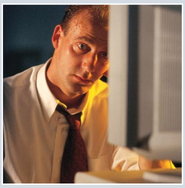
   

A NATIONAL DIVIDEND:

The economic impact of financial advice

Resolution Foundation

About the Resolution Foundation

The Resolution Foundation is an independent research and policy organisation, concerned with how people on low to moderate incomes fare in the mixed welfare economy. We aim to provide new thinking and to deliver change by actively engaging in the policy-making process. Not-for-profit and impartial, we are committed to producing the highest quality socio-economic research and practical proposals for action which are capable of being implemented.

Written by Patrick South
September 2006

Foreword

15 million people in the UK on low to moderate incomes currently have little or no access to financial advice. They are worse off and are exposed to future risk as a result.

The Resolution Foundation has published costed options for delivering a national advice resource to provide impartial, generic financial advice targeted at people in this income group. Such a resource would provide them with the help they urgently need to make the right financial choices.

To evaluate the case for establishing such a resource, the Foundation commissioned modelling from Deloitte & Touche LLP to assess the potential impact of receiving financial advice. We wanted to assess the influence it would have on financial outcomes both for the individual, and for the State in terms of future spending on welfare benefits.

This report presents the results of this work. It shows that, by receiving and acting on financial advice, young people in this income group could increase their financial assets at the age of 60 by an average of £60,000. It also identifies potential public expenditure savings rising from £100 million within 10 years of the advice being delivered, to £800 million later in the century, as better financial decision-making lifts people off Pension Credit.

These findings are significant. They underline just how much could be gained, both by individuals and the State, from providing financial advice. But it would also deliver much more than this. As the report also highlights, it would help achieve wider public policy objectives and bring long term benefits to the financial services industry.

In light of this evidence, the report makes a compelling case for establishing a national financial advice resource.

Clive Cowdery
Chair of the Board of Trustees

Summary

This report evaluates the case for developing a national advice resource to provide impartial, generic financial advice targeted at people on low to moderate incomes. It is based on modelling commissioned from Deloitte & Touche LLP to assess the impact of receiving financial advice on financial outcomes for individuals in this income group and the implications of this for public expenditure on Pension Credit. The report also illustrates how providing financial advice would support key public policy objectives and deliver benefits to the financial services industry.

The modelling highlights the benefits financial advice could deliver to individuals in this income group by improving their financial decision-making. These benefits are most significant for young people and include:

- A potential average increase in personal wealth of around £60,000 by the time they reach 60 years of age
- An increase in annual retirement income of up to £1,500
- A reduction of up to two-thirds in the number of people experiencing financial stress

The modelling also shows the significant savings in public expenditure it could deliver over the coming decades, as improved financial decision-making lifts people off Pension Credit:

- Within 10 years of delivering the advice, annual savings in Pension Credit could be as much as £50 - £100 million
- By 2055, these savings could rise to £200 - £400 million a year
- In the latter half of the century, annual savings could be as high as £400 - £800 million

As the report also sets out, delivering financial advice would support other public policy objectives. By improving financial outcomes and promoting self-reliance, a national financial advice resource would:

- Support and strengthen strategies to improve financial capability and promote financial inclusion
- Play an essential role in supporting pension reform and, in particular, delivering the proposed new system of personal accounts
- Encourage a more preventative approach to tackling debt and provide an opportunity to get on the front foot in response to concerns about this issue
- Reinforce strategies to tackle poverty, reform the welfare system and promote asset-based welfare
- Support efforts to promote healthy living and reduce pressure on the NHS by preventing the health problems associated with financial stress

By helping to facilitate a more effective interface with consumers, providing financial advice would also deliver benefits to the financial services industry including:

- A better functioning market as more engaged consumers stimulate demand and competition
- A reduction in the high distribution costs associated with generating sales among disengaged consumers
- An expanded market, boosted by increased product sales to people in this income group
- A reduction in the significant and growing cost of dealing with complaints

Introduction

The Resolution Foundation has published proposals to establish a national advice resource to provide impartial, generic financial advice targeted at people on low incomes. This report evaluates the case for providing this advice by presenting modelling commissioned from Deloitte & Touche LLP to assess its potential impact on financial outcomes for individuals in this income group and its implications for public spending on Pension Credit.[1] It also draws on other research to show how providing financial advice would support key public policy objectives and deliver benefits to the financial services industry.

The report is published as financial capability is coming under increasing scrutiny. Responsibility for managing financial well-being across the lifecycle, and the risk that accompanies this, is increasingly shifting to the individual. At the same time, changing patterns of work and family life have added further layers of complexity to the decisions people face in planning and managing their finances. These trends will be reinforced over the coming decades by pension reform which places the emphasis on individuals to ensure that they save adequately for their retirement.

In this environment, an effective interface between the consumer and the financial services industry, on which people are increasingly reliant, is essential. However, this interface is currently undermined by a market that often fails to function effectively, complex products and poor communication between the industry and its customers, a lack of access to basic financial products for people on low incomes and mistrust of the industry among consumers, partly driven by high profile market failures. As the Financial Services Authority's recent 'baseline' survey showed, financial capability in the UK is also low, with a significant proportion of the population making poor product choices and failing to plan ahead.[2]

The State therefore has a crucial enabling role to play by supporting people in their financial decision-making and improving the interface between consumers and the financial services industry. This is particularly the case for people on low to moderate incomes who currently have little access to financial advice.

This income group comprises approximately 15 million adults. The Foundation's previous research has shown that people in this group often fail to secure their financial future, are less likely to hold certain financial products and are more likely to suffer from financial stress than higher earners.[3] Crucially, unlike those on higher incomes, they do not have the cushion of wealth to offset poor financial decision-making, leaving them at risk of falling into debt and poverty should their incomes fall or their circumstances change. They therefore have a great deal to gain by making better financial decisions.

This group's financial advice needs are typically not met by the financial services industry which packages up advice with product sales or offers it at commercial rates via independent financial advisers. As they are not reliant on benefits, they are also unlikely to be catered for by services aimed at the poorest and most vulnerable. This lack of accessible advice has been exacerbated over the years by the withdrawal of the industry from providing community-style services as it has sought to improve its competitiveness.

With support from McKinsey & Company, the Resolution Foundation has developed proposals for bridging this 'advice gap' by delivering a national financial advice resource, targeted at this income group. These proposals are predicated on providing impartial, personalised advice to meet a range of needs including product-related advice, financial management advice, advice at different life stages and crisis-related advice. This advice would be 'generic' and not subject to regulation by the Financial Services Authority.[4]

Research carried out to develop these proposals showed that 60 per cent of people would be interested in receiving this advice. 90 per cent of people indicated that they would be willing to use a telephone service, suggesting that much of the advice could be delivered in high volumes, at low cost. Including an element of face-to-face advice would also be important to reach those for whom the telephone and Internet are not accessible.[5]

[1] The modelling is subject to a number of simplifications and assumptions. See technical appendix for further explanation. The views expressed in this report are those of the Resolution Foundation except where expressly otherwise stated.
[2] *Financial capability in the UK: Establishing a baseline;* FSA, 2006
[3] *Closing the advice gap: Providing financial advice to people on low incomes;* Resolution Foundation, 2006
[4] Generic advice is information, advice and guidance that does not involve recommending a course of action in relation to specific providers or products. As such, it is not subject to regulation by the FSA.
[5] See *Closing the advice gap*; Resolution Foundation, May 2006

Based on detailed business analysis and financial modelling, we arrived at a number of fully costed options for delivering a national financial advice resource. Depending on the delivery channels chosen and the scale of the service provided, the annual running costs would be:

- £10-£15 million for an Internet-based service, providing information, interactive tools and access to self-help packs
- £25-£35 million for a telephone advice line, supported by web-based information, enabling personalised advice to be delivered to around 2 million people a year
- £35-£65 million for a telephone and web-based service, augmented by some face-to-face advice, with a combined reach of 2-3.5 million people a year
- £90-£110 million for a comprehensive telephone, web-based and face-to-face advice service, reaching the same number of people but serving a far greater proportion of them with face-to-face advice

The Foundation is currently consulting stakeholders on these options. We will publish the outcome of our consultation process, alongside further research to determine the operational framework for the resource, later in 2006. In the meantime, by evaluating the benefits of financial advice to the individual, the State and the financial services industry, this report aims to inform the debate about establishing this resource.

Research methodology

The Foundation commissioned Deloitte & Touche LLP to model the potential impact of providing generic financial advice to people on low to moderate incomes.[6] The model was designed to illustrate:

- The potential benefits to the individual of receiving financial advice in terms of increased financial assets and retirement income
- The potential reduction in the numbers of people qualifying for Pension Credit in retirement and the public expenditure implications associated with this[7]

The Foundation's previous research has defined its target group of people on low to moderate incomes. This established that approximately 12 million adults in the UK are on below median incomes and receive no more than 20 per cent of their income from welfare benefits. A further 3 million elderly people are on below median incomes and do not receive means-tested benefits. This research also segmented the target group into five key life stage clusters: young people, families, middle-aged people, those on the eve of retirement and elderly people.[8]

The model takes individuals from the different clusters and builds in a series of assumptions about:

- Their individual characteristics including age, gender, income, working patterns and wealth, based on the Foundation's research[9]
- The life events (such as marriage, divorce, redundancy, inheritance and retirement) that will drive their income, expenditure, debt and savings[10]
- The typical outcomes that are likely to emerge should individuals not receive financial advice, based on observable financial behaviour among the population[11]
- The potential impact of financial advice on consumption patterns, debt repayments, investment income and other assets and liabilities[12]

6 Existing research has not established a firm causal link between receiving financial advice and improvements in financial well-being. However, previous analysis by Deloitte has demonstrated a relationship between the two, with those receiving advice more likely, for example, to accumulate greater wealth, hold more financial products, be willing to take some risk with their money and claim to be more interested and confident in financial matters.

