

Scottish
Council
Foundation

independent thinking



Thrifty Scots?

Steps to improve
financial literacy

Jim McCormick, Mike Chapman, Deirdre Elrick



PRUDENTIAL

Supported by Prudential plc

Scottish Council Foundation

independent thinking

The Foundation stimulates and influences social, cultural and economic change.

Working with government, business and communities, we aim to make a difference by

- Understanding the dynamics and impact of change
- Anticipating and activating positive change
- Initiating and leading informed debate
- Encouraging and applying new thinking
- Promoting innovation and social justice
- Energising people to find their voice and to fulfil their potential

The Foundation is building a distinctive reputation for its independent, original thinking and long-term vision on a diverse range of social, economic and governance issues.

We are a non-profit organisation, funded through charitable contributions and commercial projects.

principal supporters



Thrifty Scots?

Steps to improve financial literacy

Jim McCormick, Mike Chapman, Deirdre Elrick

Supported by Prudential plc

Acknowledgements

In supporting our study of Financial Literacy, the authors would like to thank in particular Liza Vizard, Damian Leeson and Ben Forsyth (Prudential plc). In addition, we have benefited from helpful comments on our preliminary findings from Kay Barton and Robbie Clyde (Scottish Executive); participants in two seminars and in-depth interviews; colleagues at the Scottish Council Foundation; and Joan Simpson (Simpson Bairstow).

We would welcome comments on this report to: scf@scottishcouncilfoundation.org.

Jim McCormick is Director of the Scottish Council Foundation.

Mike Chapman is Financial inclusion Officer at Capital City Partnership.

Deirdre Elrick is Policy and Research Manager at the Scottish Council Foundation.

Contents

Foreword, Malcolm Chisholm MSP, Minister for Communities	2
Foreword, Liza Vizard, Prudential plc	3
Introduction	4
What is financial literacy?	5
The Scottish context	6
A nation of savers?	6
Public opinion	7
Why does financial literacy matter?	9
Consumer credit and debt	9
Financial need	11
Principles for action: what could be done?	13
Primary as well as secondary prevention	13
Changing lives	13
Existing approaches	14
Consumer demand	17
Incentives and assets	18
Distribution channels	22
Measuring progress	22
Conclusions and recommendations	23
Ten propositions for improving financial literacy	24
Appendices	27
References	29

Foreword

Scotland is home to one of the world's most successful and thriving financial centres. However it is clear that people's knowledge, skills and understanding of financial products and services have not kept up with the pace of change in this market. Moreover, many people cannot access even the most basic of these products such as bank accounts.

Tackling this financial exclusion is a key part of the Scottish Executive's 'Closing the Opportunity Gap' approach to overcoming poverty in Scotland. Addressing levels of financial literacy is one of the fundamental strands of this work. In today's financial services market it has never been more important for people to have the ability to understand and deal confidently with their finances. This ability to manage money-matters is the real meaning of financial literacy, the focus of this report.

by Malcolm Chisolm, MSP
Minister for Communities

The Scottish Executive is already supporting the development of financial education in schools through the work of the Scottish Centre for Financial Education, and Learning Connections in Communities Scotland is supporting the local adult literacies partnerships to provide numeracy learning opportunities. We are already developing other innovative ways to provide support to deal with financial matters when people need it most, but it is equally important that any new work in Scotland complements the UK-wide approach for improving financial capability being led by the Financial Services Authority.

I thank the Scottish Council Foundation and Prudential for their contribution to the debate on the future development of financial literacy, and welcome the fresh suggestions and ideas contained in this report.

Foreword

by Liza Vizard,
Head of Group Corporate Responsibility, Prudential plc

Rightly or wrongly, the Scots are regarded as a nation that understands money. The concept of the 'thrifty Scot' may be little more than a caricature, but Scotland is home to much of Britain's domestic and international financial services industry.

With financial services playing such a significant role in the Scottish economy it might be expected that financial literacy levels would be high. But how much do people living in Scotland actually understand about the financial products that play an increasingly large part in their daily lives? And what are the issues that drive their financial decisions?

Understanding personal finance is a growing concern for individuals, governments and voluntary bodies – not to mention the financial services community. Prudential employs over 2000 people in Scotland and with hundreds of thousands of our customers also living in Scotland, we have a particular interest in how the Scottish consumer views his or her financial needs.

We have been actively involved in the development of personal finance education across the UK since 2001, working with a range of public bodies, academics and think tanks such as the Scottish Council Foundation. We have two overall goals. The first is to generate debate about the impact of financial education which for too long has been a marginal interest when, in reality, it should underpin some of the most important lifestyle decisions any of us can take. The second goal is to work with the non-profit sector to develop practical generic solutions for adults and children, enabling them to make appropriate financial decisions.

In many cases, that decision will not lead to an investment with Prudential or indeed with any other financial services company. For many people, the issue of financial education should begin with debt management. Determining the appropriate moment to begin saving is not only in the interest of the consumer, it is also vital for

the future of a financial service sector if it is to restore trust that has been badly damaged over the last two decades. Many lessons from our programme are already starting to crystallise and we are now analysing and interpreting these. If we want to make a significant and lasting impression on how people understand their own financial needs and how to meet them, we must begin by understanding what those needs are.

Essential work is already being done by voluntary organisations (often with the support of the financial services industry) focusing on financial education in schools. In the long run, this should pay dividends as a new generation of consumers emerges, better equipped to understand if and how they should save.

However, this report highlights the lack of financial education available for the existing adult population and, equally importantly, offers a number of tangible proposals for closing the knowledge gap.

We all aspire to financial independence. Practical financial education for adults, although far from being a panacea in itself, is a welcome step on the road to achieving that goal. It can enable adults to make the right decision for them with confidence. This is why Prudential wholeheartedly welcomes this report by the Scottish Council Foundation which highlights the fact that, for a nation with such a solid financial services base, there is room for improvement when it comes to financial literacy.

The report calls for a nationwide strategy, recognising the particular needs of those in debt, and those who should be investing for their future.

It is our hope that this report will stimulate debate in Scotland about how we can build a nation that not only profits from a strong financial service sector but which is also made up of individuals who are confident about how to make the correct decisions about their personal financial needs.

Introduction

Scotland and the UK are more affluent than ever before. We are better educated, housed and living longer and healthier lives. Employment rates are high and stable, underpinned by perhaps the most diverse working patterns in Europe. On most measures, poverty is falling slowly though inequalities in wealth continue to grow. Consumer expectations have risen steadily, fuelled by greater market competition delivering a wider choice of goods and services.

The financial services sector is a prime example, where intense competition has been to the benefit of most consumers. More of us are covered by financial products than in the past. The problem of financial exclusion, measured by the number of households without any products, has decreased. Yet, the consequences of being unbanked, uninsured or unable to access affordable credit are probably starker than ever before. Along with greater competition has come the risk of confusion and potentially expensive mistakes.

The personal finance landscape has been transformed in the last 20 years, with personal responsibility and consumer choice playing a more prominent role. Patterns of work, family life and demography have changed, with long-term financial implications. Availability of credit and the acceptance of some debt as a normal part of personal finance - with people less willing, or required, to save in order to buy - mark important shifts in expectations. Regardless of income and types of financial need, consumers in the UK are required to navigate a more complex range of products in order to make informed choices. Whether we are able to draw upon trusted sources of education, information and advice is far from clear.

The concept of financial literacy (or financial capability) is not new, but its significance is growing. Most notably, the Financial Capability Steering Group, meeting under the auspices of the FSA to develop a national strategy for improving financial capability, has set out seven thematic priorities towards this goal.

Supported by Prudential plc, the Scottish Council Foundation has undertaken research into the need for both targeted and 'whole population' approaches to improving financial literacy in Scotland. Our main findings are published in this report.

We have explored:

- + what financial literacy is
- + what it might contribute to longer-term financial security, savings and management of debt in Scotland given current trends
- + tools for improving financial literacy
- + how the current range of initiatives help and where there may be limitations and gaps

We reach a number of conclusions and recommendations to help ensure the Scottish contribution to the UK Financial Capability strategy is focused on practical action.

Our study has involved:

- + reviewing key findings from the policy and practice literature from Scotland, the UK as a whole and North America, including recent public opinion evidence
- + a stakeholder seminar to identify experiences and expectations in the public, private and voluntary sectors in Scotland
- + in-depth interviews and a smaller briefing seminar to test preliminary findings with a group of senior practitioners

What is financial literacy?

Financial literacy describes the skills and competencies developed in achieving better outcomes in financial matters. The National Foundation for Educational Research (NFER) definition is:

“the ability to make informed judgements and to take effective decisions regarding the use and management of money”¹

The Financial Services Authority (FSA) objectives around financial capability are:

“to provide consumers with the education, information and generic advice needed to make financial decisions with confidence”

Actions should therefore help people reach the point where they recognise the importance of financial matters, where they know how to set about identifying their own financial needs and knowing where to go for advice. Improving financial capability is viewed by the FSA as one means to develop a more discerning customer base and as complementary to, not a substitute for, providers treating their customers fairly.

