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CAPITAL
 By DAVID WESSEL


Why Middle Age May Be Good For Your Wallet

Your Financial Savvy
May Hit Its Peak at 53,
Survey of Data Suggests
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Baseball players are said to peak in their late 20s. Chess players in their mid-30s. Theoretical economists in their mid-40s.

But in ordinary life, there's an obvious tension between sheer smarts, often seen in the supple minds of the young -- and experience, which comes only with age.

Which one is more valuable in making personal-finance decisions?

A quartet of economists think they have found an answer. In looking at which consumers get stuck paying those pesky credit-card fees, the economists noticed a puzzling pattern: Younger and older consumers were more likely to pay easily avoided fees than others. So the economists expanded their inquiry, and sifted through records of tens of thousands of consumers.

They found that middle-aged adults tend to borrow at lower interest rates and pay fewer fees than younger and older adults. The age at which consumers are least likely to make financial mistakes: a few months past their 53rd birthday, despite all the pressures that accompany middle age.


The economists call it "the age of reason." (Full disclosure: I turned 53 a month ago.)

THE EUREKA MOMENT

Credit card issuers often lure customers by offering low-interest rates to consumers who transfer current balances to a new card. Borrowers pay attractively low teaser interest rates on the new

The evidence is circumstantial, but the same pattern is clear -- by varying degrees, to be sure -- in several different financial products. So it's hard to dismiss. And the researchers are no slouches. David Laibson of Harvard (40 years old), Xavier Gabaix of the

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FULL TEXT

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[Read the paper²](#) by Messrs. Agarwal, Driscoll, Gabaix and Laibson.



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FORUM



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Research suggests that the best personal financial decisions are made by the middle-aged and that young and old make more mistakes. [What do you think?⁵](#)

balances for six to nine months. But *new* purchases on the new card incur a higher "annual percentage rate," in consumer finance jargon. "The catch," the economists say, "is that payments on the new card go first towards paying down the low-interest transferred balances, and only subsequently towards paying down the high-interest debt accumulated from new purchases."

Being economists, the four researchers say the "optimal strategy" is to make all new purchases on the *old* credit card and make no new purchases on the *new* card to which balances have been transferred, at least for the first several months. Looking at the files on 14,798 credit-card holders from one big bank between January 2000 and December 2002, the economists find that about a third of the customers do no spending on the new card at all, and slightly more than a third use the new card every month during the promotional period.

The remainder experience what the researchers call a "Eureka moment." They use the new card at first, but then realize that's foolish and change their ways. Among consumers with similar credit scores, education, gender and income, the economists looked to see if there was any pattern by age. There was: Fewer young and older credit-card holders ever have a Eureka moment.

--David Wessel

Massachusetts Institute of Technology and Princeton (35), John C. Driscoll of the Federal Reserve Board (37) and Sumit Agarwal of the Federal Reserve Bank of Chicago (36).

With access to records on 75,000 home-equity loans made in 2002 by a large financial institution that they agreed not to identify, the economists compared borrowers who were otherwise similar and found that younger and older borrowers paid interest rates that averaged a full percentage point more than borrowers in their late 40s and early 50s. And it isn't because the loans to young and old are riskier; they aren't.

Then the economists looked closely at home-equity lines of credit, for which borrowers were asked to estimate the value of their home on an application; the bank charged more if the loan-to-value ratio is higher. The bank checked the value of the house independently.

If the borrower overestimated the value of the house -- so that the true loan-to-value ratio was higher than the application stated, and the loan thus riskier -- the bank

moved the buyer to a higher-interest-rate loan.

But what if the borrower underestimated the value of a house? Ah, the bank didn't generally direct the borrower to a cheaper loan.

Good consumers made the switch to a low-rate loan anyhow, as most people did. Fewer than 10% of borrowers in their 40s and 50s made the mistake of paying more than they had to for their home-equity lines, but 70% of the 20-somethings did, and roughly 30% of the 70-somethings. Those who erred paid an interest rate about 1.25 percentage points higher, on average, than they could have gotten. That works out to an extra \$250 a year on a \$20,000 credit line.

OLDER AND WISER

Results from the key areas of financial responsibility considered in the study:

Financial decision	Age at which fewest mistakes are made
Lower interest rates on:	
Home equity loans	55.9
Home equity lines	53.3
Credit cards	50.3
Auto loans	49.7
Mortgages	61.8
Small-business credit cards	56
Other decisions:	

A similar pattern emerged, though not as starkly, among credit-card users who incur fees for making payments late, exceeding their credit limit or using a credit card for a cash advance. Such fees are easy to avoid without much hassle, by paying on time, keeping track of card balances and avoiding cash advances.

The pattern also holds for those who figure out how best to take advantage of a credit card that offers a low, teaser interest rate for six to nine months after a customer transfers a balance. (The catch: Payments on the new card go first toward paying down low-interest rate balances, not toward higher-interest debt incurred on new purchaser. The trick: Transfer a balance, but use the old card for new purchases.) In cracking that

Avoiding credit card late fees	51.2
Avoiding credit card over-limit fees	54
Avoiding credit-card cash advance fee	54.8
Taking advantage of credit-card teaser rate	45.8
Average of 10 studies	53.4

Source: Agarwal et. Al, "The Age of Reason: Financial Decisions Over the Lifecycle"

puzzle, performance peaked around age 46.

The economists have a hunch why this might be. Cognitive ability -- being economists they call it "analytic capital" -- deteriorates steadily beginning at age 20, they say, citing psychological research. That decline is partially offset by what they call "experiential capital," the savvy that grows with experience.

The two lines cross in middle age, they hypothesize. At younger ages, the lack of experience offsets analytical ability; at older ages, declining cognitive abilities offset experience.

At first glance, this seems to contradict recent research, widely celebrated by Baby Boomers, that some brain functions actually improve with age. But that work also suggests that the brain functions differently at older ages, relying more on recognizing familiar patterns than unraveling new ones.

The four researchers acknowledge that their work isn't conclusive. Mr. Gabaix notes they haven't yet observed individual consumers closely enough to defend their hypothesis. Nor have they studied whether decisions about managing wealth display a similar pattern.

Mr. Laibson adds that the mystery may not reflect the immutable good and bad effects of age, but could instead reflect the unique behavior of each generation -- the financial habits of Baby Boomers versus their parents or their children.

But there's no doubt this is important. The move in the U.S. and elsewhere away from the no-need-to-decide-anything pension and retiree health-care schemes to those which require the elderly to pick among competing health plans or to manage 401(k)-style retirement-savings plans relies heavily on the financial sophistication of older people.

Mr. Wessel responds to reader comments at [WSJ.com/CapitalExchange](http://www.wsj.com/CapitalExchange)⁶. Or email him at capital@wsj.com⁷.

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