7 The model does not 'prove' that financial advice would deliver improved outcomes but rather assumes a more optimal set of financial decisions would be made in the event of an individual receiving and acting on the advice.

8 See *Closing the advice gap*; Resolution Foundation, 2006

9 Ibid; information based on analysis of the British Household Panel Survey (BHPS) and the FSA's baseline survey of financial capability

10 The incidence of these events is based on data from a number of sources including the BHPS, FSA baseline survey, Office for National Statistics' Expenditure and Food Survey and Deloitte's 'wealth' database

11 This information is calibrated through the same sources as above

12 Calibrated through discussions based on existing evidence and advice from industry experts

The projected outputs if individuals do not receive financial advice are based on existing evidence which shows that people often do not optimise their financial decision-making. For example, they often borrow using high interest rate products, do not save when they have the opportunity to do so and achieve poor rates of return on their investments.

These assumptions are changed to illustrate the potential impact of receiving financial advice. For example, people are assumed to achieve:

- A better balance between consumption and saving
- More efficient management of debt (for example, high interest rate debts are paid off first)
- Improved interest rates on savings and debts
- A better balance between short and long term saving and improved annuity rates in retirement

Based on these assumptions, the model calculates the expected surplus or deficit in income against expenditure for individuals each year and projects forward how that surplus or deficit will be used. Using the Monte Carlo technique,[13] 1,000 iterations are run for each cluster group to account for the probability of different life stage events. This gives rise to different income and expenditure patterns for 1,000 'typical' consumers in each of the clusters.

A set of rules is then imposed that describe how the individuals deal with surpluses and deficits in their income for each year of their life. The model produces outputs to illustrate the potential impact on the basis of three scenarios: that they receive no financial advice, act on some of the advice they receive or respond fully to the advice over the remainder of their lifetime.

The average outputs for each cluster and for each scenario include:

- The personal wealth accumulated by individuals with a particular focus on age 60 and retirement age
- The proportion of people experiencing financial stress during their lifetime
- The value of contributions paid into personal pension schemes
- The value of the individual's pension fund at the time of retirement
- The average annual annuity rate received in retirement
- The value and average annual amount of Pension Credit received in retirement
- The total value of the individual's consumption over the remainder of their lifetime
- The proportion of each cluster who experience financial difficulty over the remainder of their lifetime and the income deficit that cannot be met by drawing down savings or borrowing

The individual results are then scaled up to estimate the impact on the number of people eligible for Pension Credit in retirement and the public expenditure implications associated with this. These estimates are calculated on the basis of 10 and 20 per cent of the target group changing their behaviour by acting on the advice they receive.

During the period covered by the modelling, the Government's new pension reforms will come into force. Where possible, the research accounts for this by modelling outcomes under the current system and then adjusting for the impact of the reforms in later years. Thus, it assumes that, unless forced by ill health, people will retire at the current state pension age until the point at which the reforms are due to be implemented, when it is assumed that they will retire later, in line with the proposed reforms.[14] The model also links the Basic State Pension with earnings from 2012, in line with the Government's proposals.

It has not been possible to include the impact of the proposed new system of personal accounts within the model.[15] The advent of personal accounts, which would lead to more people saving for their retirement, is likely to increase the benefits to the individual and the State outlined in this report.

[13] A research technique which involves running several iterations to minimise the impact of uncertainty on the analysis

[14] The state retirement age is currently 65 for men and 60 for women (this will rise to 65 by 2020). The Government's proposed pension reforms will see the state pension age for men and women increase to 68 by 2044.

[15] The Pensions White Paper proposes to implement personal accounts from 2012

The benefits to the individual

The FSA's baseline survey of financial capability showed that people are generally poor at choosing financial products and planning ahead. Although the survey also showed that income is not a key determinant of financial capability, the Foundation's research has highlighted some important differences between the financial health and decision-making of people on low to moderate incomes, in comparison with higher earners, including:

- They are much less likely to be members of an available employer's pension scheme; only 53 per cent are members of such a scheme compared to 81 per cent of those on higher incomes
- They are less likely to hold certain insurance products; only 40 per cent have life insurance compared to 55 per cent of those on higher incomes and they are only around half as likely to have protection products
- Nearly a quarter of the group have 'chronic' financial health problems, including high numbers of families and middle-aged people, with one in ten facing 'acute' difficulties and potentially reaching crisis point[16]

Crucially, unlike those on higher incomes, people in this income group do not have the cushion of wealth to offset poor financial decision-making, leaving them at risk of falling into debt and poverty should their incomes fall or their circumstances change. They therefore have a great deal to gain by making better financial decisions.

Previous research by the FSA has shown that the typical consumer could gain between £70 and £710 a year by making better financial product choices.[17] The Deloitte modelling highlights potentially significant additional benefits to people in this income group from receiving financial advice including:

- Increased personal wealth, reduced reliance on State support and a higher standard of living over their lifetime
- A more optimised portfolio of financial products, providing greater protection against adverse movements in the economy or changes in circumstances
- Reduced levels of financial stress
- Higher levels of income in retirement for the majority of people

Income and expenditure

An illustrative example of the potential impact on income and expenditure of receiving financial advice is shown by the graphs opposite. This is based on a 25 year old man who gets married and buys a house when he is 31. His earnings increase from £12,000 a year at the age of 25 to £25,000 when is 49.[18] In the meantime, he has two children in his early 30s. He is made redundant at the age of 50, before setting up his own business two years later and retiring at the age of 68.

Chart 1 shows his income and expenditure over the remainder of his lifetime on the basis that he does not receive any financial advice. His income rises in his late 20s and early 30s as his salary increases, reflecting progression in his career. This is matched by increased expenditure which exceeds his income throughout his 30s and 40s, peaking when he buys a house, gets married and has children. Both income and expenditure fall significantly when he is made redundant and drop again when he reaches retirement.

Chart 2 illustrates the potential impact of receiving financial advice. It shows a closer alignment between expenditure and income in the man's 30s, 40s and mid-50s, as he manages his expenditure better and secures better interest rates on his debt. Most significantly, by contributing to a private pension, he achieves an increase in his income of £3,000 a year when he retires.

[16] See *Closing the advice gap*, Resolution Foundation, 2006; financial health findings based on analysis of the BHPS and FSA baseline survey
[17] *Losing interest: How much can consumers save by shopping around for financial products?* FSA occasional paper series 19, October 2002
[18] All values are expressed in real terms

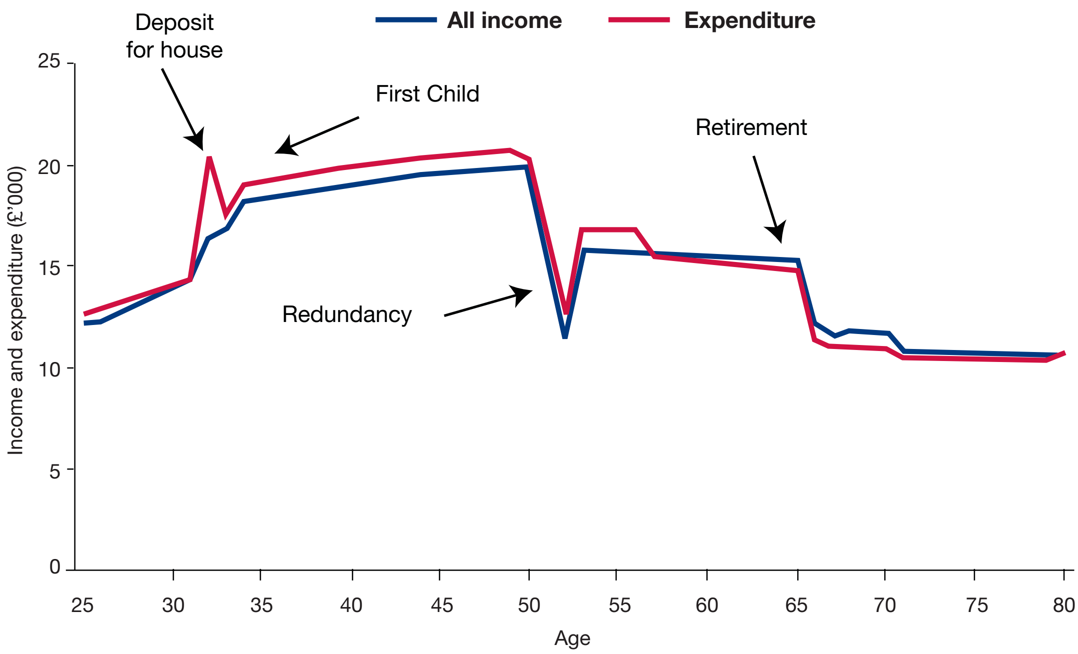


Chart 1: Income and expenditure (before advice)

