Fixing Family Finances

Taking a household view to improving financial capability in Great Britain

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Social Market Foundation

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DATA USED IN THIS REPORT

This report uses the 2010-2012 Wealth and Assets Survey for analysis of financial capability.[1] It also uses results of a nationally representative poll of 2007 UK adults[2] and a focus group held in December 2015.

FOREWORD

Despite having one of the most developed financial systems in the world, too many people in the UK struggle to navigate the market for financial services due to a lack of financial capability. Through my work at Santander, I have seen the costs to customers that acute money problems can cause, but also the difference that understanding and information makes in facing these pressures with confidence.

We know that there is little correlation between market share and customer satisfaction for financial services and financial capability is key to tackling this problem. More capable customers are more empowered and more empowered customers are likely to be better engaged and shop around to get the best deal. Getting sufficient numbers of customers into this frame of mind will encourage financial services providers to be more competitive and constantly innovative in their propositions - not just to win customers, but to keep them. This will help drive up customer value and standards in the process and for banks like Santander, this enhanced competition will allow us to continue challenging the dominance of the incumbent banks.

I welcome this report from the Social Market Foundation. It provides a thought provoking contribution to a long-running debate. Whilst there will no doubt be challenges made around some elements of the findings, I am confident that the insight which it provides will be a great asset to policymakers from across the political spectrum.

Angela Wakelin
Managing Director, Business Operations & Control
Santander UK plc

EXECUTIVE SUMMARY

This report takes a fresh look at financial capability in Great Britain. It extends previous work using the Wealth and Assets Survey to understand the nature and drivers of the problem that Britain faces and make recommendations for how capability and outcomes can be improved. In particular, by using the household nature of the Wealth and Assets Survey and original polling and focus groups commissioned for the report, it assesses how families share responsibilities and asks whether social ties can reduce the impact of individuals' low financial capability. It highlights three key groups of households where interventions could be targeted and makes suggestions for a way forward.

Britain's financial capability problem

Financial capability can be summarised as the ability an individual has to collect, collate and assess the information needed to make an informed decision when purchasing a good or service or making choices about their future financial plans.

It is clear that Britain has a problem with financial capability. Previous research has shown that one in three mortgage holders do not know the rate of interest they are currently paying; and half of the UK population have numeracy skills no better than those expected of nine to eleven year olds. Research in this report uses detailed analysis of the Wealth and Assets Survey and methodology previously used by the ONS, Bristol University and FCA to show that:

- Nearly a third of people have low capability in terms of planning ahead financially;
- One in five people score poorly on being able to make ends meet; and

- One in eight people would not be able to last more than a week if they lost their main source of income.

Overall the research suggests that one in every eight people has low financial capability.

The impact of low financial capability

The impacts of poor financial capability can be seen in how individuals feel about the financial choices they make. The table shows that individuals with low capability are significantly more likely to lack the confidence and understanding they believe they need to make the right financial choices. In turn, this leads to them delaying decisions or simply not taking action and limits the extent to which they can actively engage in financial decisions.

Table ES1: Results from polling split by financial capability level

Question	Total Agree (%)		
	Low capability	Average or high capability	High capability
Confidence and consequences			
"I am confident in making financial decisions"	41.5	74.7	92.6
"My lack of understanding of financial products limits my ability to make the right choices"	37.7	18.9	8.2
"I often delay or avoid making financial decisions because I'm worried I will get it wrong"	40.9	25.4	16.2

Source: Populus on behalf of SMF
Notes: Base is all respondents with a bank account (1,801)

The impacts can also clearly be seen in individual and family outcomes:

- There are 2.6 million people suffering from severe problem debt and one in six people are in some way over-indebted;
- Consumers are losing out on £4.3 billion a year by keeping savings in accounts with very low rates of interest.

- The average family loses out by around £400 a year if they do not switch energy supplier, current account and mobile tariff. Across Britain this suggests billions of pounds of disposable income lost each year from a lack of engagement.

It is not just individuals and families that suffer. A lack of informed consumer engagement is stifling competition and lowering innovation, productivity and growth across the economy.

Taking a household perspective

Given this evidence, it should be no surprise that there have been a range of attempts from governments, policy makers and wider stakeholders to tackle the issue. However, capability in Britain remains stubbornly low. Urgent policy action is needed to improve capability and outcomes.

A key area for this to focus is on financial capability within households. While the vast majority of previous research in this area has focussed on individual capability, it is clear that individuals do not make decisions in isolation. Often choices need to be made for (or with) other members of a household. For example, choices over a mortgage or utility provider will impact on all household members.

This means that it is the overall level of capability across the household and how household members support each other to make decisions that is important for outcomes. This came out clearly in the focus groups conducted for this report. For example a number of participants talked of sharing household decisions and giving responsibility to household members with greater capability:

“If I need to change something I would probably ask my fiancé to do it…”

Male focus group participant

"…my husband knew that I wasn't very good with money so he just made the decision that he would do the mortgage and the poll tax so at least we've always got a roof over our heads. And then I could do the utility bills and the smaller bills."

Female focus group participant

This highlights that other household members might play an important role in helping low capability individuals make the right financial decisions. The extent to which this is feasible will be determined by the degree to which individuals with low capability live in households alongside other members with higher capability.

The household nature of the Wealth and Assets Survey allows an analysis of household capability to be undertaken. Table ES2 shows the breakdown of this analysis. Capability poor households are those where all of the members have a relatively low capability. Conversely, capability rich households are those where all members have a relatively high capability. It shows that extreme clustering of low and high capability is relatively uncommon as most households have members with a range of different financial capability levels.

Table ES2: Proportion of households with each financial capability level

Household type	Proportion of population
Capability poor	1.7%
Mixed capability	95.4%
Capability rich	2.9%

Source: SMF analysis of the Wealth and Assets Survey 2010-12

These results are used to make recommendations, summarised below, for how engagement, capability and outcomes can be improved for each of these groups.

Capability poor households

While a seemingly small group at just 1.7% of households, this group amounts to at least half a million capability poor households across Britain. Overall, 28.8% of individuals with low financial capability live in these households where decisions over individual or household finances cannot be supported by other household members with an average or above level of financial capability.

These households are almost solely found towards the bottom of the income distribution and the majority are not in work. With many of these families being financially supported by benefits, it is essential (for them and the taxpayer) that this money is used to improve living standards, rather than increase the revenues of firms relying on inertia to drive profits.

To ensure this happens, two new approaches should be adopted or tested to support existing schemes:

- ***Better deals on benefits:*** All new claimants of benefits should be offered a free switching consultation. This should work with claimants to understand the range of contracts across utilities and financial service products they are currently under and assess whether better value options could be available. The Government could work with existing aggregator / switching sites to provide this service at relatively low cost.
- ***Super Switch:*** The Government should also develop a collective switching initiative. This would be open to all, but particularly targeted at low-income households (for instance by offering to it to new benefit claimants). It would bring together a large number of willing switchers and, in turn, a

bulk discounted tariff could be negotiated with a range of providers.

Mixed capability households

Over seven in ten (71.2%) individuals with relatively low capability live with someone with a higher level of capability, suggesting that the role of social networks in mitigating the impacts of low financial capability could be strong.

However, the viability of this approach and the range of potential policy solutions will depend on the attitudes towards supporting, or receiving support from, other household members. Polling commissioned as part of this research shows that those with low capability are less likely to be comfortable talking about their finances than those with average or high capability. However, over half of low capability individuals would turn to family or friends if they were in financial difficulty and more than four in ten low capability individuals would also be comfortable talking about finances with friends and family. For those with average or high capability, the results show a significant majority being comfortable helping friends or family in making choices about their personal finances.
Overall, this suggests that the use of friends and family in making financial decisions could play an important role in mitigating the impact of individuals' low financial capability: those with higher financial capability are willing to help, and (at least some of) those with lower capability are willing to discuss their finances.

