



Financial Capability in the UK:

Establishing a Baseline



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Foreword



John Tiner
Chief Executive
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In a world in which individuals are increasingly required to take responsibility for their financial affairs, people need to be able to manage their money well. This report, the product of a survey of over 5,300 people, assesses the ability of the UK population to do so.

The Financial Capability Survey's main purpose is to establish a baseline measure of financial capability in terms of how well people: make ends meet; keep track of their finances; plan ahead; choose financial products; and stay informed about financial matters. The results give us rich and complex data, from which four main themes stand out:

- Large numbers of people, from all sections of society, are not taking basic steps to plan ahead, such as saving sufficiently for their retirement or putting money aside for a rainy day.
- The problem of over-indebtedness is not that it affects a large proportion of the population, but that when it strikes it is often severe, and that many more people may find themselves in trouble in an economic downturn.
- Many people are taking on financial risks without realising it, because they struggle to choose products that truly meet their needs.
- The under-40s, on whom some of the greatest demands are now placed, are typically much less financially capable than their elders, even allowing for their generally lower levels of income and experience in dealing with financial institutions.

In short, unless steps are taken to improve levels of financial capability, we are storing up trouble for the future.

The Survey results are an important contribution to setting the priorities of the National Strategy for Financial Capability, which is led by the FSA and a Steering Group of partners and supported by many others. We intend to repeat the Survey – probably every four to five years – so that we can measure the impact over time of initiatives to improve financial capability, including the seven point programme of action¹ we and our partners have devised to help address the challenges.

I am very grateful to our partners and supporters in this work. My thanks go also to Professor Elaine Kempson and her team at the Personal Finance Research Centre at Bristol University, as well as Jenny Turtle and her team at BMRB, for providing such a rich source of data from which we and others will derive great insight.

John Tiner

Chief Executive, Financial Services Authority
March 2006

¹ For details, see *Financial Capability in the UK: Delivering Change*, 2006 (available at http://www.fsa.gov.uk/pubs/other/fincap_delivering.pdf).



Executive summary

Background

The economic and social environment in which people take financial decisions has changed – and this change is set to continue. People are having to take increasing individual responsibility for their financial affairs. To take just two examples, the costs of higher education and of retirement are both increasingly being borne by individuals rather than the state or other organisations. This means that the cost of not having the necessary skills to make sound financial decisions is becoming increasingly significant. It is therefore vital that the UK population's financial capability improves to meet these greater demands.

As part of addressing this challenge, we need to know as accurately as possible where the population stands today, and set a baseline against which we can measure progress in future. We have therefore surveyed over 5,300 adults to create a comprehensive picture of financial capability in the UK, and this document presents the results.

Overview of results

The main themes emerging from the Survey are:

- **Many people are failing to plan ahead adequately for retirement or for an unexpected expense or drop in income.** This is not a case of people failing to do so simply because they do not have enough money. The Survey finds many people at all income levels who are not planning ahead, while also providing plenty of examples of people with very low incomes who do. Nearly half of people have no savings at all.
- **Although only a small proportion of the population is experiencing problems with debt, they are often very severely affected.** In addition, a further two million households (or around three million people) are exposed to potential difficulty in the event of deterioration in economic conditions, since they are constantly struggling to keep up with their commitments.
- **People do not take adequate steps to choose products to meet their needs.** Most households spend material amounts on financial services, yet many do not shop around to find a good deal. People also take risks without realising they are doing so, while others buy insurance to cover against risks they do not face.
- **The under-40s² are less capable, on average, than their elders.** This is true even after taking into account factors such as their lower average incomes and relative inexperience in dealing with financial institutions. It is especially true of the 18-30 age group.

These findings confirm serious concerns about current levels of financial capability:

- **Unless action is taken, the UK population will store up problems for the future.** People need to save, both for a rainy day and for the longer-term. Our Survey found that, while most people do not make provision for an unexpected drop in income or major expense, such events are fairly common even in a favourable economic environment, and often push people into difficulties. In addition, adequate pension provision is becoming ever more important: for example, defined benefit (“final salary”) schemes are in steep decline³.

² This group refers to people aged 18-40. The Survey was conducted with people aged 18 and over.

³ According to the Pensions Commission, active membership of defined benefit schemes has fallen by over 60% since 1995 (p.52, *A New Pension Settlement for the 21st Century*, 2005). The Employer Task Force on Pensions estimates that employers contribute at least twice as much to defined benefit as to defined contribution schemes (p.15, *Report of the Employer Task Force on Pensions*, 2004).