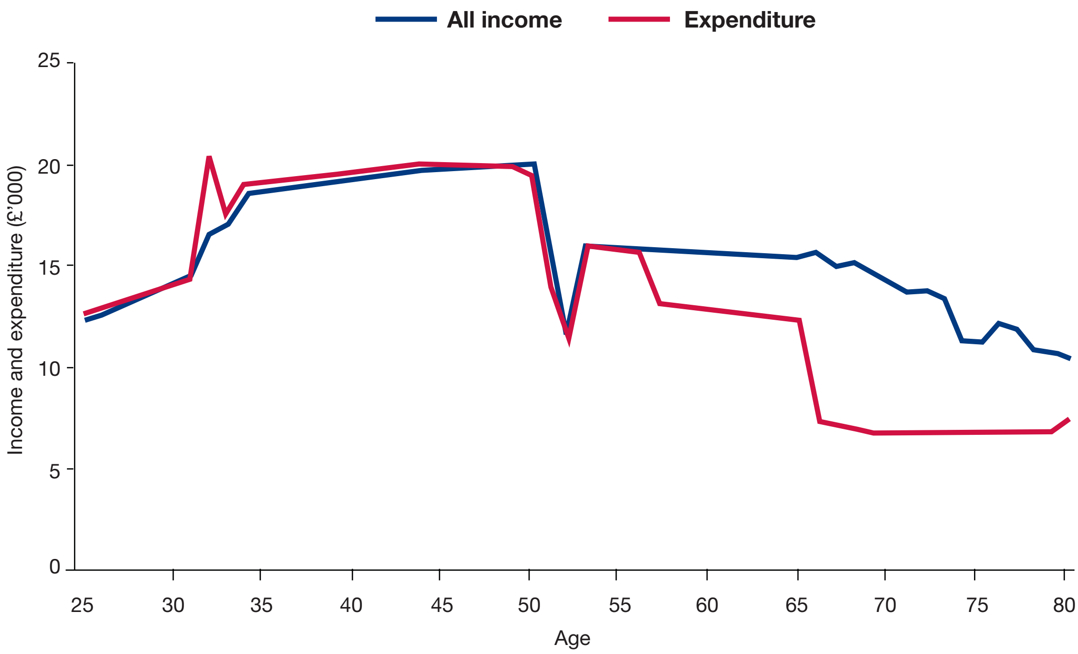
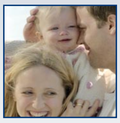


Chart 2: Income and expenditure (after advice)

Financial product holdings

The model can also be used to illustrate the effect of receiving financial advice on the portfolio of financial products held by the same individual. Chart 3 shows the value of his assets and debts at different points over his lifetime. His main asset is the value of his house which for these purposes is assumed to appreciate over time at an annual rate of 1 per cent above the growth of his income and expenditure. Alongside the mortgage he takes out to buy his home, he also has credit card and other debts that he uses to finance his day-to-day expenditure. However, his mix of products, interest rates and payments are not optimised.

Chart 4 shows the potential impact of receiving advice:

- His debt is managed more efficiently and is eliminated by the time he is 60
- He and his wife take out life insurance to provide cover in the event that one of them dies
- Optimising his savings and contributing instead to a private pension provides for a much higher income in retirement
- Further savings and investments are accumulated after he retires, providing a cushion during his later years

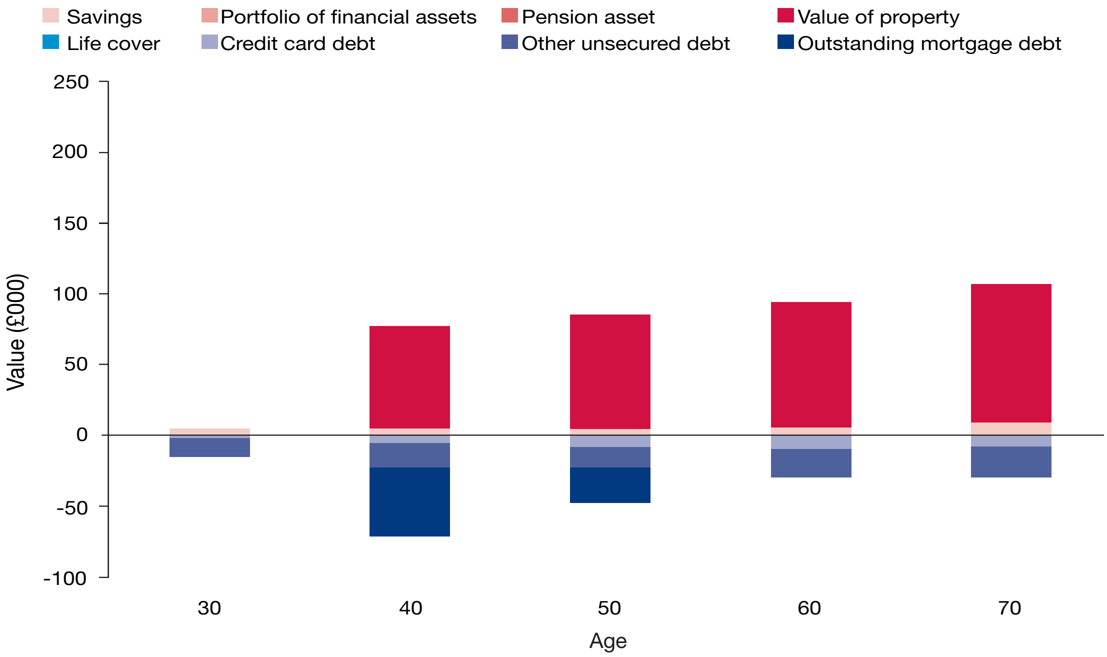


Chart 3: Financial product holdings (before advice)

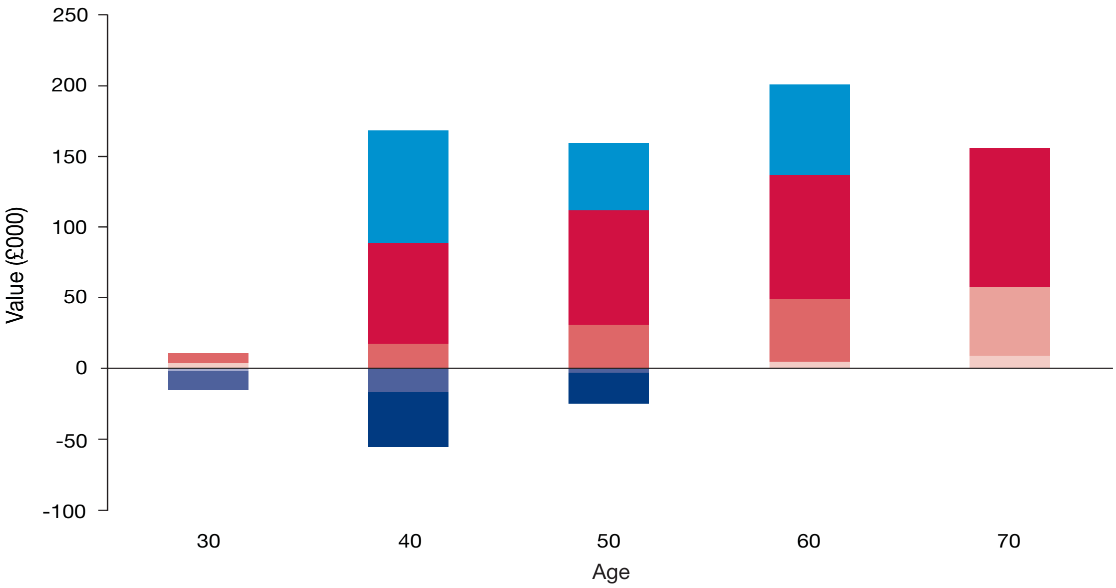


Chart 4: Financial product holdings (after advice)

Personal wealth and consumption

By improving financial decision-making and helping them access appropriate products, financial advice could significantly increase personal wealth among people in the target group. Chart 5 shows the impact of acting on financial advice on the value of financial assests held at retirement across the different life-stage clusters. As the chart shows, the impact is greatest among young people where personal wealth (including housing wealth) is improved by an average of around £60,000. This represents an increase of 60 per cent on the value of wealth if advice is not received.