However, there are still barriers. This is particularly true with respect to the extent to which people are willing to talk about their finances. Recent research demonstrates the extreme nature of this aversion to talking about finances in the UK, highlighting that:

> *After surveying 15,000 men and women, researchers from University College London found that people are seven times*

> *more likely to tell a stranger how many sexual partners they've had, whether they've had an affair, and whether they've ever contracted a sexually-transmitted disease than have a chat about their income.*

To break down these barriers, focus group participants argued that the subject needed to be made less embarrassing and more interesting. To help this to happen and to get families talking and supporting each other to make better financial decisions, the report recommends the introduction of an Active Consumer Week.

> **Active Consumer Week:** Government and regulators should co-ordinate to rebrand and improve the existing "National Consumer Week". This should build on the Government's recent publication, *A better deal,* and rather than focussing on consumer protection, the new week should look across the whole range of consumer engagement opportunities including switching and protection.

The Government should work with experts in behavioural science to develop a strategy for making the most impact with Active Consumer week. This should look to explore ideas for making it more of a social norm to discuss finances during this week and also communicate the potential benefits of engagement.

The regulator could also have a role in prompting discussions with friends and family members:

> **Changing risk warnings:** To prompt discussions with others with potentially higher capability, financial risk warnings could highlight the benefits of discussing decisions with others. For example, when taking out a loan or short-term credit, this could be a formal part of any product journey with regulated questions being asked as to whether you have spoken to a friend or family

member about whether it is the best decision for you. Similar prompts could be provided as part of advertising for financial products and services: for example, stating that '…your capital may be at risk; and many people find that it's useful to chat to someone about a big decision like this.'

Capability rich households

There could also be important policy interventions for households classed as capability rich. More broadly, these approaches will also support mixed capability households.

One in ten people with high capability believe that their lack of understanding limits their ability to make financial choices and one in six with high capability delay or avoid making financial decisions because of a fear of getting the choice wrong. This suggests that prompting greater engagement from this group could increase their living standards and help them make better decisions.

There are also much wider potential effects on the market. For instance, active engagement by this group could help drive competition and innovation across the market. In turn, by supporting this group of capable by cautious households to engage more actively, consumers and households across the whole market could gain. The economy would also gain.

Two recent Social Market Foundation report, *Should Switch Don't Switch: Overcoming-consumer inertia* and *Balancing Bricks & Clicks: Understanding how consumers manage their money*, outlined recommendations that could be effective in ensuring this happens.

Recommendations included:

- **Improving the midata scheme:** Implementing a full review of the midata scheme to understand why it has had a relatively low impact. Building on conclusions coming from the review, firmer action is needed to move to the next iteration of the midata scheme.
- **Facilitating the open API standard:** To ensure this has the impact it should, work is needed to reassure consumers using such services and protect them if something should go wrong.
- **Consulting on a Unified Data Portal:** Taking the principle behind the API standards and midata scheme to the next level would mean developing a Unified Data Portal. This could allow consumers to choose a third party provider to hold their usage data from a range of sectors. Firms would update it automatically and consumers could access all their data and a set of personalised recommendations all in one place. A consultation is needed to understand how this could be taken forward in practice and how to ensure that consumers (and their data) are appropriately protected.

Boosting financial capability, improving living standards and growth

This report demonstrates the poor level of financial capability across Britain and the impact it has both on individual living standards and wellbeing and, more generally, on the economy and growth.

Tackling this will not be easy. Many schemes have attempted to do so before and have largely failed. The report suggests that to ensure that future schemes are more successful, a household approach needs to be taken. This would consider the links between household members and the fact that individuals do not make decisions in isolation. The support that household members can give each other will be essential in improving outcomes.

By targeting support on the 500,000 households with the very lowest capability; encouraging financial discussions between household members and wider social networks; and super-charging the engagement activity of those with already high capability, a significant improvement in financial capability, consumer engagement and outcomes could be delivered across Britain.

CHAPTER 1: WHY FINANCIAL CAPABILITY MATTERS

What is financial capability?

Financial capability can be summarised as the ability an individual has to collect, collate and assess the information needed to make an informed decision when purchasing a good or service or making choices about their future financial plans. For example, this might include making informed decisions about how much money to put aside for a rainy day; choosing the right mortgage or bank account to meet their needs; or managing their finances to ensure they keep within their means. Beyond this, there are a range of different concepts and measures of the exact components of financial capability.

Why does it matter?

Whatever the chosen measure, the importance of financial capability for individuals and families is obvious. Without the ability to collect, collate and assess information and take appropriate action, individuals risk making poor financial decisions. While in many cases these will have a relatively small impact, the consequences can be large. For example, there are 2.6 million people in the UK suffering from severe problem debt and one in six people are in some way over-indebted.[3] A total of 12 million adults are also failing to save enough for their retirement.[4] As well as the impact this has on families' immediate and longer term financial situation and living standards, research consistently highlights the negative impact that money problems have on wellbeing.[5]

But it is not just individuals and families that suffer from the consequences of poor financial capability. There is also a much broader perspective that highlights the role that individuals exercising financial capability has on the effective functioning of markets. In short, by making informed and effective decisions, financially capable individuals drive competition in financial markets, incentivising firms to lower prices, improve value for money and innovate. As well as providing all consumers with better goods for lower prices, this makes good businesses successful, improves productivity and boosts economic growth. In short, strong financial capability is a key element to making the UK's financial services industry and wider economy tick.

Existing evidence on the UK's financial capability

Despite this clear importance, research has consistently found relatively poor levels of financial capability across the UK. For example, recent research has shown that:

- One in three mortgage holders do not know the rate of interest they are currently paying;[6]
- When asked, more than one in five people (22%) could not read the balance on a bank statement;[7]
- While nine in ten people have agreed to terms and conditions when buying a product or service online, only 16% say they always read them;[8]
- Half of the UK population have numeracy skills no better than those expected of nine to eleven year olds,[9] meaning they might struggle to understand prices or pay household bills;[10] and
- One in eight people would not be able to last more than one week if they lost their main source of income.[11]

There are worrying trends for the future

It is also concerning that, when looking to the future, there does not seem to be a clear indication that these challenges will be overcome. In fact, there is a strong argument to suggest that they may become even more problematic.

As markets develop across the globe and digital platforms open up new markets for consumers, the range and technicality of products and services available in the UK and internationally will continue to increase. At the same time, the range and complexity of choices that consumers are being required to make are also increasing. Whether it be the need to fund university education or social care provision or make decisions as a result of the new pension freedoms introduced in 2015, the financial decisions consumers are required to make come with ever increasing risks and consequences.

In part, making decisions over this extended range of options has been made easier with digital innovation. Price comparison websites, Midata for current accounts in banking and a range of apps to manage personal finances are all now available. However, each requires a level of financial sophistication to engage with effectively and, of course, require the user to want to engage in the first place. A recent SMF report highlighted that this "motivation" factor in consumer decision making is vital in driving consumers to engage in markets and, in turn, is driven by financial capability.[12] In short, consumers are being asked to make more complex decisions and the costs of either not acting, or making a poor decision appear to be rising over time.

Existing research also shows that people are taking longer to develop capability. Numerous reports show that capability is built as individuals and families make important life choices.[13] Moving out of the family home, starting work, getting married, buying a first house and having your first child all require people to engage and make decisions and are linked with a rise in financial capability. These are all things that are happening later and later in life. For instance:

- The average age of a first time house buyer is now 31. This has risen by eight years since the 1960s and from 28 in 1995;[14]
- The mean age of mothers giving birth to their first child is now 28.3, compared to 27 in 2003; and[15]
- Since 1972, the mean age at first marriage has increased by eight years for both men and women.[16]

However, the need to develop financial capability as soon as possible has not diminished and not doing so can have significant impacts on living standards both now and in the future.

