friends and family to help in the decision-making process.** This is important as the 2019 Canadian Financial Capability Survey conducted by the Financial Consumer Agency of Canada found that "young people who speak with their families about financial matters tend to have a higher level of financial literacy", which leads to better financial decisions. As such, we encourage Canadians and younger people, in particular, to speak with their families before making credit decisions.

36%

of credit-constrained Canadians rarely or never check out a lender's website prior to applying for a loan.



Canadians Can Improve Their Financial Well-Being Through Financial Literacy

Education and improved access to helpful and practical financial information both play a crucial role in improving financial well-being. According to the 2019 Canadian Financial Capability Survey (CFCS), Canadians who deepen their financial literacy through advice and education can strengthen their "ability to manage money and debt wisely, helping them plan and save for the future".

Our findings show that lack of financial knowledge often leads to poor financial decisions, bad credit, and issues with debt. From those polled we found that credit-constrained Canadians are struggling to save for emergencies, are unaware of when interest is charged on credit credits, and are taking on too much debt. One of the key findings of this study is that many Canadians seem to have a high level of confidence in their financial knowledge despite not adopting good financial behaviours. Financial literacy is an important component of the credit building process and can lead to other great outcomes such as lower costs of borrowing and better financial health as a whole.

Follow this link to read [Canadians and their Money: Key Findings from the 2019 Canadian Financial Capability Survey](#) from the Financial Consumer Agency of Canada.

Survey Methodology

From January 7, 2020, to January 16, 2020, a survey was conducted by Loans Canada. A representative sample of 1665 users, from across Canada, were asked questions related to their financial health and literacy. Participants were asked 22 questions and data was collected using Google Forms.