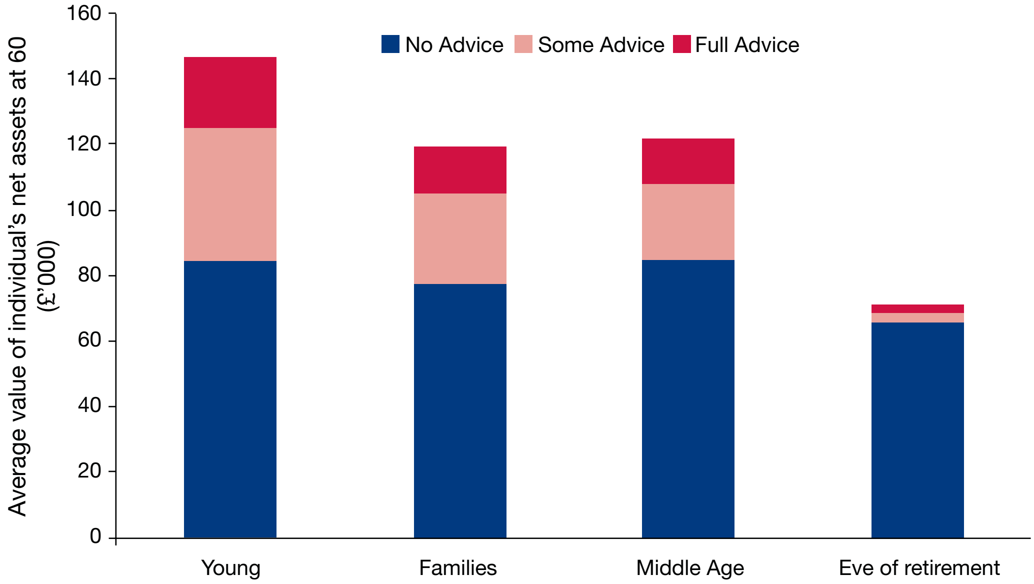


Chart 5: Financial assets at retirement

One of the assumptions behind the projected expenditure outputs from the model is that receiving advice is likely to improve people's day-to-day financial management and budgeting skills, particularly in periods of low income. Chart 6 shows how this typically leads to an overall increase in consumption over the lifecycle, and therefore a higher standard of living, as people's financial decisions are optimised. In most cases, the increased consumption will largely be deferred until later in life, with the greatest benefits experienced by the younger age groups due to the time it takes for these benefits to accrue.

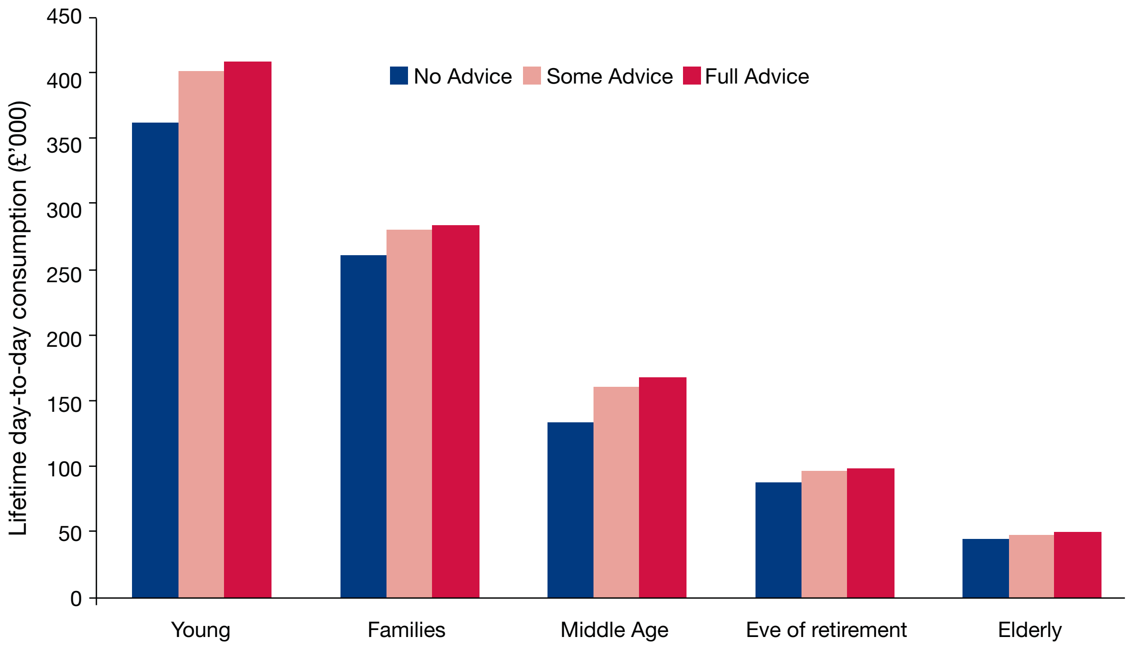


Chart 6: Lifetime consumption

Financial stress

As set out above, the Foundation's previous research has shown that a significant proportion of the target group suffer from poor financial health and are at risk of falling into crisis should their incomes fall or their circumstances change. The model assesses financial stress by projecting the number of people whose income fails to match their expenditure over a prolonged period, forcing them to take drastic action to reduce their expenditure. Chart 7 highlights a significant reduction in the number of people experiencing financial stress at some point in their lives, as a result of receiving financial advice. This shows that it would be possible to achieve an average reduction of around two-thirds in the proportion of people in the target group experiencing financial stress over their lifetime.

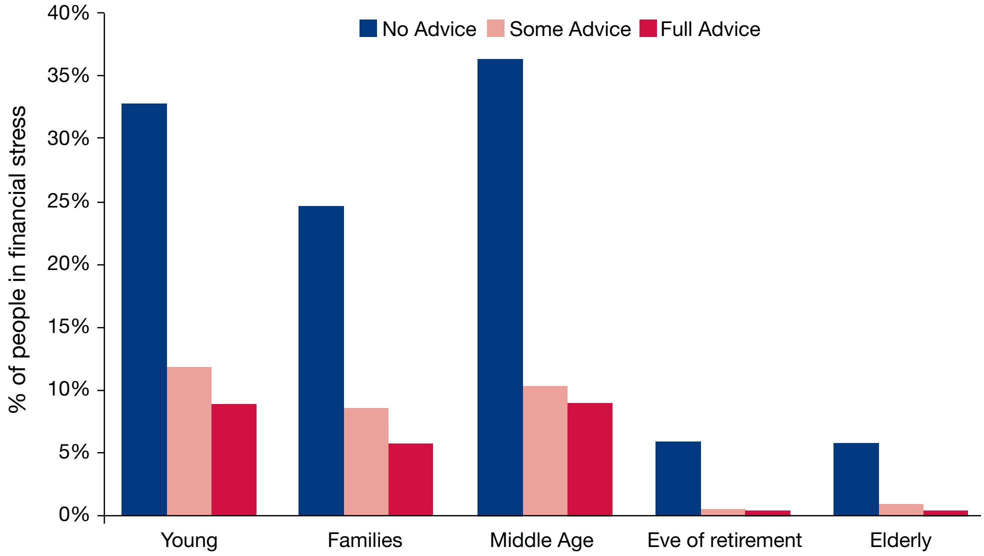


Chart 7: Proportion of people experiencing financial stress

Retirement income

The Pensions Commission's report highlighted that large numbers of people on low to moderate incomes are failing to plan adequately for their retirement.[19] The Foundation's research has also shown that a significant proportion of this income group do not belong to an available occupational pension scheme or hold a personal pension.

The model illustrates the impact on retirement income of increased and more regular pension contributions, made as a result of acting on financial advice. Chart 8 highlights the increase in the average pension fund, which is far greater among the younger generations than for those in the older clusters. It shows a projected increase in the average fund on retirement for the young cluster from just under £10,000 to nearly £40,000.

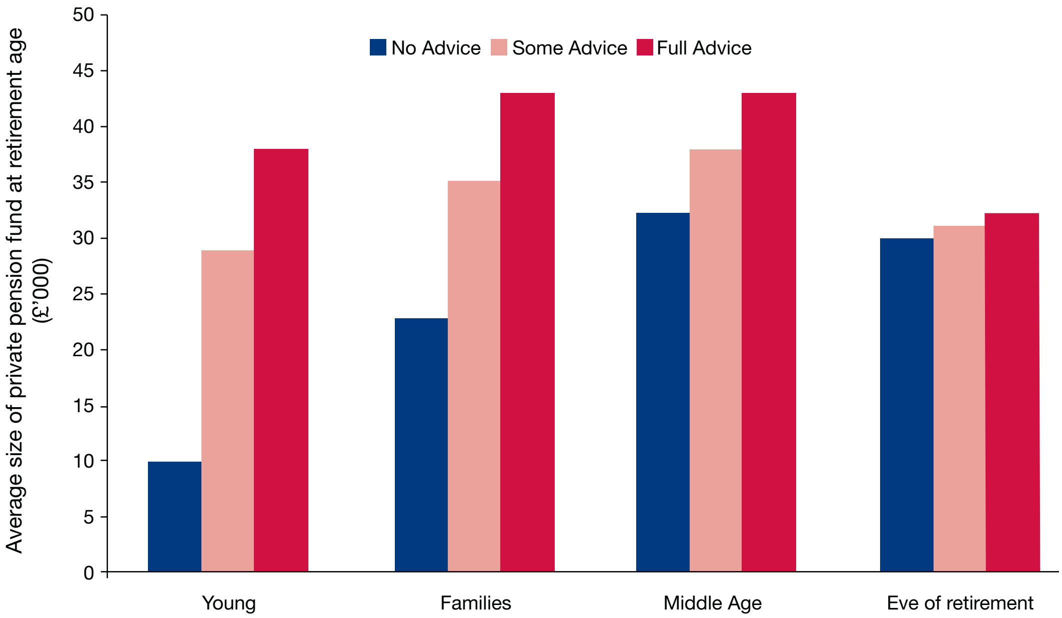


Chart 8: Average size of private pension fund at retirement

[19] *A new pensions settlement for the 21st century*: Second report of the Pensions Commission; April 2006