What this means in practice

It is hard to accurately measure the impact of poor financial capability across the economy, or even for individual families and individual. However, the potential impacts of failing to engage in markets or making poor decisions, has been demonstrated in other research. For example, recent reports have shown that:

- Consumers are collectively losing out on £4.3 billion a year by keeping savings in savings accounts with very low rates of interest;[17]
- Some seven in ten consumers are on mobile tariffs that are more expensive than they need and, on average, these users could save £159 a year by switching;[18]
- The average consumer could save around £70 a year by switching current account provider. Heavy overdraft users could save £250 a year or more;[19] and
- The average user on a dual-fuel energy tariff could save £160 a year by switching provider.[20]

Wider research has looked to understand the combined impact of consumer inertia. A recent Government publication estimated that the average family could save around £400 a year just from switching energy supplier, current account and mobile tariff.[21] Looking across wider markets, including insurance and broadband the average household could be losing out on even more than this.[22]

In the context of household budgets that continue to be squeezed, boosting financial capability and improving these outcomes could substantially increase wellbeing and living standards for a significant proportion of the UK population.

Existing efforts to boost financial capability

Given the importance and potential impact of financial capability, it is of no surprise that this topic has been high on the policy making agenda for many years. There have been numerous programmes and approaches that attempt to boost financial capability. However, despite this action, financial capability remains stubbornly low.

Recent initiatives, including the work of the Social Inclusion Commission and the Money Advice Service, have tried to tackle this issue.[23] Both highlight the importance of financial capability for individual wellbeing and living standards as well as the wider economy. Both also highlight the need for coordinated and collective approach to improving financial capability. Achieving this relies on effective partnership working, robust evaluation of what works and continued efforts to better understand the problem and how it might be tackled.

This report contributes to this approach. It uses original analysis to shed new light on the nature of the financial capability problem in Great Britain and puts forward firm recommendations for action that can be taken now to improve capability and outcomes for families across Britain.

CHAPTER 2: FINANCIAL CAPABILITY IN GREAT BRITAIN

Defining financial capability

This chapter presents new insights into the level and nature of financial capability in Great Britain. Measuring financial capability is a difficult and subjective matter. There are a number of possible measures that might be used. To build on existing evidence this report draws heavily on previous research (primarily from the Financial Services Authority, Bristol University and the Office for National Statistics) using the Wealth and Assets Survey, which outlined five component measures of financial capability. Research for this report derives these variables for the third wave of the Wealth and Assets Survey (2010-12).[24]

The five components are outlined below:[25]

- ***Staying informed:*** the extent to which individuals keep an eye on indicators of the wider economy;
- ***Choosing products:*** the types of information that individuals use to consider and make financial decisions;
- ***Making ends meet:*** the ability to live within financial means;
- ***Planning ahead:*** the extent to which an individual puts aside money for potential future needs; and
- ***Organised money management:*** the extent to which an individual knows how much money they have, and how much they spend, day to day.[26]

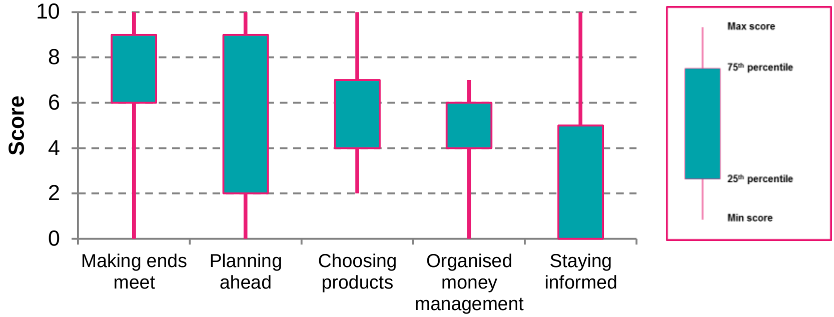
For each of the components, apart from the choosing products component, the Wealth and Assets Survey provides a sample size of around 30,000 individuals. The choosing products component has a sample size of around 16,000 individuals as the questions were only asked of those who had relatively recently purchased a financial product.
It is important to note that scores cannot be compared across the components. For instance, a score of seven on one component is not necessarily worse than a score of eight on another component. However, scores between individuals on the same component can be compared. With this in mind, we have taken an approach to identify “relative high and low capability” on each component, where a relatively low (high) is defined as being more than one standard deviation below (above) the mean score for that component.

Overall financial capability in Great Britain

Figure 1 shows that scores for each of the five components of financial capability vary significantly both in terms of their levels across the population and their distribution. For example, the making ends meet component scores relatively highly, with a mean score of 7.5 compared to a mean score of 3.0 for the staying informed component.

The staying informed component also has more than a third of people scoring zero, implying that they do not keep track of any indicators of the broader economy. The spread of scores for the planning ahead component is the largest of the five components, with a wide range of responses reflecting the varying approaches to financial planning across the population.

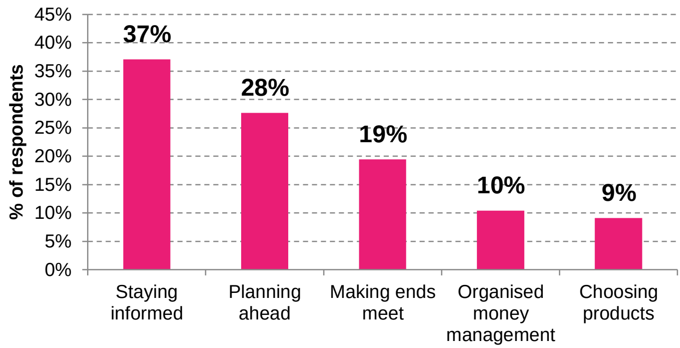
Figure 1: Distribution of financial capability scores across the five components



Source: SMF analysis of Wealth and Assets Survey 2010-12

As the measure of relatively high and low scores in this report is based on the distribution of the scores for each component, a different proportion of individuals are judged to fall into the low and high categories for each component. Figure 2 shows the proportion of individuals falling below one standard deviation of the mean (a relatively low score) for each component. Just over a third of people have a relatively low score for the staying informed component (driven by the large proportion of people with zero scores on this component) and just under one in ten (9%) of people score relatively badly on the choosing products component.

Figure 2: Proportion of people with relatively low financial capability scores, by component



Source: SMF analysis of Wealth and Assets Survey 2010-12

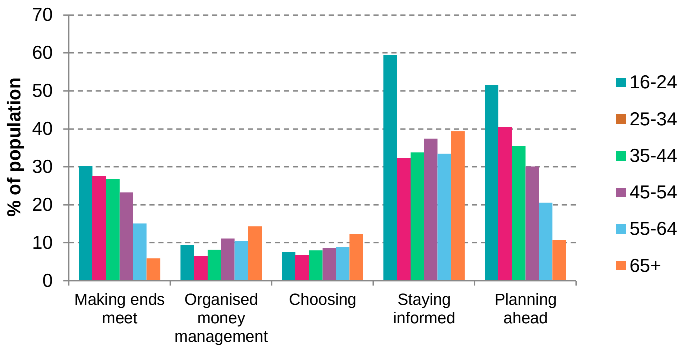
The characteristics of those with low relative financial capability

Once the prevalence of relative low scores across the population has been determined, it is important for policy makers to understand the characteristics of the individuals who are more likely to have low scores. Figure 3 shows how the proportion of low scores varies by age. It shows that:

- For organised money management and choosing products, older age groups are more likely to score relatively poorly, however the differences are small;
- Larger differences by age can be seen for making ends meet, staying informed and planning ahead. For making ends meet and planning ahead, the likelihood of a relatively poor score falls significantly with age. Over half of those aged 16-24 score poorly on the planning ahead component, compared to just one in ten of those aged over 64; and

- Young people also score relatively poorly on the staying informed component, with the majority of 16-24 year olds having a relatively low score. However, scores for age groups older than 24 are fairly similar.

