How financially capable are we?

Kay Blair, *Vice Chair of both the UK Financial Services Consumer Panel and EIOPA's Insurance Stakeholder Group, argues we still have a long way to go. But progress is being made.*

There can be little doubt that financial services are essential parts of modern life. It's barely possible to function as a full member of society without access to a bank account, credit card, and means of electronic payment. Yet, there remains a yawning gap in financial understanding that means many people don't make the most of their money, fail to use financial services effectively or end up making bad choices. Millions have been caught by mis-selling scandals, or have over-borrowed. Serious measures have to be taken when you discover that many of us think that the higher the APR, the better. We are not a financially literate nation.

Most EU Governments, regulators and policymakers realise that effective action is required to engage and enthuse consumers about the need to enhance their financial wellbeing and develop good money habits. Much of this is driven by economic need, as governments try to shift financial responsibility away from states and firms on to individuals. A prime example is the move away from Defined Benefit to Defined Contribution pension schemes and the growth of individual pension schemes.

Realising the pitfalls posed by ever more sophisticated financial markets and products, many European regulators have a growing consumer protection agenda, striving to improve professional standards and disclosure requirements, while calling for more effective complaints handling and redress systems. They are keen to address the imbalance of power between industry and consumer. Yet, as the experience in the UK has shown, improving financial capability is likely to be a long haul.

For a start, people regularly fail to understand the need to have a greater knowledge of financial services in the first place. Often consumers' confidence about their financial capability far outstrips the reality. Worse still, the way financial services are marketed, described and deployed often makes a challenging subject even more impenetrable. While many in the financial services industry do, admirably, run financial capability programmes in their communities, they also continue to revel in complex language and jargon. Opaque charging structures and incomprehensible products challenge even the most sophisticated consumer.

Some years ago, the Financial Services Authority (FSA) conducted a baseline survey on Financial Capability[1]. Depressingly, it found that 15% of people surveyed were unable to correctly determine whether, by looking at a typical bank statement, there was sufficient money in the account to pay a direct debit. One quarter of those surveyed were unable to use a graph to identify the best return on three separate investments. Problems understanding percentages were also apparent with 10% of consumers unable to give the right answer when asked whether a cash discount of £30 was better than a ten per cent discount on a television with an original price of £250.

Engagement with consumers is, therefore, difficult and starts from a particularly low base. Consumers don't tend to be rational as the development of a fascinating new discipline, behavioural economics, illustrates. Presenting people with rational arguments as to why they should save, why they should switch from poorly paying accounts, or why they should buy

[1] http://www.fsa.gov.uk/pubs/other/fincap_baseline.pdf

insurance products to protect them against possible adversity, doesn't always work. Indeed, sceptics argue that the effort put into financial education is misplaced, and that, instead, regulators should be much more intrusive and interventionist.

Others argue forcibly that the most effective way to improve financial capability is to address the challenge at an early age. There is something odd about an education system which in most parts of the UK means that students can leave school without sufficient knowledge to be able to access financial services and manage their finances at least in a basic way. Students are encouraged to take on debt, without the skills to manage that debt. There is hope in Scotland where Learning and Teaching Scotland, the Government appointed body reviewing and supporting the curriculum, is taking action to address financial capability in Scottish schools. Elsewhere, there is a PFEG[2] and Money Saving Expert[3] campaign to get the curriculum changed in England to include compulsory financial education.

Other groups experiencing key lifetime events are also receptive to financial education. The Frankfurt-based European Insurance and Occupational Pensions Authority (EIOPA) recently carried out a survey of financial education initiatives across the EU[4]. Seven EU nations specifically target young people including one targeting the young unemployed and another targeting those who have just left home. Six EU members have strategies for targeting students and there are bodies in some nations that target first time parents, non-married couples, employees in the workplace and senior citizens. At present the UK is targeting groups at key lifestyle stages which include those approaching retirement, going through divorce, redundancy, residents in social housing, offenders and those with a mental illness or learning disabilities. There are also some innovative workplace schemes. However, there is always room for this to be expanded to include experience from other EU nations.

The Money Advice Service (MAS) has led the way in the UK since being given the FSA's responsibility for financial education by the 2010 Financial Services Act[5]. It is attempting to reach out to people at the right time in their lives, when appropriate prompts might trigger them into appropriate action. As well as offering an annual financial healthcheck, its website[6] has guides for parents and those getting divorced as well as a host of useful tools and planners.

Needless to say, the Financial Services Consumer Panel (the Panel) is a supporter of effective financial capability programmes. While keen to see MAS succeed in improving financial wellbeing, the Panel believes the existence of MAS neither absolves the FSA, nor financial services providers, from their responsibilities to treat customers fairly. Indeed, the Panel would like a new duty of care, or fiduciary duty, to be imposed on firms providing financial services so that they put their customers' interests first. Providers of financial services can do much more to ensure consumers understand their products by making them simpler. A range of reliable straightforward products could generate trust and encourage engagement. So, too, could an end to complex, hidden charging structures and incentive programmes pushing high margin products. Marry better industry behaviour up with effective financial education programmes and, hopefully, we might achieve far higher levels of engagement and confidence.

---

[2] http://www.pfeg.org/our_work_in_education/petitions_for_financial_education/epetition.html
[3] http://www.moneysavingexpert.com/financial-education/
[4] https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/Report_on_Financial_Literacy_and_Education__EIOPA-CCPFI-11-018_.pdf
[5] http://www.legislation.gov.uk/ukpga/2010/28/contents
[6] http://www.moneyadviceservice.org.uk/?&gclid=CM7a9terua0CFSEhtAodAlFenQ