

FINANCIAL CAPABILITY: THE GOVERNMENT'S LONG TERM APPROACH

Summary

On 15 January 2007, the Treasury published *Financial capability: The Government's long term approach*, a consultation document outlining the Government's approach to improving financial capability. The centrepiece is a commitment to developing a national approach to providing generic financial advice. This would play a key role in delivering the Government's long term aspirations which are to ensure that:

- All adults in the UK have access to high-quality generic financial advice to help them to engage with their financial affairs and make effective decisions about their money.
- All children and young people have access to a planned and coherent programme of personal finance education, so that they leave school with the skills and confidence to manage their money well.
- A range of Government programmes is focused on improving financial capability, particularly to help those who are most vulnerable to the consequences of poor financial decisions.

The document outlines the Government's ambition for informed, confident consumers to play a more active role in the financial services market, delivering significant benefits to the consumer, the financial services industry and the economy. It highlights, in particular, the close link between financial capability and pension reform, especially the introduction of personal accounts.

To achieve its aspirations, it anticipates a more active role for the Government in promoting financial capability, identifying three ways this will be taken forward in the short term:

- An independent feasibility study, led by Otto Thoreson, Chief Executive of AEGON UK, will research and design a national approach to generic financial advice and report to the Government by the end of the year.
- A ministerial group, chaired by the Economic Secretary to the Treasury, will be established to develop, oversee and co-ordinate a cross-cutting approach to financial capability across government.
- An action plan will be published by the end of 2007, setting out how financial capability will be integrated into existing services, particularly for those most vulnerable to the consequences of poor financial skills.

Background

The document follows the publication of the FSA's 'baseline survey' in March 2006 which identified low levels of financial capability among the UK population. It defines financial capability as:

'..... a broad concept, encompassing people's knowledge and skills to understand their own financial circumstances, along with the motivation to take action. Financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this

advice, leading to greater participation in the financial services market.'

It places this in the context of demographic and other long term changes, identifying a number of particular challenges for the financial services sector:

- The roll out of the Child Trust Fund (CTF) which will give more financial responsibility to young people who are increasingly coming into contact with financial services at a younger age than previous generations.
- The need for young people to plan for longer and more diverse working lives and, with the decline in defined benefit pension schemes, to be more engaged in planning for their retirement.
- Changes to the pensions system, in particular the implementation of personal accounts, which will place more onus on the individual to take responsibility for planning their retirement income.
- Increased life expectancy and levels of home ownership, which bring more people into contact with 'decumulation' products such as annuities and equity release to generate their retirement income.

The document highlights the complexity of financial decisions and identifies significant difficulties for consumers in engaging in the financial services market. These include the complexity of many products, the difficulty of assessing future product performance and the 'asymmetry' of information which makes it difficult for them to understand and compare products. It suggests that these weaknesses in the interface between consumers and the financial services industry lead to significant problems:

- High search costs: for some products, the difficulty of obtaining information and making comparisons lead to high search costs for the consumer, making them less likely to shop around or switch providers, costing them money and potentially limiting market competition.
- Consumer detriment: where people have limited knowledge, they may choose inappropriate products, misunderstand the risk involved or fail to understand the 'small print', potentially leading to consumer detriment as a result.
- Consumer disengagement: 'product failure' from the consumer's perspective can lead to a loss of confidence in the financial services market, making them reluctant to engage with it and driving up sales costs for the industry.

Improving financial capability

The Government is keen to see consumers play a more active role in the financial services market. Recognising that 'regulation may protect consumers from making some bad decisions, but it cannot empower them to make good ones', the document emphasises the Government's role in 'demand side' initiatives as well as in promoting 'supply side' reforms:

'It is vital for the Government to pursue an approach focused on giving people the expertise to engage with financial issues – to build financial capability.'

It identifies significant benefits from improved financial capability for consumers, the

financial service industry and the economy including:

- Lower levels of debt, increased savings and more appropriate use of insurance products among consumers.
- Reduced welfare dependency.
- Support for the development of employment skills and enterprise culture.
- A more efficient, innovative and competitive financial services market as more active consumers drive firms to be more efficient.
- Lower business acquisition costs, greater persistency and less need for regulatory intervention.

The document notes the progress already made in a number of areas under the FSA's National Strategy for Financial Capability including the promotion of financial education in schools, schemes working with young people, adult education initiatives and work with families. It also identifies a wide range of initiatives being undertaken by the financial services industry and the voluntary sector.

However, it sets out a more active role for the Government in future, building on the FSA's strategy:

'The Government's aim is to contribute to a substantial increase in measured levels of financial capability across the population in the next 10 to 20 years, taking account of long term challenges and opportunities, and using available evidence to help determine priorities.'