Chart 9 shows the increase in the average annuity received. This is predicated on the impact of increased contributions on the overall size of pension fund at retirement and the improved annuity rate that can be secured by shopping around on the open market, rather than simply taking the rate offered by an individual's pension provider. Research indicates that people can achieve an increase in income of 10 per cent or more by moving to another provider, although only 40 per cent currently exercise their option to do this.[20]

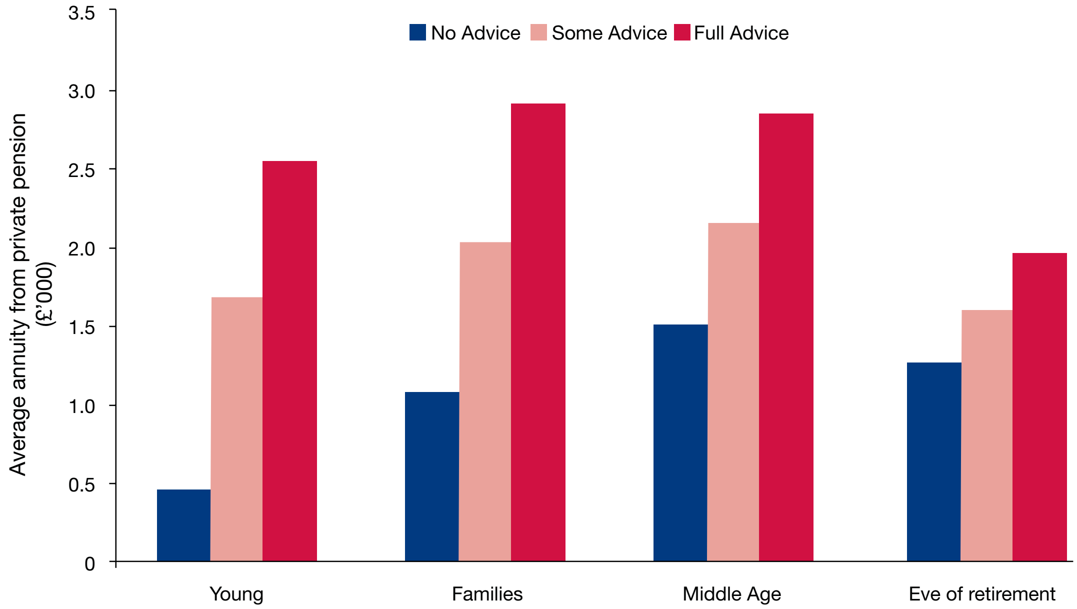


Chart 9: Average annuity from private pension

The model also shows the potential impact of improved financial decision-making on the receipt of Pension Credit. Pension Credit is paid on a means-tested basis to ensure that pensioners' incomes do not fall below a minimum level. As income, personal wealth and asset holdings increase as a result of improved financial decision-making, more people are lifted above the threshold for receiving it. Chart 10 shows how the amount received in Pension Credit falls as a result of receiving financial advice.

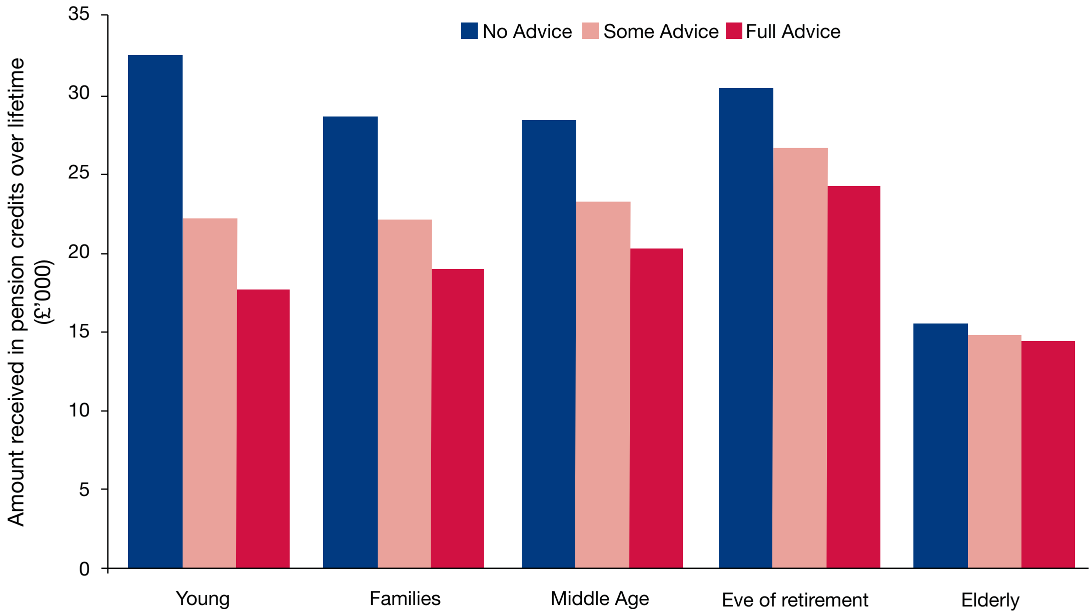
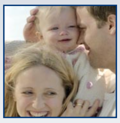


Chart 10: Amount received in Pension Credit

[20] *Annuities: Bonus or burden*; ABI, 2005






Although some people may suffer a net loss of income in retirement due to the loss of Pension Credit,[21] Chart 11 shows that the overall effect for the majority of people is that the income generated far outweighs the amount lost in Pension Credit.

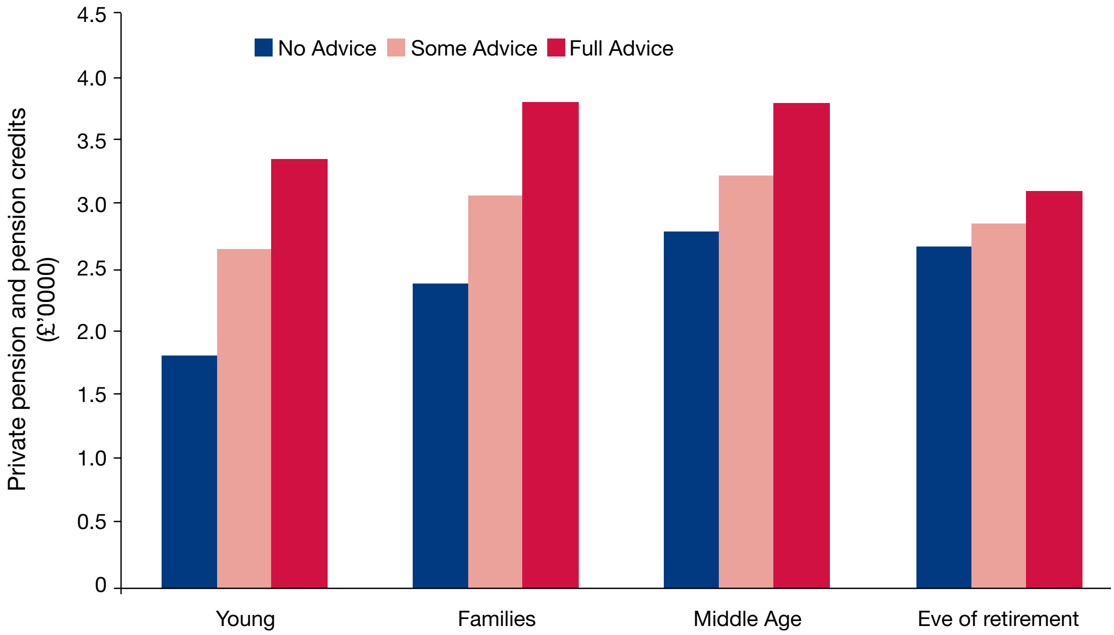


Chart 11: Net retirement income

[21] The model shows that the majority of the income group would experience an increase in consumption over their lifetime. However, for a minority of approximately 20 per cent of people, the model suggests that they would not be better off, as reductions in Pension Credit would not be offset by increased income in retirement. The financial advice provided would therefore need to be modified to reflect their particular circumstances.

The benefits to the State

In addition to estimating the potential impact of receiving financial advice on the individual, the model also assesses the associated implications for public expenditure on Pension Credit.

Pension Credit is currently claimed by more than 2 million people. It is paid on a means-tested basis to ensure that pensioners' incomes do not fall below a minimum level. It includes two elements, a Guarantee Credit, which brings weekly income up to the guaranteed threshold,[22] and a Savings Credit which aims to ensure that those who have accumulated savings are rewarded.

As set out above, by increasing income, personal wealth and asset holdings, financial advice would help lift people above the threshold for receiving Pension Credit. In calculating the annual impact of receiving advice on Pension Credit payments, there would be a time lag before the full benefits are realised:

- Within 10 years of financial advice being delivered, savings could only be made from those currently in the elderly cluster group
- In the following decade, additional savings would be made as people currently in the eve of retirement cluster reach retirement age
- Over the decade after that, further savings would be generated as people currently in the middle-aged cluster begin reaching retirement age

Eventually, young people and those in the families cluster will reach retirement age, at which point the savings will reach their peak as far as the current members of the target group are concerned.

