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Consumer Voices on Financial Rules to Live By

Consumer Financial Protection Bureau

About CFPB Research, Tools, and Resources for Financial Educators

An essential part of the mission of the Consumer Financial Protection Bureau (CFPB or Bureau) is to empower consumers to take more control over their financial lives. Since the Bureau opened its doors in 2011, we have worked to improve the financial literacy of consumers in the United States and to ensure access to tools, information, and opportunities for skill-building that they need to manage their finances.

The Bureau's principal financial education mandate is set forth in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act created the Bureau and mandated the establishment of an Office of Financial Education to "be responsible for developing and implementing initiatives intended to educate and empower consumers to make better informed financial decisions." 12 U.S.C. § 5493(d)(1).

To better help consumers make well-informed financial decisions and achieve their own life goals, we at the CPPB have sought to increase understanding of three broad areas: consumer financial behavior, the financial education field, and effective practices in financial education.

We conduct research in these areas to inform the CFPB's own financial education efforts and to share our insights with others who have a common interest in improving the financial well-being of consumers.

The CPFB's goal for its financial education activities is to help consumers move towards financial well-being. In the CFPB's definition of financial well-being, consumers:

- have control over day-to-day, month-to-month finances
- have the capability to absorb a financial shock
- are on track to meet financial goals, and
- have the financial freedom to make choices that allow one to enjoy life

To learn more, visit the Resources for Financial Educators webpage at http://www.consumerfinance.gov/adult-financial-education

To get regular updates on CFPB research, tools, and resources for financial educators, sign up for the CFPB Financial Education Exchange (CFPB FinEx) by emailing CFPB_FinEx@cfpb.gov.

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1. Introduction

Consumers face a daunting set of tasks and decisions in managing their financial lives. These choices range from daily low-stakes decisions such as whether to buy a cup of coffee, to infrequent high-stakes choices related to homeownership and car purchases. The wide array of financial decisions to be made -- around savings, bill paying, use of credit and debt, choice and use of financial products, retirement, housing, and more -- can be overwhelming to many consumers. The range of choices available in today's complex financial marketplace adds to the challenge.

Financial educators face a dilemma in helping consumers navigate these complicated financial choices. Often, financial education offers detailed information on how to make the most appropriate and optimal financial choices for each consumer's unique situation. The research on the ability of such financial education to improve knowledge, and do so in a way that it is retained and applied by consumers, is mixed at best.[1]

In response, financial educators have been exploring approaches that attempt to make the decision-making process easier for consumers, in situations where this is appropriate. For example, approaches that reduce the cognitive demand on consumers – such as reminders,

[1] Fernandes, Daniel, John G. Lynch, Jr., and Richard G. Netemeyer. "Financial Literacy, Financial Education, and Downstream Financial Behaviors." Management Science. 60(8) (2014): 1861–1883

simplifying choices, and reducing the “hassle factor” of making good decisions – have been used successfully by financial educators.[2]

One example of this approach is emphasizing financial rules of thumb. In many domains, people may use rules of thumb in making complex decisions. Research on decision-making has explained how people use simple, easy-to-implement shortcuts (also called heuristics)[3] in managing day-to-day as well as infrequent decisions. Rules of thumb can be defined as specific, actionable guidelines consumers can apply to their decisions. These rules may be consciously or unconsciously held, but their simplicity can make them easy to apply and recall when needed.

For financial educators and others who help people with decision-making, there is evidence that providing financial rules of thumb to consumers can work better than more detailed and complex financial education in some situations. One study found training in simple, practical rules of thumb resulted in significantly improved financial practices among micro-entrepreneurs relative to traditional financial literacy training.[4] Other evidence is more mixed; for example, a recent study showed that training in traditional financial education and in financial rules of thumb did not differ markedly in outcomes around financial knowledge and self-efficacy.[5]

One possible drawback is that rules of thumb may be prone to errors relative to more involved, information-laden decision processes. There may be a tradeoff between the ease of using rules of

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[2] See, for example: Karlan, Dean, Margaret McConnell, Sendhil Mullainathan, and Jonathan Zinman. “Getting to the Top of Mind: How Reminders Increase Saving,” forthcoming in *Management Science* and Hernandez, Mindy. “Applying Behavioral Research to Asset Building Initiatives.” Corporation for Enterprise Development (2011).