To these we would add the notion of **thrift**. The image of the ‘thrifty Scot’ has long-standing resonance. It is part of how others view people in Scotland, and has often been associated with ‘stinginess’ - being unwilling to spend their money. Yet, returning to a literal definition of ‘thrift’ may be helpful in designing an effective strategy for financial literacy in Scotland:

“Wisdom and caution in the management of money”

Rather than implying a distaste for consumer spending, this definition might point towards a more positive awareness of the short and longer-term consequences of personal finance decisions, and skill in assessing risks.

In this report, we use the term ‘financial literacy’ as shorthand for these various characteristics.

Financial literacy is not synonymous with financial education, information or advice. These are related elements of any effective strategy, but we should not make the mistake of confusing inputs and processes with outcomes. Enhanced levels of financial literacy ought to be a direct result of effective financial education initiatives, but it remains an open question as to what range of approaches will best build financial literacy among individuals, households and communities. Other approaches without a direct financial education badging may also contribute to this goal.

The Scottish context

A nation of savers?

Scotland is home to one of Europe’s largest financial service sectors. It has earned a reputation as a low-risk and secure environment in which to trade. To these attributes, the international ambitions of some key industry players have been added. But is the image of domestic consumers as thrifty Scots accurate?

A telling indicator is the balance between consumption and saving. Evidence from the 2003 Scottish Household Survey, the most comprehensive annual survey of economic and social conditions in Scotland, shows that more than one in three households (37%) had no savings or investments at all² while just over half (54%) did. The proportion without savings is much higher in Glasgow and North Lanarkshire, and highest among single parent households (Table 1). Moreover, a significant proportion of respondents in Glasgow (17%) refused to answer. The proportion of Scottish households with any kind of formal savings has risen by 1% since 1999.

Table 1: Households with no formal savings or investment products

Scotland (1999) ³	40%
Scotland (2003)	37%
Single parents	74%
North Lanarkshire	50%
Glasgow	47%
UK (1995-96) ⁴	37%
UK (1999) ⁵	24-31%

Determining trends over time and making comparisons between different data sources are fraught with difficult. The most detailed UK survey evidence on savings comes from the Family Resources Survey, but it does not ask respondents about endowment policies or life insurance as forms of saving. Nor do most surveys ask

about informal savings, usually held in cash. The best estimates available for the UK as a whole suggest that between a quarter and a third of households had no savings in 1999.

It appears that Scots are less likely than the UK average to have any form of household savings: barely half possess an asset for a ‘rainy day’ and there is little sign of coverage improving. Turning to the extent of savings, the Scottish Household Survey shows that almost half of those with savings can count on less than £5,000. A MORI survey for Prudential in 2001 shows that Scots were less likely than the UK average to be saving specifically with retirement in mind and saved around £40 less each month (including pensions) than the UK average⁶.

On the basis of these findings, the image of thrifty Scots saving rather than spending their money as they become better off looks more like illusion than reality for a large minority of the population. An in-depth analysis of how personal wealth accumulates in the UK⁷ identifies four key factors that can help explain the current picture of saving in Scotland:

- + **ability** to save reflecting income and outgoings (the single most important factor)
- + **attitudes** to saving
- + **awareness** of appropriate opportunities to save
- + **access** to opportunities to save (including appropriate and affordable products).

To these we would add **incentives** to save.

The chances of having no formal savings at all are strongly related to ability to save, as measured by the relative risk of poverty in Scotland. This is consistent with take-up of other mainstream financial products including bank accounts, where the proportion of unbanked is falling, and household insurance where around four out

of ten renting households are uninsured against the risks of theft, fire or flood (Table 2).

Tackling disadvantage is the single most important objective in order to improve financial security today. But whether that will result in improved long-term security is another matter. Having the means to save does not account for the whole story. **Significant proportions of better off consumers have no savings. Almost one in three Scottish households with a net annual income up to £25,000 and one in five households with up to £40,000 are without formal savings.** To develop a strategy on financial literacy and improve longer-term financial security for all, we will also need a deeper understanding of the other factors, in particular attitudes to personal finance and the balance between spending (based on earned income and borrowing) and saving.

Table 2⁸: Unbanked and uninsured

Respondent or partner without bank or building society account	
Scotland (1999)	12%
Scotland (2003)	7%
Single parents	18%
Glasgow	16%
Glasgow: refused to say	13%
Single adults	12%
Single pensioners	10%
Household without home contents insurance	
Scotland (2003)	15%
Tenants (1999)	38%
Tenants (2003)	40%

Public opinion

Prudential commissioned MORI to explore public attitudes to various elements of financial literacy. Two surveys were conducted in November 2001 and September 2003⁹. An additional booster sample was conducted in Scotland in the most recent survey, resulting in around 200 interviews north of the border. Some apparently encouraging findings have emerged on the issue of confidence in dealing with financial matters for example, but some contradictory messages are also evident. Bearing in mind that survey methods offer a snapshot of experiences and opinions rather than a forecast of how trends may develop, the key findings are as summarised:

- + **Scottish respondents were among the most likely to say they felt confident in dealing with all or most of their financial affairs - more than 80% expressed confidence.** Professional and managerial employees, and those aged over 35, were more likely to be confident. Around 7% said they felt confident in 'few or none' of their affairs, concentrated among those reporting any financial difficulties.
- + **Fewer than one in ten respondents across Britain (8%) reported having any financial difficulties, and only 3% in Scotland.** Just under 60% said they were managing financially 'very or quite well'. People living in the social rented sector and in social classes C2DE were least likely to agree. Scottish respondents were slightly more likely than average to say they were 'getting by all right.' However, research in 2003 for DTI has pointed to a higher proportion of people experiencing financial difficulties. Recent evidence suggests that as many as one quarter in the past 12 months had faced some difficulty, and one in five at the time of the survey¹⁰.
- + Although the survey points to a high degree of confidence in dealing with financial matters, at a time of relatively low levels of reported financial difficulty, **a clear majority of Scots (59%) did not feel that their own education had prepared them**

for dealing with personal finances. Particularly likely to report a lack of preparedness were people housed in the private rented sector, the under-35s and C2DE respondents. Moreover, the overall proportion agreeing that this was an issue was significantly higher than that recorded in the 2001 MORI survey (42%). Among parents, a very high proportion (almost 90%) felt confident about their own ability to give sound financial advice to their children. Two-thirds of respondents in a UK-wide NOP survey commissioned by the FSA said they had learnt nothing at school about personal finances, while the same proportion said if they had learnt more while at school, they would feel more confident in dealing with their personal finances¹¹.

- + Despite the very high degree of confidence expressed in dealing with their own financial matters, and in giving advice to children, **almost 90% across Britain agreed that more education and training on financial matters is needed for adults generally.** Moreover, around 30% of Scottish parents (and 20% of parents in Britain as a whole) said they felt 'totally reliant' on schools or others to prepare their children to deal with their finances.
- + Amongst employees in the 2004 NOP survey, 58% said **learning through the workplace** would make them more confident in dealing with their personal finances, with around seven in ten employees who said they were not good at money management, or preferred not to think about planning their finances, agreeing. Separate data for Scotland are not published.
- + **Independent, not-for-profit organisations (like Citizens Advice Bureaux and Money Advice agencies) were most trusted to take the lead in improving knowledge about handling personal finances, with the support of around 40% of people in Scotland and Britain as a whole.** Schools and other education centres were most trusted by around one quarter of people, with the financial services industry chosen by 13% of respondents. Government (including the Scottish Executive) and

government agencies combined were ranked higher in Scotland than average, but was still only trusted to take the lead by 15% of Scots compared with just 9% in the rest of Britain.

Compared with a similar question in the larger 2001 MORI Survey asking 'who is best placed to supply information and education relating to financial services?', it appears that **both independent organisations and schools/education centres have become relatively more attractive sources**, while on this measure support for the financial services industry has declined. The rating of government agencies is similar in both surveys.

While consumers appear to feel confident about handling most of their financial affairs today, it is less evident that they feel confident about the future. A high degree of self-reported confidence today may in fact be consistent with an unjustified sense of security and relatively low levels of awareness about how best to match needs with value for money products. A paradox here may be that lower levels of consumer confidence in future might actually reflect growing awareness of the issues. The FSA points to the high risks facing consumers arising from inadequate understanding of financial products, at a time when responsibility is being transferred increasingly from state provision to individuals. Poor value for money from dealing with a limited range of providers and products, insufficient savings compared with spending (often driven by borrowing), and an increased risk of fraud have a direct impact on household resources immediately and in the long-term.

The high level of interest in accessing trusted independent financial advice and in the provision of education and training for adults indicates a need to explore ways of developing a whole population approach to financial capability, alongside approaches that can help people who are in financial difficulty or who have little confidence in their ability to manage their financial affairs.

Why does financial literacy matter?

On the basis of these findings, should we be confident about the state of financial literacy in Scotland? What should we read into the apparently high degree of confidence in dealing with our personal finances, set against the even higher levels of agreement that adults generally would benefit from greater financial education? It matters how the questions are posed - and the findings suggest there is little room for complacency. Even if we have not fully recognised or articulated the need for greater support, there is clearly a sense that, as a nation, we are not as well prepared as we should be.

According to John Tiner, Chief Executive of the FSA:

“Never has the need been so great or so urgent ... No one should be under any misapprehension about the scale of the problem that needs tackling or about the time it will take to make a significant impact¹².”

So how is the problem of inadequate levels of financial literacy manifested?