Its aspirations are intended to address the findings of the FSA's baseline survey that young people and certain vulnerable groups have particularly low levels of financial capability. The survey will be repeated in 3-4 years time, and other indicators will be developed to measure progress.

The document identifies a number of policy developments that will provide opportunities to promote financial capability including the roll out of the Child Trust Fund, the development of the Saving Gateway and, in particular, pension reform and the introduction of personal accounts. It also highlights a number of areas where the Government can take action to 'accelerate the pace of change and to use fully the levers it has to achieve higher levels of financial capability':

- Children, young people and families: the document stresses the role that financial capability has to play in contributing to the Every Child Matters agenda. The Government will therefore consider how to integrate it across a range of services working with children, young people and families and ensure that staff working in these services are trained accordingly.
- Schools: the Government aims to build on recent work to increase the teaching of financial education in schools by producing new guidance for schools on incorporating the Child Trust Fund as a context for teaching financial capability. It will also improve the resources available for primary schools in time for the introduction of additional Child Trust Fund payments to seven year olds in 2009 and consult on the Qualification and Curriculum Authority's proposals for including financial capability within the national

curriculum.

- Training teachers: the Government will explore options for giving personal social and health education teachers more support to teach financial education, alongside the measures already being brought in to train teachers in the new 'functional maths' element of GCSE mathematics.
- Information for parents: the Government will consider how best to disseminate the FSA's *Parent's guide to money* to new and expecting parents, and to promote financial capability alongside the Child Trust Fund.
- Adult skills: in light of the findings of the Leitch Review, efforts to integrate financial skills into basic skills learning will be increased.
- Benefit recipients and jobseekers: the Government will build on existing efforts to promote access to financial education and advice through the Social Fund and Jobcentre Plus.

Noting the link between financial capability and a wide range of Government objectives, and the importance therefore of working across departmental boundaries, the document sets out plans to establish a new ministerial group to review a range of policies and programmes that contribute to improving financial capability. The group will be chaired by the Economic Secretary to the Treasury and will include representatives from DfES, the Department for Work and Pensions, DTI, Department for Communities and Local Government and the Cabinet Office.

The ministerial group will work alongside the FSA's financial capability steering group. Its work, as well as that of the feasibility study on generic financial advice (see below) and the response to the consultation document, will feed into a new financial capability action plan which will be published by the end of 2007.

Increasing access to generic financial advice

The document notes the lack of financial advice available, particularly to people on low incomes, who are less likely to use independent financial advisers. It argues that this 'advice gap' is unlikely to be filled by the market and highlights the consequences of this:

'This lack of advice may have the effect of excluding consumers from certain products and contribute to a failure to provide adequately for the future through savings and insurance. This is all the more important given that financial risk is increasingly being transferred to individuals, in particular through the decline of defined benefit pension schemes'.

To address this, and to move from crisis-intervention towards a more preventative approach, the Government believes that there needs to be a significant increase in the availability of generic financial advice. Its long term aspiration is for all adults in the UK to have access to this advice. It also sees this as having a critical role to play in meeting its broader financial capability objectives.

The document proposes a national approach to providing the advice. It raises a number of issues that need to be resolved before this can be implemented including:

- Standards: the document highlights the work carried out by the Financial

Services Skills Council in developing National Occupational Standards for generic advice, which the Government believes provide a sound basis to work from.

- Content: the Government believes that advice should cover wider issues including eligibility for benefits and tax credits and the advice available from commercial providers, as well as a wide range of financial issues, for which it states that 'robust generic advice protocols' will need to be developed.
- Regulated advice: the document highlights the need to establish clear boundaries between generic and regulated advice.
- Delivery: the document leaves open the question of how the advice should be delivered, suggesting that it could be a telephone-based service, with the potential for additional face-to-face advice, particularly for those most vulnerable to the consequences of poor decision-making. It also highlights the need to recruit enough advisers with sufficient skills to staff the service.
- Targeting and demand: the document proposes a universal service but highlights the need to target it at people on low incomes and avoid becoming 'state-subsidised' competition for the commercial advice market. It also suggests that clear branding and marketing will be needed to distinguish it from other services and to attract the intended audience.

These and other issues in developing a national approach to providing generic financial advice will be addressed by an independent feasibility study, led by Otto Thoreson, Chief Executive of AEGON UK, which will report to the Government by the end of the year.

A full copy of *Financial capability: The Government's long term approach* can be downloaded from:

http://www.hm-treasury.gov.uk/documents/financial_services/financial_capability/fin_cap_index.cfm