Charts 12 and 13 illustrate the impact if 10 per cent and 20 per cent of people in the target group receive and act on the advice they are given:

- Within 10 years of financial advice being delivered, annual savings in Pension Credit would be £50 - £100 million
- These savings increase, year-on-year over the following three decades, peaking at £200 - £400 million a year in 2055

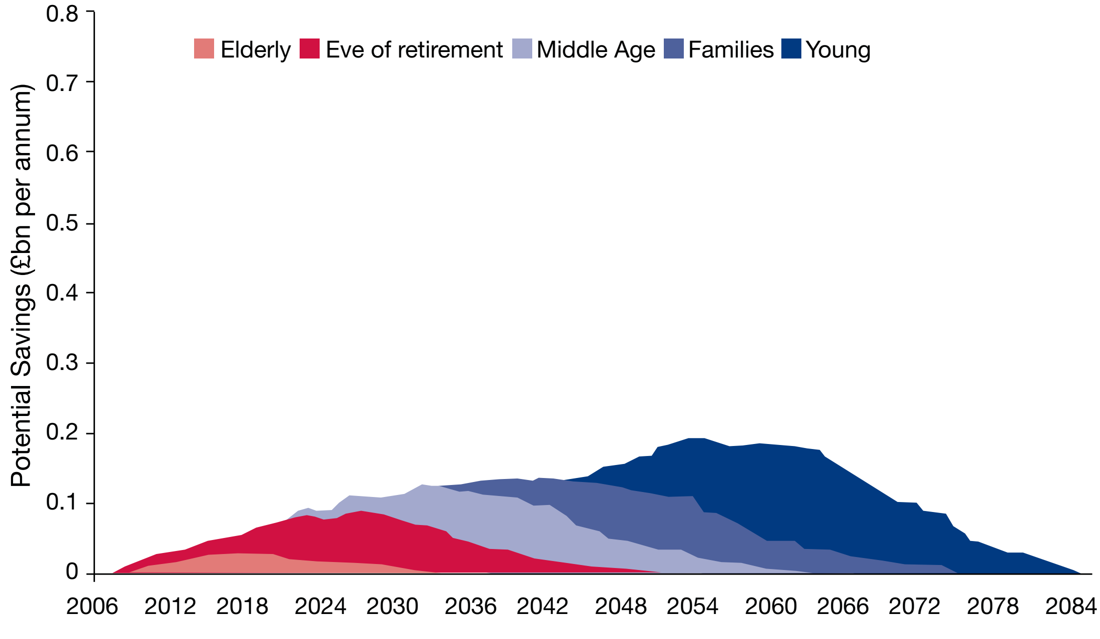


Chart 12: Annual savings in spending on Pension Credit for today's target group (if 10 per cent respond to advice)

[22] The threshold is currently £114.05 per week for single people and £174.05 per week for couples

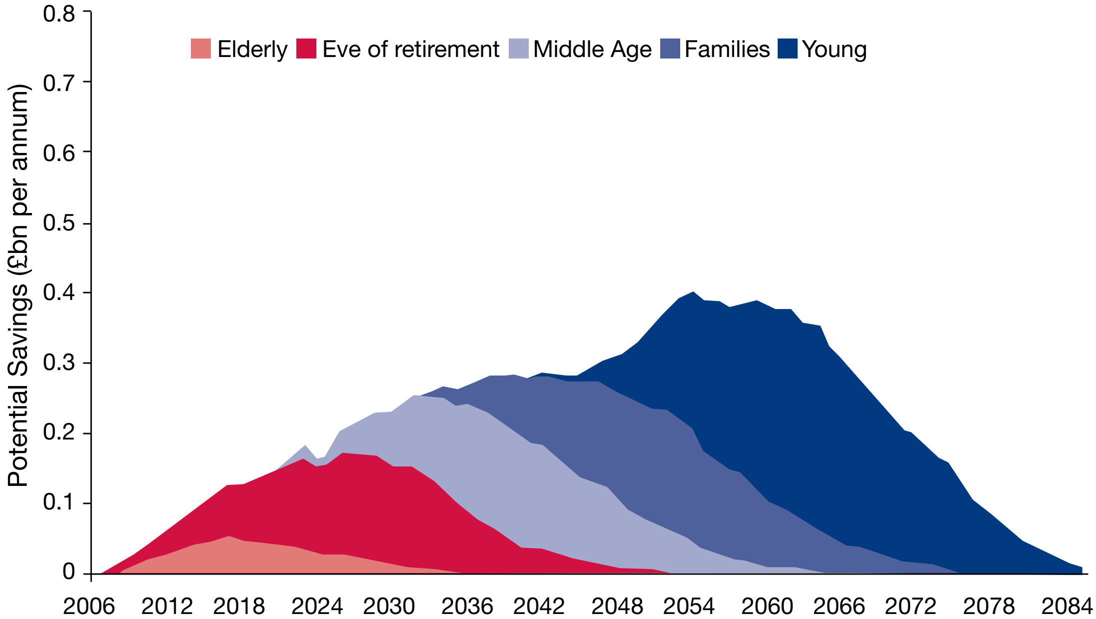


Chart 13: Annual savings in spending on Pension Credit for today's target group (if 20 per cent respond to advice)

However, to assess the full potential of the savings that could be generated, it is also necessary to include future generations who are not in the target group today. As charts 14 and 15 show, as these generations reach retirement age, savings continue to increase in the latter half of the century, reaching £400 - £800 million.

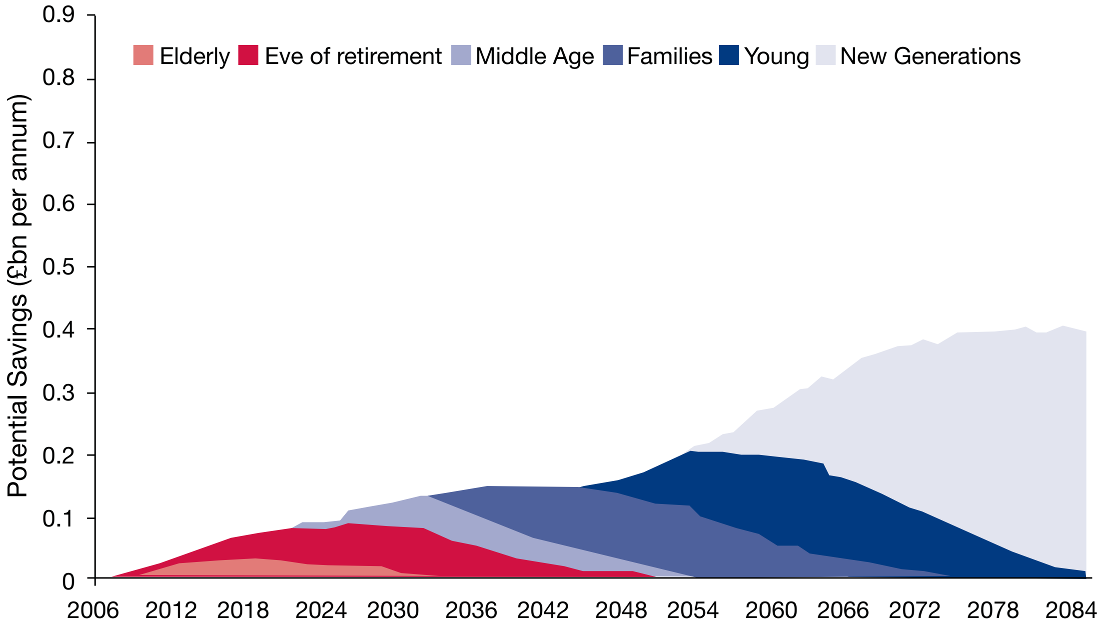


Chart 14: Annual savings in spending on Pension Credit including future generations (if 10 per cent respond to advice)

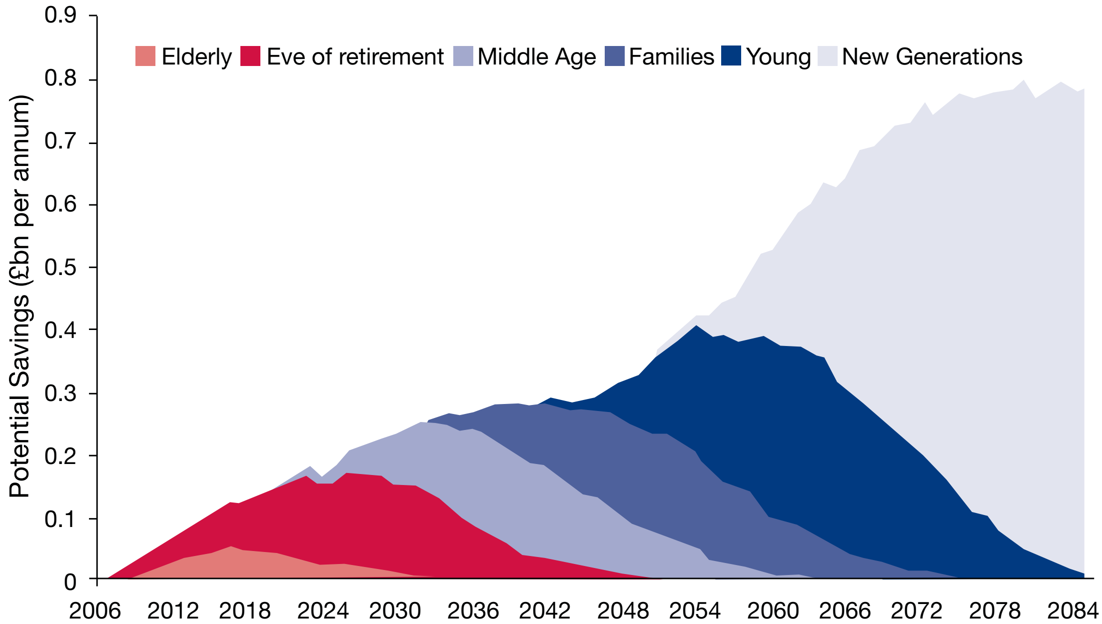
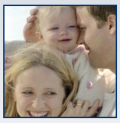