Figure 3: Proportion of people with relatively low financial capability scores, by component and age group

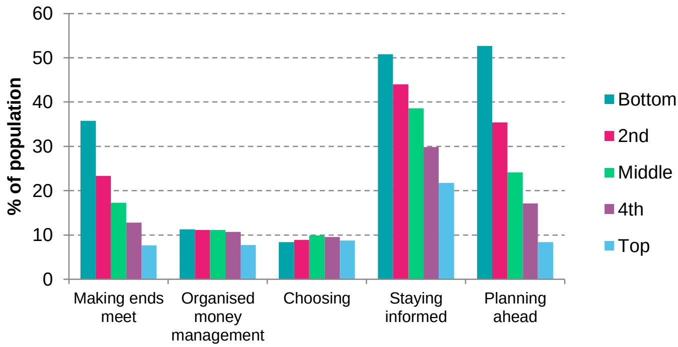


Source: SMF analysis of Wealth and Assets Survey 2010-12

Figure 4 shows the equivalent analysis for individuals in different household income quintiles. Again, scores for the organised money management and choosing products components are relatively similar for all groups. However, for the other three components, there is a clear correlation with income. Those individuals in higher-income households score far better than those in lower-income households. For instance, 36% of people in the bottom income quintile score relatively poorly on the making ends meet component, compared to 7.5% of those individuals in households in the top income quintile.

People towards the bottom of the household income distribution also score relatively poorly on the staying informed component. However, it is worth noting that there are still over one in five individuals in households at the top of the income distribution who score zero on this component.

Figure 4: Proportion of people with relatively low financial capability scores, by component and position in household income distribution



Source: SMF analysis of Wealth and Assets Survey 2010-12

The key drivers of low scores

To understand more fully the likelihood that people with different characteristics score relatively poorly on the different components of financial capability, regression analysis can be used. This shows the impact associated with each characteristic, whilst holding other factors constant. For example, we know that capability increases with both age and income but, as income also rises with age, it is hard to distinguish the two effects. Regression analysis allows us to do this.

Table 1 shows the results from a probit regression for each of the five components and shows how different characteristics impact on the likelihood that an individual scores relatively poorly. Statistically insignificant figures are excluded from the table, and each figure represents the percentage point change in likelihood of a low capability associated with the characteristic. For example, for *organised money management*, men are 1.15 percentage points more likely than women to have a relatively low capability. Conversely, for *staying informed*, men are 10.29 percentage points less likely to have a relatively low capability.

Overall, the results present a mixed picture, with the impact of different characteristics varying between each of the components of financial capability. For example, while the likelihood of having a low *making ends meet* capability falls significantly as individuals get older, the converse is true for choosing products, where older individuals are more likely to score poorly. More specifically, we can see that compared to those with no children, those with three or more children are 16.7 and 17.7 percentage points more likely to have a low score in the making ends meet and planning ahead components respectively. However, there are no statistically significant differences in their scores for the other components. Equally, compared to 35-44 year olds, those aged between 65 and 74 are 11.4 percentage points more likely to have a relatively low score in the planning ahead component. However, they are 3.5 percentage points *less* likely to have a relatively low score in the choosing products component.

This variation in the impacts of various characteristics, makes is hard to generalise results. However, some broad themes are that capability is generally lower for those:

- Not in employment;
- With lower qualifications;
- With parents who were not employment and / or had low qualifications; and,
- Who are not owner-occupiers.

Table 1: Proportion of people with relatively low financial capability scores, by component and position in household income distribution

	Marginal effects (percentage point impacts)				
Characteristic (base)	**Making ends meet**	**Organised money management**	**Choosing products**	**Staying informed**	**Planning ahead**
Gender (female)					
Male	-	1.15	-	-10.29	-
Age (16-24)					
25-34	1.81	-3.11	-5.02	-	8.37
35-44	-	-2.45	-1.96	-	2.79
45-54	-4.93	-	-	-5.21	-7.08
65-74	-8.02	-	3.45	-5.13	-11.36
75-84	-10.31	3.49	10.50	-	-13.24
85+	-11.00	10.62	16.37	12.73	-14.35
Qualifications (school level)					
Degree or above	-5.62	-2.82	-4.26	-13.59	-10.81
No quals	1.70	4.62	4.98	16.23	8.12
Marital status (married)					
Cohabiting	1.87	-3.60	-	-	3.33
Single	3.01	-4.21	4.76	-	4.12
Divorced, separated, died	4.02	-5.24	4.47	-3.46	9.22
Number of children (none)					
One child	5.70	-	-2.17	-	6.70
2-3 children	9.15	2.23	-	-	10.57
More than 3 children	16.67	-	-	-	17.86
Lone parent	-	-2.15	-	-	3.92
Employment status (employed)					
Self employed	-	-	-1.91	-	-
Unemployed	12.53	-	-	-4.93	14.09
Inactive - ill / disabled	12.19	1.80	-	12.86	18.95
Retired	-2.36	-	-2.42	-	-2.07
Other inactive	1.54	-	-	5.56	3.17
Tenure (owner-occupier)					
Rented	9.67	-	6.20	14.25	23.68
Other	-	-	7.20	6.30	4.24
Mother's employment status when teenager (employed)					
Unemployed	4.60	-	-	-	-
Family worker / home	-1.46	0.80	-	1.23	-2.42
Sick / disabled	-	-	-	-	-
Retired	-9.52	-	-	-	-
Other	-	-	-4.94	-	-2.15
Father's employment status when teenager (employed)					
Unemployed	3.96	-	-	5.83	-
Family worker / home	-	-	16.20	-	8.40
Sick / disabled	-	-1.03	-	-	9.74
Retired	-	-5.98	-	-	-
Other	-	-	-	-	-
Mother's education level (degree and above)					
None / before 15	-	-	-	3.63	-
15-18	-	-	-	-	-
Other / DNA	-	-	-	6.39	5.47
Father's education level (degree and above)					
None / before 15	1.45	-	-	4.28	3.02
15-18	-	-0.29	-	4.74	-
Other	2.29	-	-	5.73	4.40
Income control	Yes	Yes	Yes	Yes	Yes

Notes: Positive numbers reflect an increased probability of having low capability.
All figures included are statistically significant at the 5% level. Figures are percentage point change from the base category (shown in brackets for each section). Each regression controls for household income.

Multiple low and high scores

While scoring relatively poorly on one component can lead to difficulties it is, perhaps, more important to assess the extent to which individuals display low scores across the range of components of financial capability. One way to look at this is to assess the extent to which individuals have more than one component of financial capability where they have a relatively low score. This section uses four of the components to understand the extent to which this clustering of low component scores occurs.[27]

Across the population, figure 5a shows that, four in ten (42%) individuals do not have any relatively low scores across the four components of financial capability. Equally, figure 5b shows that some six in ten (62%) do not have any relatively high scores across the four components of financial capability. Just over a quarter of individuals have two or more relatively low financial capability scores. Less than 15% of people have two or more relatively high scores. In short, relatively few people have multiple low or high scores and it is extremely uncommon to have either low or high scores across the board.

Figure 5a: Proportion of people with multiple low scores across four components

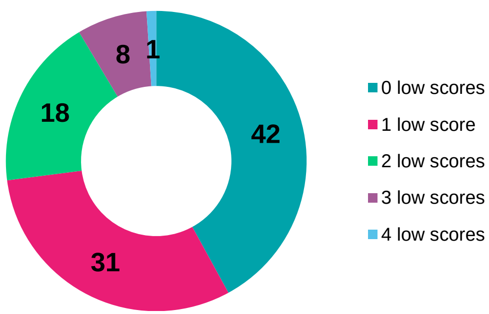
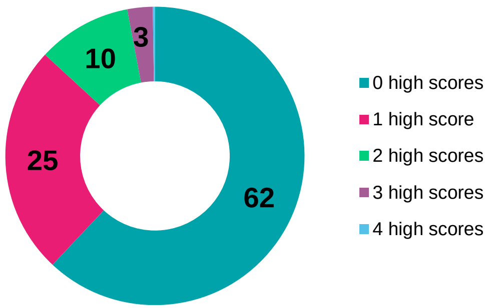


Figure 5b: Proportion of people with multiple high scores across four components



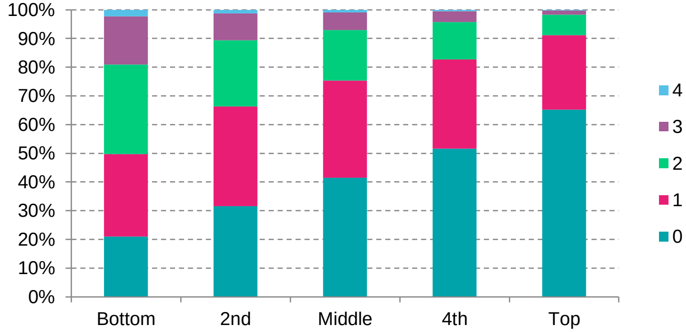
Source: SMF analysis of Wealth and Assets Survey 2010-12

However, there are still more than one in four individuals with two or more low scores. This group is likely to be those who experience the deepest problems with financial capability, so it is important to understand their characteristics.