[3] A heuristic can be defined as a useful principle having wide application but not intended to be strictly accurate or reliable in every situation. It may be used to speed up the process of finding a satisfactory solution, or as a mental shortcut to ease the cognitive load of making a decision. See Gigerenzer, G. & Gaissmaier, W. (2011). "Heuristic Decision Making." *Annual Review of Psychology*. 62:451-92.

[4] A. Drexler, G. Fischer, and A. Schoar, “Keeping It Simple: Financial Literacy and Rules of Thumb.” Centre for Economic Policy Research, CEPR Paper 7994.

[5] Skimmyhorn, William L., Brian Mitchell, Evan R. Davies, and David Mun. 2015. “Assessing Financial Education Methods: Principles vs. Rules-of-Thumb Approaches.”

thumb and the quality of the decisions made, especially as the decision complexity increases.[6] However, an argument can be made that most real-world decisions are made with limited information, and empirical evidence has shown that in certain circumstances, rules of thumb can produce accurate judgments at low cost.[7]

To further explore the potential of rules of thumb for financial education, we conducted focus groups with consumers to learn more about financial rules of thumb.[8] We wanted to explore what they know about and how they use rules of thumb, and how useful rules of thumb are in guiding positive financial behaviors.

In brief, we found that consumers in the focus groups interpreted the term "rules of thumb" to include a broad array of financial goals and aspirations, common financial advice, and specific rules of thumb. Many of these do not meet the academic definition of "rules of thumb" of being specific, actionable guidelines. We report on the full array of ideas shared by consumers, as consumers were given latitude on what they considered "rules of thumb" in their own lives.

We also found that there is a gap between rules of thumb and actual behavior, suggesting that popular financial wisdom may be seen as something to aspire to rather than to act upon. Moreover, finances are complicated and individualized, and the "right" decision can vary by person and circumstance, making highly generalized, one-size-fits all rules difficult to define and apply appropriately.

These findings suggest that common financial rules of thumb are fairly widely known among many consumers. These rules are helpful in shaping consumers' financial goals, and appear to work in some domains and have some role in financial decision making. To make rules of thumb

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[6] A. Shah, and D. Oppenheimer, "Heuristics Made Easy: An Effort-Reduction Framework." *Psychological Bulletin* 137 (2008): 207–222; J. Payne, J. Bettman, and E. Johnson, *The Adaptive Decision Maker* (New York: Cambridge University Press, 2008).

[7] G. Gigerenzer, and W. Gaissmaier, "Heuristic Decision Making." *Annual Review of Psychology* 62 (2011): 451–482.

[8] Abt Associates conducted this research under contract with the CPFB.

a more effective tool, these findings suggest that financial educators can help consumers develop and adjust their own rules – rules they themselves can live by.

2. About the focus group approach

Focus groups are a valuable way to understand the common opinions, beliefs, and values that consumers hold, as well as how wide their experiences may range. Focus groups are not intended to give us statistically significant data that can be generalized to all consumers. However, they can give us valuable qualitative information about what consumers think and feel in general.

In summer 2014, we listened to 308 consumers who participated in 32 focus groups we held in four cities—Boston, St. Louis, Atlanta, and Seattle. We also conducted one focus group in Boston with credit counselors who work directly with consumers who are making financial decisions. The consumers were selected to represent a variety of experiences with financial decisions. Though the consumers we talked to represented a demographically diverse group, they were not statistically representative of the overall population. These focus groups give us insight into the views of certain types of consumers but should not be seen as representing the thoughts or experiences of all consumers.

In summary, the information we have gathered through these focus groups is intended to inform financial education efforts, and not to give us a full picture of consumers' use of financial rules of thumb. The findings below should be read with that focus in mind.