- **Many people could be tipped into financial difficulties by a small change in their circumstances.** Two million households are only just managing as it is. Given the general tendency not to plan ahead adequately, many could be pushed into financial difficulties if interest rates or unemployment rise, or simply if their personal circumstances change.
- **Many people are taking on inappropriate risks and not shopping around to get a good deal.** Many could face problems in the future as a result of risks which they are not protected against, either through poor choices or simply lack of awareness that they face the risk. In addition, most households spend significant amounts on financial services: by shopping around for a good deal, they stand to save themselves substantial sums of money.
- **The greatest demands are placed on those least equipped to deal with them.** The under-40s face a considerably more demanding environment than their parents did, and consequently can ill afford to make mistakes or ignore the need to take action. There is therefore a particularly pressing need to equip them with greater financial capability.

Next steps

The need for intervention

The Survey confirms a clear need for the FSA and others to take action, particularly to help people plan ahead more effectively and make better product choices. The Survey also tells us, in greater detail than ever previously available, where the problems lie.

The National Strategy for Financial Capability

Meeting this challenge requires a broad range of organisations to work together. The FSA is providing leadership through the National Strategy for Financial Capability. With our partners, we have devised a seven point programme, including projects specifically targeted at groups the Survey highlights as having the most to gain from improved financial capability.

In the three years since we launched the National Strategy for Financial Capability, many hundreds of thousands of people have received help, education and advice that was previously unavailable to them. With the sustained and relentless implementation of the programme, we will now extend this to reach millions of people across the UK.

Data snapshots

Though individual statistics rarely tell the whole story, there were many telling pieces of data in the results.

- 81% of the pre-retired think that a state pension will not provide them with the standard of living they hope for in retirement. Nevertheless, 37% of these people have not made any additional pension provision.
- 70% of people have made no personal provision to cover an unexpected drop in income.
- Of the 1.5 million who say they are falling behind with bills or credit commitments, one third say they have real financial problems. Almost three million more people (or two million households) say it is a constant struggle to keep up with commitments.
- 33% of people, who hold no more complex products than general insurance, bought their policy without comparing it to even one other product.
- 40% of people who own an equity ISA are not aware that its value fluctuates with stock market performance, and 15% of people who own a cash ISA think its value does.



Illustrating the findings

The following ‘pen portraits’ have been derived from the Survey findings and other work we have done to help illustrate some of the main findings⁴.

“I finally got around to joining my employer’s pension scheme. Retirement always seemed really far away so I never worried about it before. But, because I had put it off for so long, I was shocked to discover how much I would need to start contributing to get even an okay income in my old age. I might even have to retire a bit later than I thought. I suppose one of the reasons I didn’t start saving earlier was that I enjoyed having a little extra money every month. I’m going to need to start making some small sacrifices now, but actually that’s not so bad because I’ve discovered that for every pound I put into my pension, my employer will contribute a pound too.” – 45 year old

“I have two children who are always growing out of stuff or needing new trainers. I got myself into quite a bit of debt on credit cards and store cards. I was only just managing to make the payments and sometimes I accidentally slipped into the red and added overdraft fees to my worries. I had to ask my parents to help me out a couple of times. I was getting really worried and wasn’t sleeping properly. I found out about a debt helpline and called them up. I always thought they charged for advice, but actually it was free. They explained to me that credit and store cards can be really expensive and that I could try to get a loan which would help me pay off the money I owed. It seemed like it would take me a little longer to pay it all off, but now I am making payments that I can afford.” – 32 year old

“I have worked really hard to save money over the years and hope to have a bit put away for my retirement. I used to put all my savings in my building society account. My daughter had just opened an ISA and she told me that you get the returns tax-free. I thought that sounded great. I opened an equity ISA and moved £7,000 into it. When I got my first statement, I discovered that the amount of money in my account had gone down! I hadn’t realised that there was a risk of sometimes losing money. So I talked to an adviser and she explained how that can sometimes happen with stocks and shares and how I need to balance that risk against the possibility of higher returns. As it turns out, over the last two years my equity investment has done better.” – 62 year old

“When I buy clothes or go out, I use my credit card most of the time. But that’s okay because I always aim to pay it off in full at the end of the month. Although I have been hit a few times because I haven’t set up a Direct Debit and every once in a while you do forget to put the cheque in the post on time. I heard that can damage your credit rating so I’ll definitely sort that out soon. There was one time when my car broke down and I had to get it fixed so I couldn’t pay off my credit card at all that month. I remember seeing stories on the news about pensions and so on but I’m only young – that sort of thing won’t affect me for years.” – 26 year old

⁴ The design of the Survey does not allow for direct quotes to be collected, so these simply illustrate the points.



Background

The economic and social environment in which people take financial decisions has changed – and it will continue to change. As a consequence, people are having to take increasing individual responsibility for their financial affairs. This was identified as a priority risk in our Financial Risk Outlook 2006⁵.