Characteristics of individuals with multiple low capability scores

Based on the analysis above, it is perhaps, unsurprising that figure 6 shows that the incidence of multiple **low** scores is higher towards bottom of income distribution, with over half of the bottom income quintile having at least two low scores. However, perhaps more surprising is the finding that nearly one in ten of those in the top income quintile have at least two low scores.

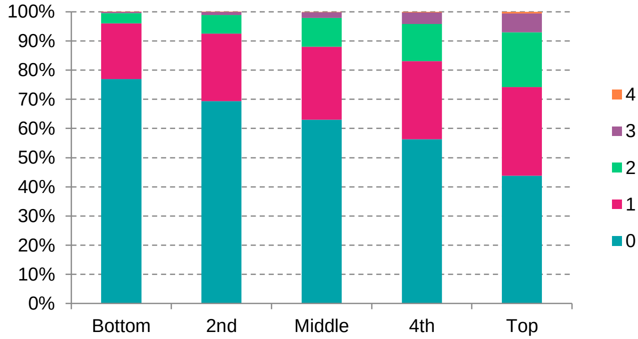
Figure 6: Proportion of people with different total numbers of low capability components by household income quintile



Source: SMF analysis of Wealth and Assets Survey 2010-12

A similar picture emerges for the incidence of multiple high scores. Figure 7 shows that multiple **high** scores are more likely towards top of income distribution, but also that one in four of those in the bottom quintile have at least one high score and 4% have two or more high scores.

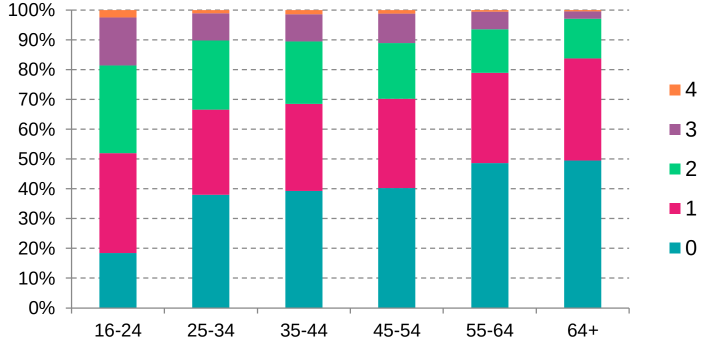
Figure 7: Proportion of people with different total numbers of high capability components by household income quintile



Source: SMF analysis of Wealth and Assets Survey 2010-12

Figure 8 presents similar findings by age group. It shows that one in three individuals aged 25-34 have low scores on at least two components, whereas the equivalent figure for those aged 55-64 is one in five.

Figure 8: Proportion of people with different total numbers of high capability components by age



Source: SMF analysis of Wealth and Assets Survey 2010-12

Creating a measure of total capability

Given the range of characteristics associated with the group with multiple low capability scores, it is hard to identify groups most in need of support. To address this, it is possible to create a measure of total capability across all the components and assess who score relatively poorly on this measure. To do this, scores for each of the components are summed together to compute a total capability measure with a maximum possible score of 40.

Across the population, the mean score is 20 out of a possible total of 40. The median score is 21. This suggests that, across the population, there is significant room for improvement in financial capability. As with the individual capability components, individuals are also assessed on whether they score relatively well or poorly on this total measure.[28] The results show that one in every eight people (12.4%) has relatively low total financial capability.

The drivers of low overall capability

The table at Annex 1 shows the mean and median scores by a range of characteristics. As with the individual components, we can also use regression analysis to unpick the drivers of low overall capability. Table 2 shows results from a probit regression analysis of the total capability score. Statistically insignificant figures are excluded from the table, and each figure represents the percentage point change in likelihood of an overall low capability associated with the characteristic. The results here are consistent with what might be expected, with income, qualifications, age and labour market outcomes all negatively (and statistically significantly) associated with the likelihood of an individual having a relatively low overall financial capability.

Table 2: Drivers of a relatively low total capability score

Characteristic (base)	Marginal effects (percentage point impacts)
Male (female)	-0.79
Age (16-24)	
25-34	2.87
35-44	-
45-54	-5.37
65-74	-7.41
75-84	-8.09
85+	-8.32
Qualifications (school level)	
Degree or above	-8.59
No quals	9.57
Marital status (married)	
Cohabiting	-
Single	1.85
Divorced, separated, died	2.96
Number of children (none)	
One child	3.87
2-3 children	6.53
More than 3 children	7.34
Lone parent	1.97
Employment status (employed)	
Self employed	-1.33
Unemployed	8.34
Inactive - ill / disabled	15.13
Retired	-2.44
Other inactive	3.22
Tenure (owner-occupier)	
Rented	14.07
Other	-
Mother's employment status when teenager (employed)	
Unemployed	-
Family worker / home	-1.16
Sick / disabled	-
Retired	-
Other	-
Father's employment status when teenager (employed)	
Unemployed	3.70
Family worker / home	-
Sick / disabled	4.16
Retired	-
Other	-
Mother's education level (degree and above)	
None / before 15	1.29
15-18	-
Other	2.73
Father's education level (degree and above)	
None / before 15	2.26
15-18	1.38
Other	3.79
Income control	Yes

Notes: All figures included are statistically significant at the 5% level. Figures are percentage point change from the base category (shown in brackets for each section). Positive figures indicate that those with that characteristic have an increased likelihood of having a relatively low score. Each regression controls for household income.

CHAPTER 3: CAN FAMILY TIES MITIGATE POOR FINANCIAL CAPABILITY?

Chapter 2 outlined the state of financial capability in Great Britain and the key drivers of relatively low capability. As with previous studies in this area, the results paint a concerning picture. However, they focus solely on individual views and behaviours, ignoring the fact that, in many households, financial decisions will be made jointly – for example over shared expenses like utility bills, rent payments or the mortgage. The measures are also often hard to translate into real life situations that people might find themselves in.

Together this means that, on their own, measures of low capability are difficult to translate into an understanding of the impact that they might have on individuals and families. For this reason, this chapter considers some of the practical difficulties that those with relatively low financial capability might have and looks at the potential for family ties to mitigate the impacts.

The impacts of low financial capability

Previous research and the analysis above both point to a large portion of the GB population with relatively low financial capability. Other research also highlights the financial consequences of consumer inertia and poor decision making. However, few studies explicitly link measures of financial capability with an assessment of the impacts that this might have on the individuals concerned.

To tackle this and better understand the potential impacts of low financial capability, as part of the research for this programme of work, representative polling was undertaken with 2007 adults in Great Britain.[29] This was structured to replicate the five components of capability outlined above.[30] Once these measures were created, the polling also asked a range of other questions about the impact that capability has on decision making and how people feel about making decisions. Finally, the polling also posed a financial choice scenario and a set of choice options designed to assess if respondents chose the cheapest option (box 1 provides more detail of this question). We were then able to cross reference these results with the underlying measures of relative financial capability.

Box 1: Scenario to test ability to choose the right financial option

To test respondents' ability to choose the best value financial option, we asked the following question:

Your friend Diane unexpectedly needs to pay £400 for urgent repairs to her car. She wouldn't be able to afford it until she gets paid in two weeks, so to pay for the bill she is considering whether to go into her overdraft, pay on her credit card or take out a pay-day loan.