Chart 15: Annual savings in spending on Pension Credit including future generations (if 20 per cent respond to advice)

Supporting public policy

As set out above, a national financial advice resource would deliver significant public expenditure savings by reducing reliance on Pension Credit. It would also benefit the economy by increasing personal wealth and consumption, and by helping to deliver a more efficient and competitive financial services market (see below). In addition, it would support a number of broader public policy objectives.

Improving financial capability and promoting financial inclusion

At the same time as it published the results of its baseline survey of financial capability, the FSA launched its *Delivering change* strategy.[23] This set out a number of initiatives to improve financial capability which are primarily focused on financial education and literacy. These initiatives include teaching personal financial education in schools, using seminars to deliver financial information in the workplace and developing online tools to help people manage their finances. Although providing generic financial advice is one of the seven key priorities identified in the strategy, progress in taking it forward has been limited compared to other areas of the strategy.

A £120 million Financial Inclusion Fund has been set up to support initiatives aimed at tackling financial exclusion. Progress is monitored by a Financial Inclusion Taskforce, with action currently focusing on three areas:

- Widening access to 'basic' banking services, with a goal to halve the number of people in households without a bank account
- Expanding access to affordable credit, with £36 million in government funding supporting the growth of credit unions and community development finance institutions
- Increasing the availability of face-to-face debt advice, with £45 million being invested in new services

Earlier this year, the Treasury Select Committee conducted a significant and wide-ranging inquiry into financial inclusion. The Committee's report is due to be published in the autumn.

Although the measures set out in the Financial Capability Strategy are very welcome, they will take time to deliver results and are not, on their own, enough to deliver the step change needed. Likewise, although the Foundation strongly supports the initiatives being taken forward to tackle financial exclusion, they will not bridge the financial advice gap for people on low to moderate incomes.

By providing impartial, personalised financial advice to the current generation of people in this income group, a national financial advice resource would address this. It would also play an important role in supporting these agendas by engaging people in their financial decisions and improving their understanding of the financial services system, encouraging them to plan ahead and optimise their financial assets and preventing them from falling into financial difficulty and debt.

Supporting pension reform

Pensions decisions are among the most complex and important financial choices people make during their lifetime. However, understanding of the pensions system is low and many people are failing to plan adequately for their retirement, particularly those on low to moderate incomes.

The Foundation's research supports this. As set out above, this shows that only around half of this income group are members of an available occupational pension scheme, compared to over 80 per cent of those on higher incomes. It also shows that they are less likely to have a private pension; only 17 per cent of the group are members of personal pension schemes compared to 27 per cent of those on higher incomes.

Tackling undersaving for retirement among this income group is a key aim of the new system of personal accounts proposed in the Pensions White Paper.[24] In drawing up the proposals on which they are based, the Pensions Commission stated that such a system 'will provide to low and middle earners the opportunity to save at low costs currently only available to those with higher incomes or working for large private companies or the public sector'.[25]

Personal accounts are based on using 'auto-enrolment' to overcome the inertia associated with saving for retirement. However, they will still leave people with a number of complex decisions to make across their pensions lifecycle:

- In deciding whether to participate in or opt out of personal accounts, people will need to consider their other financial commitments; those with high levels of outstanding debt, for example, may be better off opting out, at least in the short term
- When they first come into contact with the scheme, people may need to choose between different options, for example in relation to investment choices and, potentially, product providers[26]

[23] *Financial capability in the UK: Delivering change*; FSA, 2006
[24] *Security and retirement*: *Towards a new pensions system*; DWP, May 2006
[25] *A new pensions settlement for the 21st century*: The second report of the Pensions Commission; April 2006
[26] The Pensions White Paper leaves open the question of whether personal accounts should be provided by a single organisation or whether there should be competition among branded providers

- People may wish to change their contribution levels or reconsider their options over time; for example if their circumstances change, they reconsider their retirement aspirations or the system itself changes

- When they reach retirement age, people will need to make decisions about realising their pensions assets such as purchasing an annuity and consider these decisions alongside other issues such as their long term care needs

Generic financial advice could have an important role to play in helping people make these decisions, particularly as personal accounts are predicated on the basis of removing the 'regulated' advice which must accompany the sale of personal pension products.

The Pensions White Paper identifies personal responsibility as one of the five key tests of reform, stating 'we need to be clear that individuals must be responsible for their own plans for retirement'. As well as delivering the savings in Pension Credit identified by the Deloitte modelling, financial advice would support personal responsibility by lifting more people off Pension Credit and encouraging them to engage with their pensions decisions.

Two parliamentary select committees have stressed the importance of generic advice in relation to pension reform. In its report on the design of the proposed National Pensions Savings Scheme, published in May 2006, the Treasury Committee concluded:

> 'We recommend that the Government give consideration at an early stage in implementation of an NPSS or any comparable measure to the design and availability of generic advice to those considering participation in the scheme as well as to scheme members.'[27]

In its wide-ranging report on pension reform published in July 2006, the Work and Pensions Committee stated:

> 'We conclude that a strong case has been made for the provision of free generic advice to those on below median incomes and recommend that DWP, DTI and the Treasury continue to work with organisations such as Citizens Advice and the Resolution Foundation to develop a model to meet the needs of this group and make the necessary resources available.'[28]

Developing an effective strategy for meeting information and advice needs will be critical to the success of the Government's pension reforms. Although the Pensions White Paper stresses the importance of this, it is unclear about how it will be achieved. A national financial advice resource would play an essential role in supporting the objectives of pension reform and should play a key role in that strategy.

Tackling debt

At the end of 2005, total consumer debt stood at over £1.25 trillion, a six-fold increase over two decades. Up to now, rising house prices and the strength of the economy have meant that the fears expressed by many commentators about the consequences of mounting debt have not so far been realised. However, some worrying trends are beginning to emerge:

- Although starting from historically low levels, mortgage repossessions have begun to rise sharply for the first time since the early 1990s. More than 8,000 homes were repossessed in the first half of 2006, an increase of 76 per cent on the same period in 2005.[29]

- Having risen steadily for 18 consecutive quarters, the number of individual insolvencies has increased sharply in recent quarters. A record 50,000 individual insolvencies were recorded in the first half of 2006, a 70 per cent increase on the first half of last year.[30]

- In 2004, over £4 billion of bad debts were written off by the banks, almost double the figure of four years previously.[31] All the main high street banks recorded further sharp increases in bad debts in the first half of 2006.

Although debt remains a serious problem for only a small proportion of the population, these trends indicate that it is beginning to take a significant toll. With interest rates also rising in August 2006 for the first time in two years, there is no doubt that large numbers of people would be at risk of falling into severe difficulty should there be a downturn in the economy, with those on low incomes particularly at risk.

In response to mounting concern about the problems associated with rising debt, the Government published an action plan to tackle over-indebtedness in July 2004,[32] following this with the investment in face-to-face debt services made available through the Financial Inclusion Fund. A new Consumer Credit Act will tackle irresponsible lending. The Competition Commission is also investigating the doorstep lending industry following a 'super complaint' by the National Consumer Council to the Office of Fair Trading.

[27] *The design of the National Pensions Savings Scheme and the role of financial services regulation*; Fifth report of session 2005-06 (HC 1074-I)
[28] *Pension reform*; Fourth report of session 2005-06 (HC 1068-I)
[29] *Repossession risk review*; CML, August 2006
[30] *Statistics release: Insolvencies in the second quarter 2006*; The Insolvency Service, August 2006
[31] Babb et al: *Social trends*; Office for National Statistics, 2006
[32] *Tackling over-indebtedness*; DTI/DWP, July 2004

However, the emphasis is still very much on providing remedial services that intervene once people have reached crisis point. The Deloitte modelling shows how financial advice could improve product sequencing, reduce debt and prevent financial stress. A national financial advice resource would therefore offer people the opportunity to take preventative action to manage and plan their finances more effectively, before crisis intervention becomes necessary. It would also provide the Government with an opportunity to get on the front foot amidst rising concern about the current situation.