- + A majority of consumers think financial matters are **too complicated** and feel they **do not know enough** to choose suitable products. This perceived lack of understanding over finances exacerbates problems like indebtedness. Only one third say they review their financial situation.
- + Three in five adults do not understand what effect APR has upon a loan and one in five say they never read the small print on forms ¹³.
- + Up to one in four adults have **very low levels of numeracy** and a slightly lower proportion face significant literacy problems. Financial literacy problems are strongly associated with basic literacy and numeracy difficulties, but are a result of other factors as well, including changing personal circumstances.

Consumer credit and debt

The availability of credit underpins the housing market, much consumer spending on the high street and many of the lifestyle choices that are open to people. The importance of managing credit, however, is fundamental to ensuring that it does not turn into unmanageable debt.

Britain's levels of **consumer credit use and debt** highlight the importance of taking a whole population approach to the goal of improving financial literacy, as well as considering more targeted approaches for low-income households and communities. Debt is the single most common reason for contacting a citizens advice office. It reflects an imbalance between spending and saving. Unmanageable debt can result in intense financial pressures impacting on longer-term commitments. And it has emerged prominently in the policy and practice literature we have reviewed. We cannot expect to improve long-term financial security without understanding the changing relationship between consumer credit and savings as different ways to attain goals.

The UK's total debt commitment was estimated to have reached £1 trillion during 2004. While this figure generated considerable media excitement, it is important to distinguish between debt and *unmanageable* debt, and between secured and unsecured lending. Debt service costs as a proportion of household income are relatively lower than 10 or 20 years ago. Research from the credit industry suggests that around 4% of borrowers are in serious difficulty with repayments. DTI research on household debt indicates that around 7% of households can be considered 'over-indebted' with 4 or more credit commitments (one of the definitions used)¹⁴ Some recent trends might give cause for concern in the near future:

- + There is ambiguity over whether debt will become a macro-economic concern. Although the proportion of adults experiencing serious problems with repayment is currently small, those at risk of slipping into unmanageable debt form a larger share of consumers. For example, almost half of respondents in a recent Citizens Advice survey said it would take only a small change in circumstances to turn their current use of credit into unmanageable debt - for example, a reduction in earnings, a period of sickness or unemployment, an unforeseen increase in costs or a modest rise in interest rates¹⁵.
- + A significant growth of debt cases in the next year has been predicted by Citizens Advice, reflecting especially high levels of unsecured borrowing and high loan to income ratios on mortgages. In parallel, a marked growth in the debt consolidation and collection market is also expected¹⁶.
- + Borrowing today is easier than ever before. One in five adults in Britain are using credit to pay for everyday household bills - and one in four say they have no idea how much they owe in total to credit companies.¹⁷ Existing customers may be given higher spending limits on credit cards automatically, without applying for them. This leaves customers having to opt out and stick to a lower credit limit. A recent report by Money Advice Scotland¹⁸ found that employees in their early 30s carry more debt on average than other age groups. Further research is needed to assess how far the servicing of significant amounts of debt is crowding out longer-term savings.
- + The most common reason for problematic debt among thirty-something Scots was over-commitment, reported in almost half of cases. Changes in circumstance resulting from unemployment and relationship breakdown, as well as council tax arrears, were other significant sources of debt. This appears to contrast with a CAB survey¹⁹ in 2001, which identified changing circumstances as the main reason for financial difficulties, and relatively fewer cases of over-commitment or mismanagement.
- + There are no obvious limits to how many sources of credit the average consumer can have at any time (e.g. credit card, store cards, bank loan, catalogues) and there is evidence that multiple sources of credit are commonly a factor in reported cases of unmanageable debt. While credit scoring may result in some consumers being unable to access forms of mainstream credit, other forms of data sharing between providers are uncommon in the UK. While these would prove unpopular with customers and providers alike, there is a strong case for exploring how far consumer protection might be served by reducing the risk of multiple forms of indebtedness.
- + While many working consumers are using multiple forms of credit, others cannot get access to affordable credit at all. This may reflect the lack of an asset base or secure income stream to borrow against, postcode lending practices, variations in crime rates and consumers with a history of problematic debt. The so-called 'sub-prime' or 'non-status' market may include up to one in six adults: a large and diverse market that is often under-served in terms of choice, appropriateness and value for money. Credit card use remains lower among unemployed people, part-time employees (especially women) and retired people. For low-income consumers, cash retains an important place. It may be risky in terms of security, but offers some a greater perceived degree of control over what little spare money is available. There are negative consequences, however, for bill payment with few or no discounts available for regular transactions in cash²⁰.
- + Better-informed choices on credit require consumer education, generic information and independent advice available at the right time in a relevant format. There is clear evidence of a 'learning lag' that results in consumers not making informed borrowing decisions in their best interests in the long-term. The range of products and providers has grown substantially, outstripping our ability to navigate through the risks and costs. As a nation we are wealthier than ever before - but it appears some of us are more financially vulnerable than we may have realised.

Financial need

It is sometimes assumed that financial literacy skills are most needed by low-income consumers. It is certainly true that the impact of taking out high cost/poor value products may be disproportionate upon people in financial hardship, and there is considerable scope for improving their confidence and capacity in dealing with financial service providers. But action to improve financial literacy should be considered as part of a broader financial inclusion agenda. Educational initiatives are unlikely to be effective without attention to product design, affordability and accessibility concerns.

A small proportion of people have **no mainstream financial products** at all (around 7% of adults). This figure is higher among low-income and single adult households in Scotland, as well as Wales and London. Other 'risk' factors include renting in the social or private housing sectors, never having had a secure job, being young and vulnerable, becoming a lone mother at an early stage and being older than 70 having left school before the age of 16²¹. While the proportion of unbanked people in Highland and the Islands as a whole is low (4%)²², exclusion on the grounds of geography may be an issue for people living in more remote rural areas, where physical access to providers may be difficult, and alternative distribution channels not used effectively.

It appears that relatively few consumers are denied access on the basis of their income, postcode or other personal circumstances. However, many of them are outside the financial services system on the grounds of inappropriate products (as a result of restrictive conditions or unaffordable pricing) and 'marketing exclusion' (where providers target more affluent customers with the best deals), while others prefer to deal only in cash to retain a sense of control over whatever available money they have. Some minority ethnic groups, especially Pakistani and Bangladeshi families, make limited use of financial products due to language barriers, religious beliefs and lack of appropriate information.

While the payment of welfare benefits into bank accounts will reduce further the proportion of those with no

financial products at all, many are likely to join a much larger minority - up to one in five households - who are considered to be **'on the margins'** of financial services²³ with only one product (typically a current account).

When it comes to managing money on a low income, the gap between income and required spending remains the dominant factor, with consumers making financial decisions on the basis of immediate priorities rather than choosing from a range of financial opportunities²⁴. To gain access to small amounts of credit, low-income consumers would prefer to borrow from family or friends or join a credit union and build up a modest savings record in order to take out a loan:

"She'd maybe need a loan of just £40 or £50 – the bank would laugh at her. At the credit union we welcome everyone no matter how much they can put in or take out"²⁵.

Borrowing from high-cost sources generally occurs because people cannot access the money they need more cheaply, or believe that they will be turned down by other providers. Choice, however, is equally important to those on lower incomes. It is important to note that some people choose to borrow from the weekly-collected credit market because they feel can stay in control of their finances by managing in cash on a weekly basis. The reluctance of mainstream providers to offer credit to consumers who need small loans has a negative impact on their confidence, and highlights the ongoing need to develop alternative sources of affordable credit and routes to saving:

"People in [disadvantaged] areas aspired to save but frequently needed to borrow. They were attracted to schemes that link savings and borrowing, giving them access to low-cost loans. But there is a clear need to break the cycle of borrowing from high-cost lenders to be able to start saving ... There was widespread mistrust of banks, insurance and credit companies and a high level of disengagement from financial services. Levels of knowledge were low and people said they felt gullible ... Access to insurance and home contents insurance in particular was problematic"²⁶

Various issues are identified here: accessibility, confidence, knowledge and mistrust. People with little experience of dealing with financial service providers felt they had learned through a costly process of 'trial and error.' Financial literacy approaches can provide a starting point for developing the understanding needed in order to make well-informed financial decisions - provided choice and value for money are extended through more appropriate products and advice.

Out of necessity, poor families often make the best money managers, especially if they have had to cope with persistently low incomes. Reviewing research evidence for the ESRC, Professor Jane Millar notes:

"There is no evidence to suggest that there are two types of poor families – those who can cope and those who can't. People adopt various strategies when incomes are low ... but no money management strategy can be sustained if income is too low to make ends meet. Even the best manager cannot make too little into enough"²⁷

Our review of the evidence suggests strongly that the primary issue for people living in poverty is gaining access to an adequate income, through earnings, benefits and savings. But the need to improve financial literacy is also relevant to enable low-income consumers to cope with changing needs and circumstances.

Casting the net wider

In the course of our study we have detected a false choice. Some believe that financial literacy approaches should be targeted only to the few, either low-income households to help manage their limited resources better or those facing unmanageable debt. This is not a helpful approach. Our reading of the available evidence persuades us that the net should be cast widely: a whole population strategy is needed. As a minimum, those at greater risk of experiencing financial difficulty should be identified and supported. The strategy should ensure the appropriate mix of education, information and advice is personalised and, crucially, is future-focused. As well as addressing immediate needs, it should signpost consumers with diverse circumstances towards the most relevant forms of support to build their capacity in the longer-term.