- *Her credit card has an APR of 19%*
- *Her bank will charge her £12 for using the overdraft and borrowing has an APR of 15%*
- *The total she would pay back for the pay-day loan is £440*

Which option would you recommend she takes?

a) *Credit Card*
b) *Overdraft*
c) *Pay Day loan*
d) *I wouldn't give her advice*[31]

Results split by relative capability level are shown in table 3. Overall it shows that those with relatively low capability:

- Have lower confidence in making financial decisions (41.5% versus 92.6% for those with high capability);

- Are more likely to believe their lack of understanding limits their ability to make the right choices (37.7% versus 8.2% for those with high capability);
- Delay financial decisions more frequently because of a worry of getting it wrong (40.9% versus 16.2% for those with high capability);
- Are less likely to believe that financial services firms make choosing products easy (13.9% compared to 45.0% for those with high capability);
- Are less likely to choose the cheapest option from the choice scenario (29.0% versus 52.7% for those with high capability); and
- Are more likely to want further help to choose financial products (37.1% versus 22.4% for those with high capability).

Table 3: Results from polling split by financial capability level

Question	Total Agree (%)		
	Low capability	Average or high capability	High capability
Confidence and consequences			
"I am confident in making financial decisions"	41.5	74.7	92.6
"My lack of understanding of financial products limits my ability to make the right choices"	37.7	18.9	8.2
"I often delay or avoid making financial decisions because I'm worried I will get it wrong"	40.9	25.4	16.2
Understanding and help			
"Understanding the financial products I buy is important to me"	62.3	86.1	96.8
"It is important to shop around when buying financial products"	76.0	90.6	97.4
"My financial services providers make it easy to choose products"	13.9	32.9	45.0
"I would like more help to make the right financial choices"	37.1	30.6	22.4
	Total correct answer (%)		
Ability to choose right answer	29.0	43.3	52.7

Source: Populus on behalf of SMF

Notes: Base is all respondents with a bank account (1,801)

These results clearly demonstrate some of the negative impacts that low relative financial capability can have in terms of affecting individuals' approach to decision making and their ability to make the right choices. In particular, it shows that those with relatively low capability feel less able to make the right decisions and, as a result, delay or avoid making decisions. This was also highlighted in the focus group for this project, where one participant commented:

"…you don't want to face the reality or the enormity of how much those bills are. So you just think to yourself… stick it in the drawer…"

Female focus group participant

Table 3 also shows that those with low capability find financial products more confusing and are less likely to feel the need to understand the products they buy or shop around when they do need to purchase financial products.

This can have significant impact for household budgets. Chapter 1 demonstrated that switching current account provider, savings accounts and a range of utility providers can lead to significant financial savings, meaning that this behaviour could lead to individuals being considerably worse off.

Networks mitigating the impacts of financial capability

So far, as with other research in this area, this report has focussed on the financial capability of individuals. It has found that significant portions of the GB population have relatively low capability and that this could be impacting on their financial situation and standard of living.

However, it is clear that individuals do not make decisions in isolation. Often choices need to be made for (or with) other members of a household. For example, choices over a mortgage or utility provider, will impact on all household members. Participants of the focus group conducted as part of this research highlighted that this leads to financial decisions being shared between household members. Participants shared very different experiences:

"…all the bills come out of my account – we have a joint savings account – but it is my wife that transfers all the money around and makes sure that there's enough money in each account to cover what we need. So she controls it all but it comes out of my account."

Male focus group participant

"So when I got married decades ago, my husband knew that I wasn't very good with money so he just made the decision that he would do the mortgage and the poll tax so at least we've always got a roof over our heads. And then I could do the utility bills and the smaller bills."

Female focus group participant

"[I make more decisions] than my partner. I'm not great at it but I like to control it…I'm not that great financially on making decisions but I feel like I'm better than my partner. But we help each other out a lot."

Female focus group participant

"If I need to change something I would probably ask my fiancé to do it…"

Male focus group participant

These views highlight both that responsibility is shared (often with the member with highest perceived capability taking responsibility) and that household members also discuss finances amongst themselves. Previous evidence also shows that Individuals turn to family members and friends for advice on financial products to buy. Interestingly, this is particularly true for those with relatively low capability. Table 4 shows that those with lower capability rely more on friends and family to guide their choices. Some 13% of those with low capability were "most influenced by a friend or relative" compared to 5% of those with a relatively high capability.

Table 4: Most influential source of information when making financial decisions

Source of information that most influenced decision	Low capability (%)	High capability (%)
Best buy information	32.04	36.66
Information from providers, websites	20.95	20.74
No information collected	19.72	9.74
Friends or family	13.03	5.2
Independent Financial Adviser	6.31	13.96
Information received in the post	5.78	3.59
Independent information in media	2.17	10.11

Source: SMF analysis of the Wealth and Assets Survey 2010-12

This suggests that those with relatively low financial capability might be turning to friends and family, perhaps with higher capability, to guide their decisions. Again, this idea was supported by findings from the focus group for this project, where those with perceived low levels of capability said that they were likely to seek help from family or friends:

"I feel more comfortable talking to friends and family than going in [to speak to a provider]... I always feel if I'm talking to somebody, go to a bank and they obviously know a hell of a lot more than I do, I feel stupid with some of the questions I've got to ask. So I do feel more comfortable talking to friends and family."

Female focus group participant

"…I'm terrible with finances. All my friends know it, my family know it and it's just the way I am. So I just literally say I don't know what to do…So I talked to him [someone with higher capability who had previously made the decision] about it and talked to, my uncle [about] it."

Female focus group participant

To explore this further, the polling commissioned for this report also looked at respondents' attitudes towards supporting, or receiving support from, friends and family. Table 5 summarises the responses. Slightly contrary to the findings in the focus group, the results show that those with low capability are, on average, less likely to be comfortable talking about their finances than those with average or high capability. They are also less likely to involve friends and family in making financial plans for the future.

However, over half of low capability individuals would turn to family or friends if they were in financial difficulty and, while lower than for average/high capability individuals, more than four in ten low capability individuals would be comfortable talking about finances with friends and family. For those with average or high capability, the results show a significant majority being comfortable helping friends or family in making choices about their personal finances.

Table 5: Most influential source of information when making financial decisions

Question	Total Agree (%)		
	Low capability	Non-low capability	High capability
"I am comfortable talking about finances with my family and friends"	43.8	62.7	74.1
"I would turn to my family and friends if I was in financial difficulties"	55.7	53.0	44.4
"I would talk to my family and friends when I was making financial plans for the future"	35.9	47.1	48.8
"I avoid talking about money with my family and friends"	36.0	27.5	22.6
"I would feel comfortable helping a friend or family member make choices about their personal finances"	36.5	60.4	78.2

Source: Populus on behalf of SMF
Notes: Base is all respondents with a bank account (1,801)

Overall, these results suggest that the use of friends and family in making financial decisions could play an important role in mitigating the impact of individuals' low financial capability: those with higher financial capability are willing to help, and (at least some of) those with lower capability are willing to discuss their finances.

Household financial capability

This means that other household members and friends might play an important role in helping low capability individuals make the right financial decisions. The extent to which this is feasible will be determined by the networks of friends and family that those with low capability have. If those with low capability have family members or friends with higher capability, they could use them to support their decisions. Conversely, if low capability is clustered, such that families and social groups tend to be all low or all high capability, the role for friends and family would be more limited.

The household nature of the Wealth and Assets Survey allows an analysis of household capability to be undertaken. The analysis below uses data on households where all adult members responded to questions relating to financial capability. This means that the sample is skewed significantly towards the older population and, as such, is likely to overstate the level of capability and understate the existence of clustering of low capability (as capability increases with age). While this limits the analysis, it is the best available data source on the overall capability of households.
Table 6 shows the breakdown of this analysis. Capability poor households are those where all of the members have a relatively low capability. Conversely, capability rich households are those where all members have a relatively high capability.

Table 6: Most influential source of information when making financial decisions

Household type	Proportion of population
Capability poor	1.70%
Mixed capability	95.40%
Capability rich	2.90%

Source: SMF analysis of the Wealth and Assets Survey 2010-12

It shows that extreme clustering of low and high capability is relatively uncommon. In other words, most households have members with a range of different capabilities. This means that just 1.7% of households can be classed as capability poor.