Poverty, welfare reform and asset-ownership

Without the cushion of wealth or the protection of insurance products, people on low to moderate incomes are at risk of falling into poverty should their incomes fall or their circumstances change. This is particularly true for those on the margins of the group, who often fall beneath the lower income threshold and become more dependent on benefits. Many are also at risk of poverty in old age as they are failing to plan for their retirement.

Financial advice would prevent people from falling into poverty by improving their financial decision-making and encouraging them to invest in the financial products they need to protect themselves against fluctuations in income. It would also reduce pensioner poverty by encouraging people to take out pensions and lifting them clear of Pension Credit.

By promoting self-reliance, financial advice would also support the Government's approach to welfare reform and, in particular, asset-based welfare policies. The asset-based welfare agenda has so far mainly focused on two areas:

- The Child Trust Fund aims to provide all children with a financial asset when they turn 18. The Government contributes vouchers worth £250 (£500 for those on low incomes) when children are born and again at age seven.[33] The accounts offer parents and friends the opportunity to contribute up to £1,200 a year. Over 1.5 million accounts have so far been opened.

- The Savings Gateway, which is currently being piloted in a number of areas across the country, aims to encourage people on low incomes to save by matching their savings with a government contribution. After 18 months, the accounts mature, providing a stepping stone to mainstream accounts and services. Over 20,000 accounts have been opened in the latest pilot areas.

Realising the potential of these policies depends on people being able to make appropriate decisions about savings levels and investment choices. Financial advice would assist them in making these decisions. For example, it could prompt many more people to make proactive decisions about how to invest their Child Trust Fund vouchers and encourage them to contribute to their children's accounts. The outputs from the Deloitte modelling suggest that financial advice could also support asset-based policies more broadly by promoting the benefits of savings and other assets, and encouraging them to optimise the assets they hold.

Improving health

The Deloitte work also highlighted the potential impact of improved financial decision-making in reducing levels of financial stress. This could also deliver benefits in terms of health; research has shown that financial stress is often linked to health problems.

A study in the United States found that 42 per cent of clients of a national credit counselling organisation reported that their health had been affected by their financial problems, citing symptoms such as stress, depression, insomnia, migraines, digestive problems, ulcers and fatigue. 48 per cent of clients reported that their health improved after they received financial counselling.[34]

A survey carried out by AXA in the UK found that:

- Over 40 per cent of people have experienced stress or illness due to money worries

- 3.8 million people admit to having taken time off work as a result

- Nearly 11 million say that it has affected their relationships[35]

Recent government statements have placed increasing emphasis on preventing health problems from occurring in the first place, rather than simply treating the symptoms. In a major speech on public health in July 2006, the Prime Minister set out his 'healthy living' agenda, encouraging individuals, business and the Government to work together to reduce the demands on the NHS by living more healthily.[36] By significantly reducing financial stress, and therefore the health problems associated with this, a national financial advice resource could play an important role in improving public health and supporting this agenda.

[33] Consultation is currently taking place on whether a further payment should be made at secondary school age
[34] *Health, financial well-being and financial practices of financially distressed consumers*; O'Neill et al, 2005
[35] AXA press release, 20 January 2006
[36] Speech on healthy living, Tony Blair, 26 July 2006

The benefits to the financial services industry

The Foundation has argued that a national financial advice resource would deliver both a public good to society and benefits to the financial services industry. Forthcoming research will show that the commercial benefits to individual firms are insufficient for them to provide generic financial advice to this income group.[37] Nonetheless, as set out below, the benefits that financial advice would deliver to the industry's long term health underline the case for it to support the development of such a resource.

Market efficiencies

The financial services industry makes a significant contribution to the economy, generating up to 9 per cent of the UK's GDP. However, the market is currently characterised by disengaged consumers, complex products and low levels of trust. The weak position of consumers, who often lack the knowledge and tools to engage effectively with the industry, creates demand-side weaknesses which undermine the efficiency of the market. This often leads to a poor customer experience, damaging the industry's reputation with the public. Past reforms have not addressed this, concentrating instead on supply side regulation. Some in the industry argue that this has served to increase costs and further undermined the consumer's experience of the industry.

Providing generic financial advice could help change the dynamics of the market. In raising awareness of the existence and benefits of financial products among consumers, it should stimulate demand. By helping to create more informed, confident consumers ready to engage with the industry, it should, in turn, reduce distribution costs (see below) and encourage a more effective interface between consumers and the industry, enabling them to purchase more appropriate products that meet their needs.

By improving this interface, a national financial advice resource would provide the industry with an opportunity to support demand-side reform and, in partnership with the Government, take action to improve its long term health and reputation. As well as generating market efficiencies, this could also result in a regulatory dividend for the industry.

Distribution costs and persistency

As a result of its poor interface with consumers, the financial services industry has to invest very large sums of money in attracting new customers. For example, the Pensions Commission reported that at least 75 per cent of the costs of providing a pension is currently incurred in upfront selling and set-up costs.[38] As a whole, the financial services industry spends £1.5 billion on advertising and promotion.[39]

These costs reflect the poor response levels generated by marketing efforts (direct mailings typically generate response rates of just 1 per cent) and poor conversion rates from enquiries to sales. The industry can only meet these costs through upfront charges, exit penalties (which are now becoming unsustainable due to regulatory changes) or by recovering them over the lifetime of the product. 'Persistency' (product loyalty) is therefore critical. However, FSA data shows that less than half of individual life and pensions policy purchases are still in place after four years.

By creating more informed consumers, ready to engage with the industry, financial advice could help drive down sales and distribution costs. And, by helping people to identify, understand and purchase appropriate products, it could generate stronger product loyalty, helping to underpin the sustainability of the industry's business models. In the long term, this could also reduce costs to the consumer.

Market size

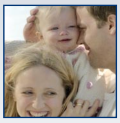
In recent years, as the industry has sought to improve its competitiveness, it has, to a large extent, withdrawn from providing services to people on low incomes.

For example, the industry does not target this income group for pensions, as the combination of high distribution costs and low persistency make it uneconomic for them to do so. As set out above, the Foundation's research also shows that only 40 per cent of the group have life insurance, compared to nearly 60 per cent of those on higher incomes, and only around 10 per cent have products such as income protection, payment protection and critical illness insurance, about half the level of take-up among higher earners.

As the Deloitte modelling shows, providing financial advice is likely to increase personal wealth and should lead to people in this income group making more informed decisions about financial products. A national financial advice resource could therefore help re-engage them, generating increased sales for the industry, as well as encouraging them to purchase appropriate products that reduce the risk of them falling into difficulty should their income or circumstances change.

[37] Forthcoming research, yet to be published
[38] *A new pensions settlement for the 21st century: The second report of the Pensions Commission*; April 2006
[39] Nielsen Media research, 1 January – 31 December 2005






Complaints and reputation

Complaints and compensation generate significant costs to the industry, both financially and in terms of its reputation. Nearly 113,000 new complaints cases were opened by the Financial Ombudsman Service (FOS) in 2005/06, two-thirds of which related to mortgage endowments. The FOS also reported an increase of more than 30 per cent in complaints relating to banking products and 25 per cent concerning insurance products.[40] The Association of British Insurers reports that, by the end of 2004, major firms had dealt with over 695,000 complaints paying out £1.1 billion in redress, a figure that is expected to rise significantly.

Providing generic financial advice could help consumer understanding of financial services, raising awareness of the risks and limitations of products, and encourage a more constructive dialogue between more informed consumers and the industry. For example, it could have alerted consumers to the inherent risks involved in purchasing an endowment mortgage and the likely impact of changes in market conditions. It could also help them decide whether they would be better off contracting in or out of the State Second Pension.

Having suffered widespread criticism in recent years, the opportunity to contribute to a high profile initiative with a clear social purpose could also deliver significant reputational benefits to the industry.

Conclusion

Promoting the ‘enabling’ role of the State is central to the Government’s public service reform agenda and to its vision of a modern welfare state. With the onus increasingly on the individual to take personal responsibility for their financial well-being, this role is critical in supporting people in their financial decision-making and promoting an effective interface between the consumer and the financial services industry. This is particularly important for people on low to moderate incomes who currently lack access to financial advice.

A national financial advice resource would provide a vehicle for fulfilling this role. Although the costs of delivering it would be significant, they are dwarfed by, for example, the £1.5 billion currently spent by the financial services industry on advertising and promoting its products or the estimated £6 billion spent each year on funding the independent advice sector as a whole.[41] In the context of potential annual savings in Pension Credit payments of £100m within 10 years and up to £800 million later in the century, it represents very good value to the public purse.

As set out in this report, such a resource would also help achieve wider public policy objectives and would deliver benefits to the financial services industry. In this context, there is a compelling case for it to be taken forward through a partnership between the Government and the industry. 80 per cent of people interviewed for our research indicated that they would support such an arrangement, provided it is delivered by an independent organisation.

The publication of the Government’s 10 year strategy on financial capability later this year provides an opportunity to set out an ambitious new strategy for promoting the financial health of the nation. This report presents a sound financial case for developing a national financial resource as a key element of that strategy.

[40] Financial Ombudsman Service Annual Review 2005/06

[41] *Getting earlier, better advice to vulnerable people*; Department for Constitutional Affairs, March 2006 (based on research carried out by Matrix Research and Consultancy

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