Principles for action: what could be done?

There is a strong consensus that a national strategy is required to learn lessons from existing initiatives, to coordinate practice and funding, to ensure quality and consistency of provision of financial services and products, and to address gaps in provision. A range of consumers and citizens advice organisations in Scotland and the rest of the UK have responded positively to the FSA's initial work on financial capability. In this section we identify key principles to underpin a successful approach.

Primary as well as secondary prevention

In Britain, consumers tend to approach agencies like Citizens' Advice Bureaux and Money Advice agencies when problems occur, or well after they suffer the consequences. A key task is to raise awareness among consumers on how getting relevant information and advice to prevent a problem becoming a crisis. Our understanding of how to go about developing 'early warning' systems among consumers and providers is weak. Research to identify practical tools for 'primary prevention', drawing on lessons learned in sectors as diverse as the utilities and banks as well as comparative evidence from abroad, should be regarded as a strategic priority. Agencies dealing largely with cases of 'relief' and secondary prevention should be closely involved in designing approaches targeted 'upstream'.

Changing lives

Frequently, policy thinking and practice is organised around stages of people's lives. The UK Government's Opportunity for All reports and the Scottish Executive's Social Justice Annual Report have taken a similar approach. They identify progress towards various milestones and targets by:

- + children and young people
- + families
- + people of working age
- + older people
- + communities

Improving financial literacy action should be based on an explicit understanding of how financial needs and circumstances change at different stages of our lives. AdFlag (the Adult Financial Literacy Group) has identified promoting awareness of financial products and services *when people are most likely to be receptive*, such as moving into work, as a high priority²⁸. This is reflected in how various financial service providers develop and promote generic advice, and is the organising concept for the FSA's initial recommendations published in Building Financial Capability in the UK. The seven thematic areas being taken forward by a series of FSA Working Groups are:

- + schools: laying the foundations (personal finance education)
- + young adults: new responsibilities
- + work: reaching people through the workplace
- + families: being a parent (using the Child Trust Fund as an opportunity)
- + retirement: planning ahead
- + borrowing: making informed decisions
- + advice: the role of generic advice (role, delivery, resources)

With varying emphasis, these cover the three dimensions of financial education, information and advice; key stages during life; and suggest a range of settings through which financial capability can be improved. This is an encouraging approach, not least because financial problems can often be traced back to *changes in life circumstances* (e.g. a drop in income or unplanned expenditure), especially around transitional phases.

We believe that for approaches to be successful, **the context must be personally relevant, and solutions should also be focused beyond the individual**. The FSA approach allows as well for peer group, community and trade union involvement in improving financial literacy.

Existing approaches

The FSA's work will build on what we know of existing practice. It has identified, to date, up to £40 million currently spent on financial capability work, funded

by a combination of Government money, industry contributions, charitable trusts and the FSA itself. This is a surprisingly small amount of investment and helps to explain why good practice is so patchy and poorly co-ordinated. Our own review of the evidence suggests that the profile of financial education in schools has risen steadily in recent years, but much less research has been published about financial information and generic advice for adults.

Children and young people

Provision of **financial education** in schools is increasing. The goal with most financial education programmes is to give children and young people problem-solving experience, while improving numeracy and ICT skills. It is clear that money provides a realistic context through which these skills can be developed. Understanding how mobile phone bills are calculated, and how to weigh up priorities in paying bills, is one example.

Financial education in schools

The Scottish Centre for Financial Education (SCFE), part of Learning and Teaching Scotland, has a role in raising the profile of financial capability through its work with schools and local authorities, to roll out its Excellence and Access project in Scotland. SCFE is raising awareness of how personal and macro-finance issues can be reflected in the 5-14 curriculum and beyond²⁹. The overall aim is to lessen the potential for financial exclusion in future³⁰. SCFE is collaborating with the Personal Finance Education Group (PfeG), which has worked with over 300 schools in England using an action research curriculum and professional development projects.

In 2002, the SCFE distributed an interactive CD Rom 'Facing up 2 Finance' to all secondary schools in Scotland. This was developed in partnership between Learning and Teaching Scotland and the Royal Bank of Scotland and examines issues such as getting to grips with a new job and pay slips, aiming to develop young people's financial understanding and capability³¹.

The Royal Bank of Scotland's Face 2 Face with Finance programme builds upon 10 years of experience accumulated by NatWest.

The Financial Education Partnership is organised through the Chartered Institute of Bankers in Scotland and aims to give young people access to business experience and improve young people's ability to manage personal and business finance³².

Other organisations offering financial education activities include:

- + the Stewart Ivory Foundation
- + local CABs
- + Money Advice Scotland
- + credit unions
- + trading standards councils

While financial education has a longer history in the Scottish curriculum than might be assumed, provision has increased steadily in the last five years. There is little doubt that children and young people can benefit from financial education. If, as one practitioner told us, **“the future is debt”**, young people will need to be equipped with the skills to engage with providers.

It is fair to say that the importance of financial education is rising. Its ‘reach’ is improving, reflected in its presence in growing areas of the curriculum and in more schools and local authorities. The Scottish Executive is committed to ensuring a minimum guaranteed entitlement to financial education with a set of target learning outcomes to match. As things stand, resources only allow for ‘little and not very often’. And it is difficult to see how significant new resources will be invested in financial education until more evidence on impact becomes available.

Overall, we know relatively little about the effectiveness of financial education initiatives. Learning outcomes in Scotland are categorised as financial understanding, competence, responsibility and enterprise. In addition, evaluations tend to focus on *input measures* such as:

- + the number of hours offered per year
- + the number of schools covered
- + the number of teachers trained, their confidence and skills in delivery and, in future the number of Chartered Teachers
- + the range and depth of education materials used

- + comparisons of take-up between schools and authorities over time

These are some distance from the evidence on impact and outcomes needed to tell us how effective these approaches are in terms of understanding and application, and how long the benefits are felt. It is important that the evidence ‘bar’ is not set unfairly high at an early stage, and to recognise that financial education approaches are still working towards more comprehensive coverage. However, we believe it is fair to ask to what extent financial education alone can be expected to equip young people with the skills to make sound decisions in a world of easy credit and consumption, and to prevent tomorrow’s adults suffering financial difficulties.

Financial education is based on a sound concept and has attracted the engagement of government, business, schools and the voluntary sector. It now needs to be extended in more ambitious ways. We know from other areas that active learning - through ‘hands-on’ experience - is one of the most effective ways to promote true understanding. We also know that young people crave authenticity through activities that are relevant to their experiences outside school. We believe there are limits to how far current approaches delivered through the standard curriculum are likely to succeed.

A strategy for active learning could address:

- + The nature of materials used: involving young people in the design of the content and in deciding the media through which learning should take place. The Child Trust Fund to be introduced in early 2005, offers an outstanding opportunity to focus financial education in schools upon a tangible personal asset, however modest to start with.
- + How they are used: opportunities to gain direct experience, for example through the establishment of savings clubs within schools, community credit unions opening membership to school branches³³; and by involving young people in some school budgeting and spending decisions.

- + Who is involved: earlier and more extensive work experience in various sectors, as well as greater 'in-reach' of financial service employees, CAB and Money Advice staff to complement the role of teachers.

There is less evidence and much less practice to support financial literacy among young people preparing to leave school and starting work, going into training, continuing with their education or at risk of achieving none of these³⁴. Basic financial security is an essential feature at transitional stages in life, and the lack of any strategic approach for young adults represents a serious blind spot. The FSA's proposed piloting of new ways to reach young adults with appropriate messages should be complemented with better research into the diverse attitudes and expectations of young adults. Their early experiences of credit and debt, for example, are likely to be distinct from older age cohorts. The Scottish Council Foundation is exploring how to improve our understanding of some of these issues in Glasgow.

Adults

Arising from financial education and information should be the consumer skills to allow people to manage their money better, know where to go for advice, separate fact from hype and understand the consequences of their behaviour. Consumer education has been described by NCC as 'the poor relation', receiving a very small amount of FSA funding. Yet, the impact of financial education for adults is unclear.

For some, 'best buy' guides and websites provide a useful source of information on various financial products. In an area with strong consumer demand, such as the re-mortgaging market, this clearly has a value. It may help consumers decide whether to go ahead with a new provider, and which one is the best option for them. However, such sources of *information* are distinct from financial education for adults and generic financial advice. Some practitioners interviewed in our study have cautioned against putting too much emphasis on individual solutions through consumer education, on the grounds that supply-side reforms should not be neglected. On the other hand, they proposed that 'less is

more' when it comes to social marketing approaches to information and advice. A few generic messages need to be communicated consistently over time in order to raise awareness and promote better understanding.

The Basic Skills Agency plays an active role in England and Wales, working with the FSA for example to develop an adult capability framework for financial literacy. To date this has resulted in training materials, guidance for teachers and tutors (intended for adult learning classes) and development projects with the voluntary sector reaching excluded groups including homeless, drug users and offenders.