In practice this means that over seven in ten (71.2%) individuals with relatively low capability live with someone with a higher level of capability, suggesting that the role of social networks in mitigating the impacts of low financial capability could be strong.

Less positively, the remaining 28.8% of individuals with low financial capability live in capability poor households and, while relatively uncommon, these estimates suggest a lower bound of close to half a million such households in Great Britain.[32] For these households, decisions over individual or household finances cannot be supported by any members of the household with a relatively high or average level of financial capability. As highlighted earlier, it is also likely that this estimate presents a lower bound on the true number, because of the bias in the survey sample.

CHAPTER 4: PRACTICAL STEPS TO TACKLE THE FINANCIAL CAPABILITY CHALLENGE

This report has outlined the challenges facing the British population in terms of low financial capability. As with other reports, it has found a significant problem with poor financial capability. It has also taken existing literature a step further by assessing the extent of capability within households. Taking an overview of the research suggests three broad groups of families where support to improve financial capability and confidence might lead to improved outcomes.

- Mixed capability households;
- Capability poor households; and
- Capable but cautious households.

The next step is to understand what interventions might be successful in helping each of these groups. The sections below outline a set of proposals for policy interventions and pilots to do this.

Helping mixed capability households

These are households where at least one occupant has low financial capability, but others have a higher level of capability. For these low capability individuals, there is potential for family members with higher capability to support financial decision making and pass on financial capability.

However, table 4 showed that, while those with relatively low capability rely more on friends and family as a source of information, a significant majority do not. Indeed, even when in a mixed capability household, just one in five people (20%) with low capability were influenced in their decision by a friend or family while three in five (62%) chose products entirely on their own. Table 5 also shows that two in five of those with average capability would not feel comfortable helping friends or family with their finances. Similarly, more than one in five individuals with high capability actively avoids talking about finances with friends and family.

Recent research demonstrates the extreme nature of this aversion to talking about finances, highlighting that:

> *After surveying 15,000 men and women, researchers from University College London found that people are seven times more likely to tell a stranger how many sexual partners they've had, whether they've had an affair, and whether they've ever contracted a sexually-transmitted disease than have a chat about their income.*[33]

Participants at SMF roundtables on this issue also highlighted these concerns and suggested that people in other countries like the USA or Scandinavian countries are far more likely to discuss personal finances and purchasing decisions with friends, family and work colleagues.

Overall it is apparent that an aversion to talking about finances in the UK could severely limit the likelihood that average or high capability individuals will support those in their household that need it. This raises the question of what is driving this aversion and how those with low capability could be better supported by friends and family when making decisions.

Barriers to discussing finances

Previous research has shown that one of the main barriers is cultural. For instance, in one of its evidence sessions, the Financial Inclusion Commission found witnesses highlighting the view that managing money is seen as boring. One witness outlined that:

"We have in this country a massive money taboo. People do not like talking about money and so there is not much sharing among social networks, friends and family or anything else about these serious issues"[34]

Participants at SMF focus groups also highlighted that people find the issue boring:

"People don't like talking about finances and things like that. It's almost a bit, not grown up but it's too serious and important, stuff like that…[that means people just think] I'm not interested, just carry on, get enough money, spend it and use it."

Male focus group participant

Other participants felt that it was embarrassing to discuss finances, particularly when you have a problem. To tackle this, one participant argued that more should be done to help people feel able to discuss finances without being embarrassed:

"…make it acceptable that people can feel comfortable talking about these things and that it's not something that you've got to be ashamed of because when you start talking to people you find out that most of us are all in the same boat."

Female focus group participant

More broadly, participants in the focus group felt that the perceived lack of benefit from changing financial behaviour was a barrier to both engagement and discussing finances with friends and family. Participants commented that:

"If something isn't broke don't fix it. So I don't go out there actively trying to change to save a few pennies really."

Male focus group participant

"…if you change, you're going to get £100. I am not an affluent person but £100 over the course of a year means literally nothing. It's nothing."

Male focus group participant

Increasing financial discussions

Overall, it appears that a combination of embarrassment, disinterest and lack of perceived reward all drive aversion to discussing personal finances in the UK.

In part, as the Financial Inclusion Commission highlight, if overall financial capability improved, it would be more likely that people would have the confidence to talk about their finances. So, improved capability is a clear route to tackling this issue. However, it is likely that success in this area will rely on cultural barriers to talking finances being broken down and this is an area that future Government supported schemes should focus on.

To help support these efforts the following approaches could be adopted:

> **Active Consumer Week:** Government and regulators should co-ordinate to rebrand and improve the existing "National Consumer Week". This should build on the Government's recent publication, *A better deal,* and rather than focussing on consumer protection, the new week should look across the whole range of consumer engagement opportunities including switching and protection.[35]
>
> To encourage engagement, firms should be encouraged to offer fixed contracts of one or two years that start and end in Active Consumer Week. Once a 'critical mass' of consumers were signed up to yearly or bi-yearly contracts that ended in Active Consumer Week, this would become a regular time of year for switching and for families and friends to discuss options for the year and the choices they make.
>
> Because of the number of potential new customers firms would be incentivised to advertise their products at this time of year. Consumers would only have to engage with the switching process once a year, saving them time and hassle.

Furthermore, those who switch several products at once would enjoy substantial savings in the same week. Given evidence suggests the size of savings is a key driver of engagement, this is important.

Making the most of Active Consumer Week: The Government should work with experts in behavioural science to develop a strategy for making the most impact with Active Consumer week. This should look to explore ideas for making it more of a social norm to discuss finances during this week and also communicate the potential benefits of engagement.

One way to do this could be to communicate with households about the average savings a "family like them" could achieve by switching. This could come in the form of a clearly branded letter or leaflet tailored for individual streets or properties. It could:

- Show how much average families in the area spend;
- Provide a tool for the household to compare their own spending with this; and
- Give information about where further information is available and how they could change providers.

The regulator could also have a role in prompting discussions with friends and family members:

Changing risk warnings: To prompt discussions with others with potentially higher capability, financial risk warnings could highlight the benefits of discussing decisions with others. For example, when taking out a loan or short-term credit, this could be a formal part of any product journey with regulated questions being asked as to whether you have spoken to a friend or family member about whether it is the best decision for you. Similar prompts could be provided as part of advertising for financial products and services: for example, stating that '…your capital may be at risk; and many people find that it's useful to chat to someone about a big decision like this.'

Capability poor households

These are households where all occupants have relatively low financial capability. They cannot turn to other family members for support in making financial decisions and with a lower bound of just less than half a million of these households in the UK they are an obvious area to focus support.

In terms of characteristics, these households are almost solely found towards the bottom of the income distribution and the majority are either unemployed or classified as sick or disabled.

The Government already targets financial capability support through both the Troubled Families and Universal Support programmes.[36] However, it is likely that many of capability poor families could fall outside of the Troubled Families provision, or need financial support that goes broader than that typically available through Universal Support.

The case for further intervention here is strong:

- Where decisions over utility or financial product providers are delayed or avoided, this costs these families money. With many of these families relying on benefits to get by, it would be better to use this money to improve living standards, rather than increase the revenues of firms relying on inertia to drive profits.
- Where families face financial difficulties because of poor financial capability, all individuals in that family suffer and a

financial and public service burden is placed on the state. Supporting these families to make more of their money could save money and improve outcomes.

- There is potential for low capability to be linked across generations, with children of those with low capability more likely to have low capability themselves when they are adults. This means that this could also be a long-term problem for children in these households and their subsequent children. Targeting early interventions on this group could break this cycle.

For this reason, the following approaches should be adopted or tested:

- ***Better deals on benefits:*** All new claimants of benefits should be offered a free switching consultation. This should work with claimants to understand the range of contracts across utilities and financial service products they are currently under and assess whether better value options could be available. The Government could work with existing aggregator / switching sites to provide this service at relatively low cost.[37]
- ***Super Switch:*** To support this agenda, the Government should also develop a collective switching initiative, which could be launched during Active Consumer Week. This would be open to all, but particularly targeted at low-income households (for instance by offering to it to new benefit claimants). It would bring together a large number of willing switchers and, in turn, a bulk discounted tariff could be negotiated with a range of providers.