3. What we heard in the focus groups

During the focus groups, we asked participants about their thoughts on financial rules of thumb. They articulated a wide range of general principles, aspirations, and actionable guidelines. Most of these guidelines tended to be high-level principles of which participants were aware but not necessarily applying in their own lives, for various reasons discussed below.

Our focus groups also elicited a range of accounting and financial habits that are internalized and automatic. Some of these conform to standard financial advice while others do not. Most of the discussions focused on saving, debt, and spending.

Additionally, we asked consumers in the focus groups about the sources of their rules of thumb and if they were able to implement them in their daily lives. We also explored whether they thought their rules of thumb could be applied universally or were more situational. We discuss each of these topics below.

3.1 Rules of thumb for savings

The most common rules of thumb mentioned by consumers in the focus groups related to savings. Different rules applied to different types of savings.

3.1.1 General savings

The most common phrase participants used to describe a savings habit was "pay yourself first." By this, people meant some variation of "put something in savings from every paycheck." When pressed to name the single most important rule of thumb they could follow, participating consumers resoundingly chose this rule.

Often, consumers' everyday habits stood in contrast to their own aspirational goals. For example, although focus group consumers felt that the "pay yourself first" rule of thumb was the single most important financial advice to follow, many said that they did not in fact do this on a regular basis.

While there was a general consensus among consumers in the focus groups that everyone should save something, there was much less agreement about how much people should save. Consumers in the focus groups offered rules of thumb on saving from $5 a day up to 50 percent of one's income. For almost every savings rule suggested in focus groups, some participants voiced objections that the rule was unrealistically high.

A savings goal of 10 percent of one's income was the rule most participants were aware of.[9] This message seems to have been presented by a wide range of influencers in consumers' lives.

Some consumers in the focus groups discussed how their parents tried to instill savings habits in them by encouraging them to save as much as half of their paychecks as teenagers. However, few were able to continue saving as much of their incomes once they reached adulthood, even if they agreed that it was a good rule.

In fact, while many participants articulated ambitious savings goals, many also acknowledged that it was difficult for them to live up to these goals. The focus group discussions revealed that as much as consumers are aware of rules of thumb for saving, they are only aspirational for many consumers. Many focus group participants stated that they just did not have the money to practice their savings aspirations.

Although some consumers in our focus groups spoke strongly and clearly about how they meet their savings goals, many others expressed feelings of inadequacy about their savings, whether it was in relation to their own rule of thumb or one circulated in professional financial advice.

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[9] It was unclear if this referred to a percentage of their take-home pay or of their gross pay.

3.1.2 Saving for the unexpected

Some consumers in the focus groups earmarked their savings for emergencies or unexpected events in their lives. They classified these types of savings as either “emergency savings” or “rainy day funds.”

Much as participants had a wide range of rules of thumb for the percentage of income people should be saving, they also had a wide range of options regarding how much people should keep in a rainy day fund. Consumers offered guidelines based on fixed amounts (e.g.: $1,000) to several months’ worth of living expenses (generally ranging from 3 – 12 months).

Several consumers in the focus groups specifically mentioned “the envelope system” of physically storing savings in envelopes. The physical evidence of watching their savings accumulate provided them with both a clear sense of satisfaction and a greater sense of control against spending funds that were co-mingled with other funds in a general transaction account.

As with general savings, most consumers in the focus groups were far from achieving the rule of thumb they had anchored in their minds for an emergency fund. The longer the recommended period of time they thought an emergency fund should cover, the more consumers felt they fell short.

Some consumers in the focus groups were skeptical that people who don’t “make a lot of money” could amass a meaningful emergency fund. The recommendation of having three to six months of expenses in savings seemed far-fetched to some.

Even focus group consumers who were conscientious savers struggled with the recommended guidelines they had set for themselves for emergency savings.