The evidence base around adult financial capability is improving. However, no single agency in Scotland has similar responsibility for this area. A number of stakeholders should be involved in developing new approaches. For example, in partnership with the Scottish Executive, Citizens' Advice Scotland will work with adults through six projects across Scotland lasting for two years. These will work with partner agencies, including housing associations, to equip their workforce to deal with budgeting, bill payment and debt management issues among vulnerable tenants. The projects will use one-to-one and group work.

The CAS initiative follows on from positive evidence that local organisations providing a range of services can succeed in building financial literacy skills through a range of techniques: one-to-one advice on debt, workshops run jointly with partner agencies (often housing associations), helping people to access mainstream services through advice, sign-posting to named contacts with local providers and assistance with form-filling. A barrier to be overcome, based on the findings of one partnership offering basic financial advice in order to anticipate and prevent financial problems, was the reluctance of some of the poorest households to participate because they felt they had no spare money and therefore could not be helped.

The UK Government and Scottish Executive are concerned with establishing what works. A series of Community Finance and Learning Initiative (CFLI) pilots

were established in England and Wales to test new ways of extending financial capability, through Saving Gateway and financial literacy programmes. However, these were not tested in Scotland, and nor have convincing alternatives yet been put in place. The challenge now is to reflect the lessons learned from pilots and projects in mainstream practice.

The UK Government has announced plans to develop proposals for delivering a significant increase in the capacity of face-to-face money advice, free of charge, targeted in areas of high financial exclusion. Various models of money advice outreach will be piloted, aimed at reaching those who do not normally make use of debt advice services. This will involve provision of money advice in a wider range of locations, using new methods and with new partners³⁵.

This looks like a clear step in the right direction, allied with ongoing collaboration between Citizens Advice Scotland and the Scottish Executive. However, we believe a broader approach will be needed to assist the large number of 'at risk' consumers who do not live in disadvantaged communities.

Basic adult literacy and numeracy has seen significant investment of new resources in Scotland over a five-year period - £51 million to help the estimated 800,000 people facing problems in their basic skills. This has included a national advertising campaign, *The Big Plus*, and provision of materials to adult literacy and numeracy partnerships, and to organisations like Job Centre Plus and libraries. This provides a timely opportunity to improve financial literacy.

A number of national agencies including Communities Scotland, Money Advice Scotland, Citizens Advice Scotland and the Scottish Adult Learning Partnership (SALP) have the combined expertise to take forward the task of improving adult financial literacy. We believe they should collaborate to this end, identifying how their efforts can be coordinated better, and adding a sense of strategy and urgency that appear to be lacking in Scotland.

Families and communities

The FSA has identified 'being a parent' as a strategic phase in people's lives to assess their financial situation. This is driven in part by the need to provide information and advice to help parents make informed choices over the Child Trust Fund. If this is done well, it could serve to raise awareness of other financial priorities (e.g. longer-term savings).

This leaves the tricky question of how such information and advice should be accessed. While a number of settings should provide access, there is consistent evidence to suggest primary schools are particularly well placed to take on this task. This reflects their status as highly trusted intermediaries. In one study³⁶, consumers were interested in making use of financial education materials developed for schools and adapted for use with some adult groups. Computer-based programmes were popular because they offered the chance to learn about new technology with the help of young family members. Respondents expressed greater interest in one-off 'taster' sessions than longer courses. Where effective approaches are being provided for children and young people, access could be widened to families. 'Money Week' activities in some schools could become community events. We know that the first option for many people is to turn to family or friends for financial advice, and these approaches could help to build the capacity of self-help networks.

We conclude that schools could serve as gateways to improving financial literacy for parents and the wider community.

Consumer demand

Successful approaches in future should be based on design principles informed by unmet consumer need and demand, and indeed how to stimulate new types of demand. Our understanding of overall consumer demand remains patchy, but we are fortunate that good quality evidence has been published on meeting the needs of people on the margins of financial services.

In a recent assessment of a range of financial products, residents of one low-income neighbourhood in Bristol

weighed up three different initiatives offering financial information and advice on a free and impartial basis, as well as new approaches to banking, bill payment and savings/assets accumulation³⁷. The researchers found participants were particularly attracted by a Community Finance and Learning Initiative (CFLI) project in East London combining one-to-one advice with group workshops on money management. It involved housing providers and other community organisations. Participants wanted **information and advice** from a community-based agency wholly independent of financial service providers, delivered by experienced staff familiar with their needs. This reflects the value of easy access and dealing with trusted intermediaries. Ideally these approaches would be based on **partnerships with mainstream rather than niche providers** (whether commercial or government). Research in Wester Hailes,

Edinburgh found residents in favour of greater access to financial education initiatives, as long as they are tailored to meet local need and responsive to demand.

In terms of product design, low-income consumers favour simple and transparent products for long-term security, based on regular and automatic savings. For the short-term, there is a demand for affordable credit in the form of small fixed loans, with fixed automatic repayments (and the choice to pay in cash). We describe these as **gateway products** - basic, 'no frills' products offered by mainstream providers, suitable for people with only a little spare money to save or pay back and allowing progression to more sophisticated products as their circumstances change (e.g. bank accounts into which a future employer could pay wages).

'Wrap-around' advice

Consumers of all ages and backgrounds need to be able to access good quality, generic advice to help address the issues they face currently. Consumers wish to know the advice they receive is impartial, clear and useable. Having received assistance to navigate what may be a complex set of issues, consumers should be offered sign-posting towards providers of more specific advice, or appropriate sources of information on product providers. This approach needs to be 'wrapped around' life stages and events. Information and advice should be accessible in different ways, for example through the workplace, in community settings and through telephone helplines.

Incentives and assets

We have considered key ingredients for success. Bringing supply-side approaches closer to demand-side insights is one way to improve use of education, information, advice and suitable products. Yet, take-up is still likely to remain a significant concern, and 'relief' work will outstrip prevention, unless **tangible incentives to improve financial literacy** are offered.

Various proposals have been made previously to improve demand, such as a personal entitlement to one consultation with an impartial financial adviser. Local projects across the UK are offering services like an 'MOT

for Your Money' and 'financial fitness' check-ups. These approaches appear to be useful, but there is not enough evidence to judge whether national policy should build upon them. Other approaches can also be considered.

One way to reduce crisis intervention may be to promote **positive goal orientation**. In the US, key financial literacy programmes have been linked to buying a house, saving and progressing in work, rather than focused on individual problems. Information and advice - and sometimes resources - are wrapped around these goals.

There is growing international evidence, from countries as diverse as Canada and Taiwan, that **asset-based**

approaches can serve as a cushion against unexpected changes and help to build financial literacy³⁸. The process of building assets appears to encourage people to focus more positively on the future, helps to attract additional assets and has a role in stimulating a greater sense of control over their lives. Among the gains highlighted are evidence that low-income consumers can save, and the potential to stimulate practical responses to financial literacy issues. This is likely to create a more powerful route to understanding than stand-alone initiatives.

Various approaches to building assets have been used, notably matched savings schemes and Individual Development Accounts (IDAs).

Comparative evidence on incentives to save

In the US, the importance of financial literacy is gaining widespread attention from a range of different interest groups, including government, the Federal Reserve Board, consumer and community-based organisations, regulators and the financial services sector.

A review of financial literacy practice, research and policy by Braunstein and Welch similarly noted the growing concern that consumers lacked a working knowledge of financial concepts and that they do not have the tools they needed to make decisions most advantageous to their economic well-being³⁹.

These financial literacy deficiencies were seen as important because they:

- + impact on an individual's or a family's day-to-day money management and ability to save for long-term goals
- + ineffective money management can result in behaviours that make consumers vulnerable to severe financial crises

From a broader market perspective, informed consumers help to create a competitive and efficient market but competitive forces are compromised when consumers do not have the skills to manage their own finances, a view

echoed by Federal Reserve Board Governor Edward M. Gramlich when he stated that:

"Americans of every income and educational background want additional tools and training to address the complexities of personal finance. Educated consumers are the key to keeping our economy functioning well."⁴⁰

While financial literacy programmes in the US have developed rapidly, the research to measure the effectiveness of training and literacy programmes still is trying to catch up. The research evidence that does exist shows that successful financial literacy programmes tend to be linked to individual goal-orientation programmes, for example:

- + **Savings initiatives:** Individual Development Accounts (IDAs) are matched asset accounts that are linked to specific saving goals like purchasing a home, going to college or starting a business, the America Saves Programme and the successful pilot Cleveland Savers, shows what can be achieved through promoting savings as a positive route to improve personal and family well-being and financial security.
- + **Workplace programmes:** including employer 401(k) programmes, where employers offer financial literacy as part of the wide saving programme.
- + **Homebuyer counselling programmes:** the work of the Neighbourhood Reinvestment Corporation is a good example of financial literacy and education linked to helping people understand how to purchase a home.

According to Braunstein and Welch⁴¹ the challenges for policy makers in designing and delivering financial literacy can be set by the following questions:

- + who is the target audience for financial literacy and what are the group's information needs?
- + what does the audience need to know to understand personal financial circumstances, identifying future

goals, and implement behaviours consistent with attainment of those goals?

- + when is the appropriate time to expose individuals to both general and specific information about financial issues and options?
- + where should financial literacy education be provided to reach the broadest audience?
- + how can financial literacy education be effectively delivered, both at specific points in time and over time, to assist households in adjusting their financial plan to suit their circumstances?
- + how can the effectiveness and impact of financial literacy programmes be measured?