Supporting capable but cautious households

These are households where all occupants have average or relatively high capability, but still struggle in making financial decisions. The results above highlight that one in ten people with high capability believe that their lack of understanding limits their ability to make financial choices and one in six people delay or avoid making financial decisions because of a fear of getting the choice wrong. The results from the choice scenario also show that nearly half of those with relatively high capability did not choose the cheapest option.

In terms of the problems that this group faces, while a far higher proportion (compared to those with low capability) felt that financial services firms make choosing products easy, still over half (55%) did not agree that was the case. With this in mind, it is no surprise that more than one in five of the group would like more help in making financial decisions.

As with all other consumers, errors across financial and utility markets can be costly for this group in terms of disposable income and living standards. There are also much wider potential effects on the market. For instance, active engagement by this group of savvier consumers could help drive competition across the market; driving product improvement and lower prices. In turn, this means that by encouraging and supporting this group of capable by cautious households to engage more actively, consumers and households across the whole market could gain. The economy would also gain.

This leaves the question of how to support this group of households. Two recent Social Market Foundation report, *Should Switch Don't Switch: Overcoming-consumer inertia*,[38] and *Balancing Bricks & Clicks: Understanding how consumers manage their money*,[39] outlined recommendations that could be effective in this area. The following approaches build on recommendations from those reports.

Making it easier

One of the key problems identified in our research is that the vast majority of consumers feel that financial services firms do not do enough to make choices straightforward. Even those with high capability can struggle and, rather than trying to continually raise capability levels, there is a clear argument to make choices easier for individuals and families.

Our previous research has also shown that, in part, consumer confusion is a result of the approach of the regulator. By focussing heavily on disclosure rules, the regulator has pushed firms to provide consumers with more product information than ever before. While well intentioned, behavioural economics shows that this deluge of complex information can be a driver of inertia. Reforms of advice and sales practices (for example the Mortgage Market Review and Retail Distribution Review) have also, arguably, limited the extent to which firms are likely to provide simplified and personalised recommendations that consumers need. This has left consumers and firms in a difficult position.

This was also a view raised in the focus group for this project. One participant commented:

"…try and get the financial world to not be so stuffy…they go with all this fast spiel that you don't understand…they're trying to make it fun but then they've got the legal side that they've got to stick with to cover their asses if they do get something wrong."

Male focus group participant

For this reason, we have argued that the regulator needs to look beyond disclosure rules and push firms and the industry more generally to take firm action that will make it easier for consumers to understand and compare products and make the right choices. Particular areas of urgent work include:

- Implementing a full review of the Midata scheme to understand why it has had a relatively low impact. Building on conclusions coming from the review, firmer action is needed to move to the next iteration of the Midata scheme. This should include making midata available promptly to customers – at present some providers make customers wait 12 months to access information on their usage.
- The development of data-sharing (API) capabilities could also improve the Midata scheme and wider interactions with financial services providers. These automate the process by which consumers share their data with comparison providers or aggregator services,[40] however more needs to be done to ensure that consumers are aware of the potential of such services and that they are protected and reassured about their safety.
- In both the rebooting of midata and the development of API standards, the Competition and Markets Authority should set out an expected deadline for progress. To penalise slow progress, penalties could be introduced, or the CMA could work with the Payment Systems Regulator to commission an industry-levy-funded alternative should progress stall.
- Building on the development of API standards, the Government should launch a consultation on how a Unified Data Portal might be established. This could allow consumers to choose a third party provider to hold their usage data from a range of sectors. Firms would update it automatically and consumers could access all their data and a set of personalised recommendations all in one place.

Increasing engagement

Making it easier for households to compare and choose products will reduce the need for constantly increasing capability and should improve both individual decision making and how financial and utility markets function. However, it should be recognised that the provision of comparison and switching tools will only improve outcomes and increase competition to the extent that consumers are motivated to access these tools in the first place. A wealth of evidence shows that this level of motivation is not always present. For instance, 46% of consumers have not ever considered changing their current account provider[41] and evidence in this report shows that many consumers will simply delay or avoid making financial decisions.

This means that, alongside measures to make choices easier, more action needs to be taken to prompt engagement. The following approaches could facilitate this:

- ***Active consumer week:*** as highlighted above, this week should be implemented to encourage and support more individuals and households to take action each year.
- ***Ending rollovers:*** The way contracts are structured differs substantially between markets and impacts heavily on engagement. In the car insurance market, contracts typically last for one year, and are not 'rolled over'. At this point, consumers must purchase a new yearly insurance contract. In the mobile phone market, by contrast, contracts are typically 'rolled over' on a monthly basis after the contract ends. Consumers continue paying the same rate and are on the same tariff until they cancel the contract. Almost half of mobile customers allow their contract to roll over after it expires. The FCA are already taking action in this area in the Cash Savings market but we believe a wider cross-regulator review of rollovers is needed. This should be coordinated through the UK Regulators Network and, for each market, should make recommendations for how consumers could be moved away from roll-overs.

CONCLUSION

Improving financial capability is essential to boosting living standards and increasing competition and growth in the UK. The Government has recognised this and has promised action. However more needs to be done more quickly.

This report has presented a fresh perspective that should inform the approach going forward. It has shown that:

- While many people in Britain have relatively poor financial capability, they are generally living in households where they could receive support to make financial decisions from someone who has a higher level of capability;
- A small minority of British households (around 500,000) can be classed as capability poor; and
- Even individuals and households with relatively high levels of financial capability can lack confidence in making decisions.

A set of recommendations in this report suggest interventions that could be target at these three groups of households to improve the support they receive. They are targeted at increasing the likelihood that families and friends can actively engage each other when making financial decisions; that all households have the digital tools they need to engage in markets and accurately compare different products and services; and that low income households are helped to make the most of their money. If implemented, they should improve financial outcomes and boost living standards for a wide range of families.

ANNEX 1: MEAN AND MEDIAN TOTAL CAPABILITY SCORE, BY SELECTED CHARACTERISTICS

Characteristics	Mean score	Median
Gender		
Male	21	21
Female	20	20
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Age		
65+	23	23
55-64	22	23
45-54	20	20
35-44	19	19
25-34	19	19
16-24	16	16
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Labour market status		
Retired	23	23
Self Employed	21	21
Employed	21	21
Other inactive	18	17
ILO unemployed	16	15
Inactive due to ill health or disability	15	14
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Household income quintile		
Bottom	16	16
Second	19	19
Middle	21	21
Fourth	22	23
Top	25	25
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Parental situation when a teenager		
Both natural parents	21	21
Lone parent	19	20
One natural parent and new partner	19	19
Care / institution	18	18
Other / DNA	18	17
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Father's economic status when teenager		
Retired	21	21
Employed / SE	21	21
Sick / disabled	19	19
Other / DNA	19	18
Unemployed	17	18
Family worker / home	17	17

ENDNOTES

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[26] Note that Finney & Hayes (2015) outline a six measure of financial capability and a slightly different approach to the measurement of each component. However, the syntax for this approach was not available to us whilst undertaking this research, so we have used the original definitions. A comparison of our results and those of Finney & Hayes (2015) demonstrates that the two approaches yield broadly similar results.
[27] This analysis excludes the Choosing Products component in order to maintain the sample size.
[28] Relatively low (high) capability is defined as being one standard deviation or more below (above) the mean score.
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[31] The cheapest option for the scenario outlined is answer "a"
[32] Based on estimate of 26,700,000 households in the UK (http://www.ons.gov.uk/ons/rel/family-demography/families-and-households/2014/families-and-households-in-the-uk--2014.html) and 700,000 in Northern Ireland (http://www.nisra.gov.uk/archive/census/2011/results/population-estimates/statistics-bulletin-16-07-2012.pdf)

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