3.1.3 Saving for retirement

Rules of thumb for retirement generated the most agreement. The refrain “take the free money!” came up dozens of times as focus group consumers extolled the benefits of employers’ 401(k) and 403(b) matching contributions. Yet, even within that general consensus, there was some confusion and disagreement about how and when to put rules for saving for retirement into practice.

When discussing employer-sponsored retirement plans, focus group consumers suggested contributing enough to receive the maximum employer match. However, a few argued that making a retirement contribution that received the maximum employer match was not always practical, especially for workers just starting out who may have large student loan debt obligations or who have competing priorities.

Other focus group consumers noted the tradeoff that they face between saving for their own retirement versus saving for children’s education.

Some consumers in the focus groups noted the mistakes they thought they had made in the past regarding saving for retirement. Generally, these focus group consumers regretted not saving for retirement when they were younger and now are trying to make up for it.

3.2 Rules of thumb for spending and budgeting

Like rules of thumb for saving, many rules of thumb for spending described by consumers were broad principles, not linked to concrete steps to take in day-to-day life.

Most of the focus group conversation regarding rules for spending centered on the importance of living within one's means and spending money on needs rather than wants. The consumers we talked to recalled phrases, such as, “live within your means,” “separate your wants and needs,” “don’t spend more than you make,” “don’t spend more than what you have,” “don’t spend money you don’t have,” and “put priorities before desires.” A small subset of consumers said you should “live below your means.”

Focus group consumers also discussed the pressures of trying to keep up with peers on spending and comparing themselves to others. While the majority of focus group consumers agreed that you should “live within your means,” a few thought that people were entitled to “live a little” sometimes. Most who voiced the desire to “live a little” also acknowledged they had to be careful with their money and budget.

The topic of budgeting often came up when discussing rules of thumb for spending. Consumers in the focus groups expressed mixed feelings about budgeting. Some were very proud of the work they put into their budgeting, whether it was using a spreadsheet they created or an online tool. Other focus group consumers were less interested in keeping a formal budget.

Some focus group consumers explained that they apply the “left over” method to determine how much they have to save or spend. With this approach, they factor in all their bills for the month and then allocate whatever money is “left over” for savings or disposable spending.

3.3 Rules of thumb for debt

Consumers in our focus groups articulated relatively few rules of thumb regarding debt aside from a generalized desire to be debt-free. For those with debts, there was little agreement on guidelines about appropriate levels of debt and how to manage it. A majority of focus group consumers categorized debt between “good” debt and “bad” debt.

While there was not full agreement about what kind of debt fell into each category, focus group consumers tended to define good debt as debt someone incurs with the hopes that the item or action will put the person in a better position in the future. By contrast, they generally described bad debt as a debt someone incurs when they have no other means of paying for an item. Generally, focus group consumers identified mortgages and student loans as a “good” debt and credit card debt as “bad” debt. However, there were many who expressed mixed feelings about debt, the amount of debt to incur, and when to incur debt.

3.3.1 Mortgage debt

Mortgage debt was the primary kind of debt focus group consumers were willing to acquire and comfortable with incurring. They explained this reasoning by stating that “a house is supposed to gain value.” However, this confidence was not universally held.

3.3.2 Student debt

Focus group consumers also had mixed feelings about student loan debt. Some thought that the education would enhance their career possibilities and pay for itself in the long-run, while others expressed a negative sentiment towards student loans.

3.3.3 Credit card debt

Focus group consumers generally expressed that incurring debt on credit cards is “bad” but sometimes unavoidable. The general rule of thumb for credit cards shared by focus group consumers was to “stay away from them.” The focus group consumers based their opinions on the use of credit cards based on their past experience. They noted that if you did incur credit card debt, you should pay the balance as soon as possible and “pay down the highest interest before you pay off the lower interest balance.” Alternatively, some participants espoused paying off the smallest debt first.

3.4 Other rules of thumb

Consumers in the focus groups who introduced rules of thumb for housing costs usually had a general awareness of a recommended maximum amount to spend on housing but were not certain what the correct amount was. Most focus group consumers who discussed rules of thumb expressed the rule of thumb for housing costs as a percent of their income, with common responses of approximately 25 to 35 percent.