Financial literacy training is integral to many initiatives designed to increase the rate of savings among middle and low-income families. The America Saves programme was started by the Consumer Federation of America in May 2001. The programme promotes the benefits of enrolling local people as savers, offering no-fee savings accounts, motivational workshops and one-to-one consultation. The pilot programme Cleveland Saves has enrolled over 1,500 savers, has over 100 organisational participants and involved more than 2,000 individuals in motivational workshops. An area wide survey suggests that some 10,000 residents of Cleveland, Ohio have been persuaded to save more effectively.

Matched Asset Accounts like Individual Development Accounts are seen as part of wider strategy to promote wealth among low and moderate-income individuals and communities across the United States⁴².

Low-income families, especially those without bank accounts, often lack the means and the incentives to save regularly. When lacking alternative forms of financial resources, low-income families need to save, not only to provide a financial cushion in time of crisis, loss of a job, overtime, unexpected bill payment but to allow them the opportunities that others take for granted – improving our skills through training, going to university or college,

buying a home, starting a business.

In the US, more than 40 States now have an IDA policy of some type and there exists approximately 400 community based IDA programmes (Appendix 1). It is estimated that the total number of participants on IDA programmes is around 50,000. Yet 22% of low-income families in the US – over 8.4 million families earning under \$25,000 per year – are unbanked and often asset poor⁴³.

The American Dream Demonstration (ADD) was the first large-scale test of IDAs as a social and economic development tool for low-income communities. Initiated in September 1997 by the Corporation for Enterprise Development (CFED), ADD brought together 13 community-based organisations to design, implement and administer IDA initiatives in their communities. The ADD project ran until 2002 with evaluations continuing until 2004. Research undertaken to evaluate the ADD project confirms that the structure of IDAs encourages people to see savings as an option with positive consequences:

- + the existence of IDAs forges a social pattern as it sends the message that the poor can save
- + matches increase the return on savings, increase asset accumulation from giving savings, and attract people to the programme
- + IDAs are linked to financial education that provides knowledge of how to save
- + the match becomes a goal in the minds of participants
- + monthly statements give feedback to show progress toward goals. Furthermore, programme staff and peers provide informal encouragement. The focus of success makes savings easier
- + IDA programs ask for monthly deposits. This encourages saving to become a habit

- + IDAs give people on low-incomes access to a way to commit to save
- + through budgets, goals, and plans, IDAs focus on the future and increase future orientation
- + IDAs point out goals (such as home ownership or post-secondary education) that people might not see (or see as worthwhile) on their own
- + informal discouragement of unmatched withdrawals helps to curb dissaving

In Canada, an equivalent organisation to CFED is Social Enterprise Innovations Development (SEDI), a non-profit organisation that assists people who are struggling economically – the working poor, young people at risk, unemployed and single mothers, provides a range of services including initiatives aims to improve financial literacy through asset-building. Building on the work by CFED and CSD on the ADD programme in the US, SEDI is now leading the world's largest asset building demonstration project of IDAs - Learn\$ave (Appendix 2).

Learn\$ave, is intended to show that IDAs can make a difference for low-income Canadians, helping them to create their own pathways and routes out of poverty and financial exclusion through savings and learning. The project matches the savings of each participant in a special account, dollar for dollar, to be paid directly to the selected school, college or learning institution.

Matched Asset Account or IDA programmes are more than just savings accounts, instead the concept of IDAs is to provide a 'programme bundle' of asset-related activities, including match funding, restrictions on allowable asset purchases, financial and asset-specific education and in some programmes credit counselling, care management and social support.

In summary, IDAs can be useful multi-purpose policy tools because they:

- + improve access to financial services for low-income

families and marginalised groups – ethnic minorities, refugees, young people and women

- + help to raise awareness of the importance of money management, financial literacy and education
- + support high return quality of life investments, such as education and training, self-employment and home ownership
- + alter the behaviour and perceptions of individuals and families members towards a culture of saving and investing in their own futures
- + assist marginalised groups and individuals to reconnect with the financial and economic mainstream through confidence building, trust and peer support
- + stimulate enterprise creation through support for micro-enterprises

In the UK, the Child Trust Fund will be introduced in 2005. Although initial sums to be invested appear modest, the approach is symbolic of how saving horizons can be stretched (or established for the first time). It provides an outstanding opportunity to increase interest among parents in longer-term financial planning.

The Saving Gateway has been piloted by the Treasury since 2002, and operated through Halifax. It provides matching savings on a pound for pound basis, subject to limits on time and amount saved. In one UK study, this was considered to offer lower-income consumers the greatest incentive to save from a number of approaches and a more effective option than using tax relief⁴⁴. Full evaluation of the pilot will follow in 2005. **Matched savings schemes stand out in the international evidence as a promising way to improve financial literacy among low to middle-income consumers. The UK Government plans to introduce a larger Saving Gateway pilot in 2005, backed by £15 million investment. The new pilot will investigate alternative rates of matching, measure the impact for a wider range of income groups and will draw on the support of a wider range of community**

financial education bodies.⁴⁵ At the time of writing, it is not clear if this new phase of piloting will extend to Scotland. We believe priority consideration should be given to extending a simple version of the 'Saving Gateway' across the UK. The impact of matched savings being earned by participating in financial literacy workshops should also be tested within Saving Gateway.

Distribution channels

'Evidence-based policy-making' has been a guiding principle for the Government. It has become clear that it is not enough to base policy on sound research evidence. Successful implementation needs to be well-informed about effective implementation. So how should financial literacy objectives be delivered in practice? Part of the answer lies in the distribution channels used.

Returning to the polling evidence referred to in Section 1, a majority of employees would welcome **access to financial learning through their workplace**. Employers offering 'open learning' opportunities to their staff (e.g. ScottishPower and Ford) are well placed already to provide support to improve financial literacy. The FSA's project on 'Reaching people through the workplace' appears to be the theme in need of most development. Recruitment, promotion, relocation, parental leave, changes in working hours, redundancy and retirement are potential triggers for employees to review their financial arrangements (from pension planning issues and savings to tax credits and debt).

Consumers on low to median incomes, and employed in less secure jobs, tend to be more anxious about using electronic sources of information and internet banking. The 'old technologies' can be exploited further: many will prefer face-to-face or telephone advice services. These are time and labour intensive, but are likely to prove effective for some consumers. Moreover, there are doubts among bodies like the NCC as to whether someone using web-based financial health checks without being offered an opportunity to speak to a qualified adviser can be said to have received advice.

Other networks could extend their current roles. **The Post Office** is a trusted brand, struggling to find a secure position and new revenue streams following the switch to payment of benefits into bank accounts. One possibility is to extend the Post Office Loans initiative. At present, the minimum loan is £1,000 and two monthly repayment 'breaks' are permitted per year. If the minimum loan was reduced, repayments accepted in cash over the counter and supported by an advice service (probably by telephone), a broader range of customers could be served. The other option is to modernise the Social Fund as a zero interest form of credit, and channel this through the Post Office. In addition, significant investment has been made in modernising the **library infrastructure** in cities like Glasgow. It hosts a network of REAL Learning Centres, used by around 10% of city residents. It offers a further potential route to improving financial literacy.

Measuring progress

The vision of consumers benefiting from significantly improved financial skills is coming into sharper focus. For the first time, a national strategy to promote financial capability is being developed. These will be backed up with various practical actions and, we assume, increased resources will be required. To help guide investment decisions and measure progress towards the aims of the strategy, a much stronger body of evidence is needed.

At present, good practice approaches are patchy, weakly connected to policy-making and not necessarily disseminated well. The FSA proposes to conduct the largest survey of its kind on consumer awareness, confidence and understanding of financial matters, to provide a benchmark for measuring progress. The benchmark survey should measure future expectations and evidence of planning as well as current confidence. Recognising the limitations of any survey method, it should be supplemented with qualitative research into attitudes, motivations and responses to different scenarios.

Conclusions and recommendations

The landscape on which improving financial literacy will occur has been transformed in the last 20 years. Patterns of work, family life and demography have shifted, bringing long-run financial consequences with them. Financial markets have experienced intense competition, often to the benefit of most consumers. At the same time, unpopular political decisions and high-profile failures by financial service providers have served to dent public confidence, as citizens and consumers.

The *Restoring Trust* inquiry into the effectiveness of the UK investment system was chaired by Sir Richard Sykes and reported in June 2004. Its principal conclusion is that:

“While the whole (investment) system is relatively robust ... there has been a significant and continuing erosion of trust, not just in the financial services industry, but also in big companies as stewards of people’s savings and pension ... There is a danger that the overall investment ‘cake’ may diminish as people look for alternative means of providing for their future.”⁴⁶

While low interest rates have fuelled mortgage borrowing, they have impacted badly upon incentives to save. Lack of public confidence in pensions has been driven, as well, by the fall in capital market values and by increased means testing of benefits.

The challenge is to go with the grain of change, seek to rebuild confidence and strike a better balance in terms of responsibility. Both financial markets and consumers have changed. This suggests to us that a new model of responsibility for enhancing financial literacy is needed. This will identify what government, the industry, the media and consumers can each reasonably be expected to contribute. As an example, the FSA Working Group’s proposal to establish a thematic project on ‘Borrowing’ is helpful in itself, but the focus should be broadened

to include ‘Lending’. In that way, the responsibilities of consumers and providers can be addressed together.