The consumers in our focus groups did not discuss rules of thumb on investing at great length. When the topic of investing came up, generally, consumers thought that those who invest should be attentive to the amount of risk that they were taking.

3.5 Sources for rules of thumb

Focus group consumers shared that they learned about financial rules of thumb through various mixtures of parental influence, trial and error, and what they have heard in the financial media.

Most consumers in the focus groups described learning both broad financial guidelines as well as specific money management techniques from their parents. In some cases, focus group consumers learned positive rules of thumb from their parents and families, while other consumers tried to develop different approaches to avoid making what they described as the same mistakes that their parents made.

Many focus group consumers also shared that they had developed rules of thumb themselves, based on financial experiences and mistakes from their own lives.

In addition, many focus group consumers also said they had learned new rules of thumb from popular financial media personalities, as well as general media sources like newspaper columns and books.

3.6 How people make financial decisions and how rules of thumb fit in

It was unclear how many focus group consumers had changed their behavior by learning about and adopting a new rule of thumb. The focus group discussions suggest that many participants generally make financial decisions in a reactive manner, responding to financial situations presented to them rather than proactively using rules of thumb to do things like set up their budgets or make new financial decisions. The findings from the focus groups suggest that participants were most likely to make changes to their behavior in response to a significant financial life event.

However, some focus group consumers appeared to exhibit more of a proactive stance when discussing saving for retirement, their children's education, or a buying a house. The findings suggest that consumers seem to be able to act on rules of thumb more when planning for their future and less often for day-to-day decisions.

In some cases, consumers in the focus groups had difficulty articulating why specifically they make the kind of financial decisions they do. Focus group discussions pointed to the fact that at least some of people's financial behaviors are so deeply engrained so as to be almost automatic.

Some focus group consumers were forthright that the "rules" guiding their behavior were tied to emotional cues to do what "feels right," rather than specific quantifiable financial guidelines.

3.7 Lack of universality

The consumers in our focus groups, while generally agreeing with many of the broad rules of thumb, expressed some doubt about the applicability of many of the rules to most consumers.

When asked directly, few of the focus group consumers said that there were universal financial rules of thumb that would apply equally well to all individuals. Those who did modified the rules of thumb such that they were endorsing general principles rather than specific behaviors. Some consumers agreed with certain principles, for example, that saving is important, but would not attach a number, an amount, or a percentage to the principle.

For example, many focus group consumers emphasized that the levels of savings suggested by rules of thumb are not necessarily appropriate or possible by everyone, depending on their circumstances. One participant described how she tried to follow a rule of thumb to save 20 percent of her income but repeatedly fell short of that benchmark. Instead, she finds it more reassuring to have a lower savings goal she is sure she can meet every month. The positive reinforcement of reaching her goal keeps her more motivated than the abstract rule of thumb she heard was supposed to be the “correct” amount to save.

The focus group findings suggest that rules of thumb should be tailored to the needs of specific segments of the population or, in some cases, customized to individuals’ specific circumstances, in order for them to be actionable for individuals in their day-to-day financial choices.

4. Challenges in consumer use of rules of thumb

We identified several types of challenges among focus group participants in sticking to rules of thumb, and delved into consumer perceptions and motivations behind these challenges.

4.1 Situational financial hardship

Some consumers we talked to faced financial hardships that made rules of thumb difficult to implement. Some of these focus group consumers strongly believe in a certain financial decision-making rule of thumb and want to implement the rule in their own lives. However, they believe their current situation prevents them from doing so.

Many of these focus group consumers discussed difficult life circumstances such as an unanticipated unemployment spell or the extended illness of a child. They felt that these hardships prevent them from saving 10 percent of their income, for example, because they had no disposable income to save. Some focus group consumers also reported that they do not follow their own rule because they are not in the life stage when the rule is applicable.