Various commentators have emphasised the responsibility of consumers. For example:

“Individuals need to take a hard look at their finances and start trying to live within their means ... Living for today is presenting too many people with an enormous debt burden for the future.”⁴⁷

It is difficult to disagree. However, our understanding of ‘within our means’ has changed quite dramatically because apparently limitless amounts of credit are widely available to the majority of consumers. Most people now believe it is normal to have some debt in their lives, as long as the minimum repayments are being met. Expectations have risen: we are less willing to wait until we can truly ‘afford’ to buy the things we want. The incentives are heavily in favour of maximising borrowing, not savings. Indeed to some extent savings have lost their critical role when consumers have the security of knowing they can borrow what they need quickly.

Calls to act responsibly are right in principle, but unlikely to succeed in the present environment. Financial literacy initiatives are more likely to thrive where government and the industry collaborate to ensure incentives for both long-term savings and pensions are stronger; to make basic ‘gateway’ products easier to access, including small amounts of credit; and to link total borrowing more firmly to ability to repay, rather than capacity to spend, thus preventing the worst examples of unmanageable debt. As an example, the impact of companies increasing credit limits without the customer applying for or authorising it, should be explored. This puts the onus on the individual to ‘opt out’ of additional credit

and may have a pernicious effect on consumers at risk of unmanageable debt.

In this study, we have considered various principles for taking action to improve financial literacy in Scotland. Some believe that financial literacy approaches should be targeted only to the few - either low-income households to help manage their limited resources better or those facing unmanageable debt. We believe this is an unhelpful approach. Instead, a whole population strategy is required, to offer the appropriate mix of personalised education, information and advice. Solutions must be focused on the future to enable consumers to make sound decisions as their circumstances change.

Our ten propositions on improving financial literacy in Scotland are summarised as:

1 Invest in primary as well as secondary prevention

Action research to identify practical tools for primary prevention should be regarded as a strategic priority, drawing on lessons learned in sectors as diverse as the utilities and banks, as well as comparative evidence from abroad. Agencies dealing largely with cases of relief and secondary prevention should be closely involved in designing approaches targeted 'upstream'.

2 Tailor messages to changing lives

Materials and messages to support financial literacy, even when designed on the best available evidence, may end up having little impact. For approaches to be successful, the context must be personally relevant. A pre-condition of consumer awareness is receptiveness - times in life when interest in meeting financial needs is greatest. Often, changes in life circumstances (e.g. a drop in income or unplanned expenditure) arise from transitional stages. While tools for predicting the most relevant approach for individuals are imperfect, we can identify key life stages around which financial education, information and advice should be organised. These include information and advice strategies wrapped around student finance, having children, moving into work and preparing for retirement. This suggests that solutions

should also be focused beyond the individual, making use of settings like the workplace to deliver support.

3 Make financial education for children and young people authentic

The importance of financial education is growing and its 'reach' is improving. However, resources only allow for young people to experience a small amount of financial education, on an occasional basis. It is difficult to see how significant new resources will be invested in this area until more evidence on impact becomes available. Financial education is based on a sound concept and has attracted the engagement of government, business, schools and the voluntary sector. It now needs to be extended in more ambitious ways. A strategy for active and authentic learning could involve young people in the design of the content used; provide opportunities to gain hands-on experience, through the establishment of savings clubs within schools, community credit unions opening membership to school branches, and by involving young people in some school budgeting and spending decisions for example; through earlier and more extensive work experience; and greater 'in-reach' of financial service employees, CABs and Money Advice staff to complement the role of teachers.

4 Don't forget adult literacy

The evidence base around adult financial capability is patchy, but improving. However, no single agency has responsibility for this area in Scotland. A series of Community Finance and Learning Initiative (CFLI) pilots established in England and Wales to test new ways of extending financial capability, like the Saving Gateway, have not been introduced in Scotland and convincing alternatives have yet to be put in place. Lessons learned from pilots and projects need to be reflected in mainstream practice. Basic adult literacy and numeracy has seen significant investment of new resources over a five-year period. This has included a national advertising campaign, The Big Plus, and provision of materials to adult literacy and numeracy partnerships, and to organisations like Job Centre Plus and libraries. This provides a timely opportunity to improve financial

literacy. At the strategic level, a number of agencies with a national remit should collaborate to take forward the task of improving financial literacy, and adding a sense of urgency that has appeared to be lacking in Scotland to date.

5 Engage with families and communities as partners

The FSA has identified 'becoming a parent' as a strategic access point in people's lives. This is driven in part by the need to provide information and advice to help parents make informed choices over the Child Trust Fund. This could also serve to raise awareness of other financial priorities (e.g. longer-term savings). Because of their role as trusted intermediaries, and to widen the impact of successful financial education approaches for young people, we believe that primary schools are particularly suited to become gateways for improving financial literacy for adults and the wider community. Educational Maintenance Allowances (EMAs) could provide a focus for family involvement through secondary schools.

6 Understand consumer demand

We need more and better quality information on consumer demand. In-depth research tends to focus on the needs of low-income consumers. This suggests that people on the margins of financial services would like financial information and advice from community-based agencies, wholly independent of financial services providers, and delivered by experienced staff familiar with their needs. This reflects the value of easy access and dealing with trusted intermediaries. Ideally these approaches should be based on partnerships with mainstream rather than niche providers (whether commercial or government).

Low-income consumers favour simple and transparent products for long-term security, based on regular and automatic savings. For the short-term, there is unmet demand for affordable credit in the form of small fixed loans, with fixed automatic repayments. These are 'gateway' products - 'no frills', offered by mainstream providers, and suitable for people with only a little spare money to save or pay back to progress to more sophisticated products as their circumstances change.

Changes in the financial services market and the choices that consumers are expected to make in the course of their lifetimes highlight the need for financial education, information and advice that will enhance the ability of all consumers to make better choices, as well as practical action to support low-income consumers.

7 Improve incentives for saving

Take-up of education, information and advice is likely to remain a significant concern, and 'relief' work will outstrip prevention, unless tangible incentives to improve financial literacy are offered. There is growing international evidence that asset-based approaches can serve as a cushion against unexpected changes. Key financial literacy programmes in the USA have promoted positive goal orientation, such as buying a house, saving and progressing in work. Matched savings schemes stand out as a promising approach for improving financial literacy among low to middle-income consumers. In the UK, the Saving Gateway is considered to offer the greatest incentive for these consumers to save, and a more effective option than using tax relief. Government should give priority consideration to extending a simple version of the 'Saving Gateway' across the UK. The impact of matched savings being earned by participating in financial literacy workshops should be tested within Saving Gateway.

8 Use trusted distribution channels

It matters how strategies to improve financial literacy are delivered. In addition to the workplace and schools, other networks could extend their current roles. For example, the Post Office is a trusted brand, whose current loans initiative could be adapted to include information and signposting to financial advice. The library infrastructure offers a further potential route to improving financial literacy, especially in places like Glasgow where learning centres have been established citywide.

9 Measure progress

To help guide investment decisions and measure progress towards the aims of the strategy, a much stronger body of

evidence is needed. At present, good practice approaches are patchy, weakly connected to policy-making and not necessarily disseminated well. Gaps in knowledge should be addressed through strategic evaluation of existing initiatives. The FSA's proposed survey on consumer awareness, confidence and understanding will provide a valuable benchmark to track progress with the UK's Financial Capability Strategy. It should measure future expectations and evidence of planning, as well as current levels of confidence, and needs to be supplemented with qualitative research into attitudes, motivations and scenarios.

10 Share responsibility

Calls to act responsibly are right in principle, but unlikely to succeed in the present environment. Financial literacy initiatives are more likely to thrive where government and the industry collaborate to ensure incentives for both long-term savings and pensions are stronger; to make basic 'gateway' products easier to access, including small amounts of credit; and to link total borrowing more firmly to ability to repay, rather than capacity to spend, thus preventing the worst examples of unmanageable debt. As an example, the impact of companies increasing credit limits without the customer applying for or authorising it, should be explored. This puts the onus on the individual to 'opt out' of additional credit and may have a pernicious effect on consumers at risk of unmanageable debt.

Finally, political leadership is also needed. There is ambiguity over the extent to which the UK's reliance on credit is problematic. Rather than quibbling over current figures on unmanageable debt, a clearer focus is needed on how to address those problems that are already experienced and are likely to exist in future.

Appendix 1: Louisville Asset Building Coalition (LABC)

The Louisville Asset Building Coalition (LABC) is a broad-based collaborative effort dedicated to promoting financial stability for individuals and families. By providing both direct services and links to other community resources, the coalition strives to build an economic foundation that will allow members of our community to reach their highest potential.

IDA Programme

IDAs are dedicated savings accounts and the savings in these accounts can only be used to purchase an asset, an investment in a home, education, or a small business that keeps earning money over time. The Louisville Asset Building Coalition (LABC) is making IDAs available to eligible community members through the Common Wealth IDA Project at The Center for Women and Families.

How does the IDA project work?