Some focus group consumers adjusted the rule to work for them. For example, individuals who were not able to save 10 percent might have compromised by saving 5 percent. Other focus group consumers who felt they cannot follow the rule simply gave up. Instead of seeing a potential middle ground, these individuals chose to save nothing.

4.2 Pulled off track by others

In households with more than one financial decision-maker, some focus group consumers expressed that they felt frustrated by instances where their partners' financial behaviors and values do not align well with their own. Many of these focus group consumers said they believed that they have figured out effective financial rules of thumb but that their partners do not follow the same rules. The misalignment can cause conflict within the household, and these consumers reported needing to adjust their rules to account for the influence of their partners.

Focus group consumers also discussed ways in which children can make following rules of thumb difficult. We heard many consumers say they felt their children often asked for expensive, brand-name items that they could not afford to purchase. Some focus group consumers explained how they co-signed loans for their children, bought multiple cars for them, or simply gave them large sums of cash to spend at the mall. These focus group consumers discussed the difficulty of saying no and not providing what their children wanted.

4.3 Fear of missing out

Some focus group consumers shared that they felt they were being pulled by opposing forces in their culture. These consumers told us that they understood the importance of saving, reducing debt, and controlling their spending. On the other hand, they noted that they felt the need to "keep up with the Joneses." Many of these consumers said they faced substantial pressure to "live in the moment." These consumers expressed worries that they felt they would miss out if they followed common financial rules of thumb.

5. Conclusions and Implications

The focus group findings suggest that many consumers are aware of and interested in rules of thumb to help them make financial choices. However, many of these consumers also face difficulties in acting on these rules.

Most consumers in our focus groups expressed that pre-specified rules of thumb are not appropriate or applicable for everyone. Additionally, when rules of thumb are applicable, they still need to be tailored to an individual's circumstances and life stage. Focus group consumers explained that what a person saves, spends, and invests has to be based on circumstances in life. In reality, what people seem to have is a blend of aspirations and general guidelines that motivate some but demotivate others.

In summary, the focus group findings suggest the following conclusions about rules of thumb and financial decision-making:

- Many consumers know about common financial rules of thumb.
- Many are frustrated by what they see as unrealistic goals stated in common rules, as they struggle with competing priorities across many different dimensions of their financial lives.
- There is a sense that financial rules cannot be applied equally to all people in all circumstances. But many commonly held rules are too broad or ill-defined to offer clear guidance to anyone.
- Consumers are most likely to change their financial behaviors when they are confronted by major changes in their lives or financial trigger events.

- Where they apply rules at all, consumers seem to rely on them to guide savings and other planning-related financial decisions more than for day-to-day financial tasks.
- People learn rules of thumb from families and other trusted relationships, personal experience, and the financial media.

On their face, financial rules of thumb hold promise, as they can be memorable, easy to learn, and easy to communicate. But, in the area of financial decisions, finding broadly applicable rules of thumb that people actually follow may be challenging.

These findings suggest some considerations and implications for financial educators and others working with consumers on financial decisions, such as:

- Financial rules of thumb need to be realistic and achievable to be utilized.
- Financial rules of thumb may need to be flexible and customized to take into account the many dimensions of one's financial life.
- A promising strategy for financial educators is to work with consumers in developing their own financial rules of thumb customized to their personal situation – what we call "financial rules to live by."
- Moments of crisis such as unemployment, unexpected medical bills, or emergency home repairs may be the most promising times to encourage consumers to adopt new financial rules of thumb into their lives.

In conclusion, our findings suggest that helping consumers to customize rules of thumb for their own situation – or "financial rules to live by" – holds promise as a financial education strategy. Coupled with complementary types of financial education and other types of decision-making supports, financial rules to live by can be an important tool for financial educators in helping consumers take more control of their financial lives.

The CFPB has developed resources to help consumers and financial educators develop and use financial rules to live by; see the financial educators digest and the consumer worksheets on financial rules to by for savings, credit reports, and spending. These and all of CFPB's tools and resources can be found on the Resources for Financial Educators webpage at www.consumerfinance.gov/adult-financial-education.