- + for each \$1 (up to \$2,000) saved by a participant, \$2 will be set aside in a reserve account
- + when up to \$2,000 in savings is reached by the participant, matching dollars (\$4,000 maximum) may be used toward the costs of one of the allowable assets
- + participants earn any interest accrued on savings and on savings earned on matching funds
- + while saving money, participants must complete a financial and attend monthly budget counselling sessions in the first year of the program, and quarterly thereafter

Participants who join the Common Wealth IDA Program agree to complete the Financial Skills Building course. The course consists of 12 classes; each class is provided twice a month and every participant must attend one of these classes every month during the first year to

be eligible for the match. The Financial Skills Building Course consists of the following workshops:

- Workshop 1: Making spending choices
- Workshop 2: Individual session with case manager
- Workshop 3: Wise use of credit
- Workshop 4: Record keeping
- Workshop 5: Systems to make your money work
- Workshop 6: Responsible consumerism
- Workshop 7: Managing money in any season
- Workshop 8: Saving and investing
- Workshop 9: Banking
- Workshop 10: Home ownership
- Workshop 11: Business capitalization
- Workshop 12: Post-secondary education

Appendix 2: Asset Programme in Canada

Learn\$ave

- + largest demonstration worldwide, of Individual Development Accounts (IDAs)
- + thousands of low-income participants across ten sites, saving to invest in their own lifelong learning
- + matched accounts generating up to \$18 million in productive assets
- + innovative multi-sectoral partnership, rigorous research and evaluation framework

As of May 2003:

- + more than 3000 low-income Canadians have enrolled on the programme
- + average monthly deposits were \$55, totalling approximately \$1 million and leveraging a further \$3 million in matching grants
- + participants were predominantly young (77% are in their 20s and 30s), single with no dependants (47%), female (39%) and had some form of employment income
- + 83% of participants had a household income of less than \$20,000 while at the same time, 79% had at least some post-secondary education, if not a post-secondary degree

Source: Poverty: it's not just an issue of income. Asset building in Canada. Social and Enterprise Development Innovations. www.SEDI.org

References

- ¹ Schagen S and Lines A, *Financial Literacy in Adult Life Research Summary* 1996. www.warwick.ac.uk/fac/cross_fac/nflc/summary.html
- ² Respondents are asked if they or their partner have any form of savings or investment products.
- ³ *Scotland's People: Results from the 2003 Scottish Household Survey*. Scottish Executive 2003, Edinburgh. www.scotland.gov.uk/library5/housing/shsar03-19.asp#639
- ⁴ *Family Resources Survey 1995-96*, discussed in Rowlingson K, Whyley C and Warren T *Wealth in Britain: A lifecycle perspective*. Joseph Rowntree Foundation/Policy Studies Institute 1999.
- ⁵ Range in figures from the Office for Fair Trading and Family Resources Survey, quoted in Financial Services Authority 2000 *In or Out? Financial Exclusion: a literature and research review* (Consumer Research 3).
- ⁶ MORI (2001) *UK Financial Literacy Study*, Research conducted for Prudential (November), London.
- ⁷ Rowlingson K, Whyley C and Warren T, *Wealth in Britain: A lifecycle perspective*, Joseph Rowntree Foundation/Policy Studies Institute, 1999.
- ⁸ *Scotland's People: Results from the 2003 Scottish Household Survey*. Scottish Executive 2003, Edinburgh.
- ⁹ MORI (2001) *UK Financial Literacy Study*, and MORI (2003) *GB Financial Literacy Survey*, Research conducted for Prudential, London.
- ¹⁰ Lord, Nick *On the edge of a credit cliff?* Citizens Advice/BBC 2003. www.news.bbc.co.uk/1/hi/programmes/panorama
- ¹¹ Financial Services Authority *Financial Capability: Consumers' views on developing their financial capability through schools and workplaces*, FSA: London, 2004.
- ¹² Financial Services Authority *Towards a national strategy for financial capability*, FSA, London, 2003. www.fsa.gov.uk/financial_capability
- ¹³ MORI for Citizens Advice, *Financial over-commitment survey*, July 2003
- ¹⁴ Department of Trade and Industry (2004) *Action plan on tackling over-indebtedness*. DTI, London.
- ¹⁵ Lord, Nick op. cit. and *On the Cards*, Citizens Advice Scotland, 2003.
- ¹⁶ Lord, Nick op. cit.
- ¹⁷ Lord, Nick op. cit.
- ¹⁸ Johnson J and Hunter T, 'Meet the latest victims of debt: our young, rich professionals: living beyond their means has become the norm for affluent classes', *Sunday Herald*, 2 May 2004, p.4.
- ¹⁹ Advice Week 2001, Debt Briefing – Citizens Advice, www.nacab.org.uk
- ²⁰ Kempson E and Whyley C *Keep out or opted out? Understanding & combating financial exclusion*, Joseph Rowntree Foundation/The Policy Press 1999. www.jrf.org.uk
- ²¹ Kempson E *Life on a low income – An overview of research on budgeting, credit and debt among the 'financially excluded'* in *How People on Low Incomes Manage their Finances*, ESRC and Provident Financial, 2002.
- ²² Scottish Executive (2003) *Scotland's People: Results from the 2003 Scottish Household Survey*, Edinburgh.
- ²³ Kempson E (2002) op. cit.
- ²⁴ Kempson E (2002) op. cit.
- ²⁵ Elrick, D *Healthy Volunteering: Vision and Reality*, Case Study 7 – A Highland Credit Union, Volunteer Development Scotland/Scottish Council Foundation, 2003.
- ²⁶ Collard S, Kempson E and Whyley C, *Tackling financial exclusion in disadvantaged areas*. Joseph Rowntree Foundation, 2001.

- ²⁷ Millar J, 'Commentary', in *How People on Low Incomes Manage their Finances*, ESRC and Provident Financial, 2003, p. 37.
- ²⁸ AdFlag – Adult Financial Literacy Advisory Group (2002) www.dfes.gov.uk/adflag/0.5shtml
- ²⁹ Scottish Consultative Council on the Curriculum, *Financial Education in Scottish Schools: a Statement of Position*, 1999.
- ³⁰ www.royalbankscot.co.uk/group_info/community
- ³¹ www.ltscotland.com
- ³² www.ciobs.org.uk
- ³³ A small number of community-based credit unions in Dundee and Glasgow for example have extended membership to children and young people through schools.
- ³⁴ Furlong A, Cartmel F, Biggart A, Sweeting H and West P, *Youth Transitions Patterns of Vulnerability and Social Inclusion*. Scottish Executive, 2003. www.scotland.gov.uk/library5/social/ytpv-00.asp
- ³⁵ HM Treasury (2004) *Pre Budget Report 2004: Promoting financial inclusion*.
- ³⁶ Collard S, Kempson E and Whyley C, *Tackling financial exclusion in disadvantaged areas*. Joseph Rowntree Foundation/The Policy Press, 2001.
- ³⁷ Collard S, Kempson E and Dominy N, *Promoting financial inclusion: An assessment of initiatives using a community select committee approach*. Joseph Rowntree Foundation/The Policy Press, 2003. www.jrf.org.uk
- ³⁸ Chapman M, 'Promoting financial inclusion: an asset-based policy approach', in *How People on Low Incomes Manage their Finances*. ESRC and Provident Financial, 2002.
- ³⁹ Braunstein S and Welch C *Financial Literacy: An Overview of Practice, Research and Policy*. Federal Reserve Bulletin, 2002.
- ⁴⁰ *Financial Literacy* – Remarks made by Governor Edward M. Gramlich, at the Financial Literacy Teacher Training Workshop, University of Illinois, Chicago, Illinois, The Federal Reserve Board, 2002. www.federalreserve.gov/broaddocs/speeches/2002/20020502/
- ⁴¹ Braunstein S and Welch C op. cit.
- ⁴² Center for Community Capitalism *Financial Institutions and Individual Development Accounts: Results of a National Survey*, October 2003. The Frank Hawkins Kenan Institute of Private Enterprise, The University of North Carolina at Chapel Hill.
- ⁴³ Barr M *Banking the Poor*. Yale Journal on Regulation, 2004, Vol. 21:121, pp 121 – 239.
- ⁴⁴ Collard S, Kempson E and Dominy N, *Promoting financial inclusion: An assessment of initiatives using a community select committee approach*. Joseph Rowntree Foundation/The Policy Press, 2003. www.jrf.org.uk
- ⁴⁵ HM Treasury (2004) *Pre Budget Report 2004: Opportunity for all: the strength to take the long-term decisions for Britain*.
- ⁴⁶ Tomorrow's Company, *Restoring trust: Investment in the twenty-first century*, an inquiry into the effectiveness of the UK investment system: London, 2004. pp.10-11. www.tomorrowcompany.com
- ⁴⁷ Quote by Graham Millar (Scottish Consumer Council), in Johnson J and Hunter T 'Meet the latest victims of debt: our young, rich professionals: living beyond their means has become the norm for affluent classes', Sunday Herald, 2 May 2004, p.4.

23 Chester Street, Edinburgh EH3 7ET
tel +44 (0)131 225 4709 fax +44 (0)131 226 7868
scf@scottishcouncilfoundation.org

ISBN 1 901835 42 1

© The Scottish Council Foundation 2005

all rights reserved

Registered in Scotland as a charitable trust no 29203

www.scottishcouncilfoundation.org