The costs of not having the necessary skills to make those decisions are also becoming increasingly significant. The decline in the number of active defined benefit pension schemes, for example, means that it is ever more important that people make their own provision for retirement. With the costs of higher education increasingly being borne by students, inability to manage debt sensibly can reduce course completion rates and leave people with a heavier burden than might otherwise be the case. And, more generally, the wider availability of credit can lead to dire consequences for those inexperienced or otherwise unable to manage it. For some, the challenge is simply about gaining the confidence to engage with the financial system, particularly if they have been excluded from it in the past.

The FSA has a statutory objective to promote public understanding of the financial system. As part of delivering against this, in Autumn 2003 we brought together a partnership of key people and organisations in government, the financial services industry, employers, trades unions, and the educational and voluntary sectors. Together we have established a road map⁶ for delivering, over time, a step change in the financial capability of the UK population.

As a starting point, we need to know where the population stands today. Working with leading academics from the Personal Finance Research Centre at Bristol University and market researchers from BMRB, we have surveyed over 5,300 adults across the UK to create a comprehensive picture of how well equipped people are to manage their money. This survey will provide a baseline against which we can measure progress in future.

The Survey provides greater insight than ever previously available into where action might best be targeted. For example, the results tell us that while the over-70s are strong at making ends meet, they are much weaker in the area of choosing financial products; and that the under-40s particularly need help with planning ahead. We set out in this document the main conclusions we have drawn from our initial analysis of the results of the Survey. Further analysis of the data by the FSA and our partners will draw out other insights.

As well as influencing the priorities of the National Strategy for Financial Capability, the Survey results will help inform our wider regulatory work to help retail consumers achieve a fair deal. They will be especially useful in our work to develop more capable and confident consumers and to produce clear, simple and understandable information for consumers to use.

⁵ Sections A and D, *Financial Risk Outlook*, 2006.

⁶ *Financial Capability in the UK: Delivering Change*, 2006 (available at http://www.fsa.gov.uk/pubs/other/fincap_delivering.pdf).



Detailed results

The Financial Capability Survey covered each of five components of financial capability:

- Making ends meet.
- Keeping track of your finances.
- Planning ahead.
- Choosing financial products.
- Staying informed about financial matters.

A comprehensive report, which describes how these components were identified and contains detailed analysis of each, is also published today⁷.

Interpretation of the results

The Survey allows us to see who is more and who is less financially capable, how they think about money, and on what components they do better and worse. It tells us where we should focus our attention. But it cannot be reduced to a simple pass or fail mark, because the financial capability which a given person needs will depend to some extent on their individual circumstances.

For example, someone on a very tight budget would be well advised to maintain an accurate picture of how much money they have left to spend at any given time. On the other hand, someone whose income comfortably exceeds their outgoings can probably afford to maintain only a very general picture of their current balance.

For each of the components, the data allows us to represent graphically what proportion of the UK population performs at what level of financial capability (for example, see p11). The left hand end of these graphs is determined by the least capable response to the Survey, and the right hand end is based on the most capable response. The distributions are therefore based on a relative rather than an absolute measure of capability. For each, we have provided a perspective of what might be considered, on an absolute scale, more and less capable. This is shown using red, yellow and green shading in the graphs that follow in this section.

⁷ *Consumer Research Paper 47 – Levels of Financial Capability in the UK: Results of a Baseline Survey, 2006* (available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr47.pdf>).



Making ends meet

A basic component of financial capability is making ends meet. Though everybody has different incomes and needs, making sure that spending does not consistently exceed income is clearly a fundamental element of financial survival.

Summary

- The large majority of people do consistently make ends meet, although while some spend less than their income, others use credit to plug the gap.
- The problem of over-indebtedness is not especially widespread in terms of the percentage of the population. But, looked at in absolute terms, it is very concerning: 500,000 people have real financial problems and have fallen behind with many bills or credit commitments; a further one million have fallen behind with some.
- A further two million households (with three million people) say it is a constant struggle to keep up with commitments; this group in particular should try to take steps to cushion themselves against an economic downturn or deterioration in their personal circumstances as they are at risk of joining those falling behind.
- Four million people say they always run out of money at the end of the week or month.
- People who struggle include many earning average or even above average income.
- Being capable at making ends meet is linked strongly with age. The under-40s perform less well than their elders, even allowing for factors like differences in incomes or whether they own their homes outright. The over-60s are especially capable on this component.

Differentiating more capable and less capable

Although we asked people a wide variety of questions on their ability to make ends meet, statistically the following behaviours and attitudes are the strongest indicators of financial capability.

More capable
Keeps up with his/her financial commitments without any difficulty and never struggles
Agrees that he/she is more of a saver than a spender ⁸ , preferring to save up to buy something rather than use credit
Never runs out of money at the end of the week/month
Has not been in financial difficulties in the last five years

Key findings

- **Keeping up with commitments.** 65% of people say that they are able to keep up with their bills and other commitments without any difficulties; another 26% are able to do so although it is sometimes a struggle. But for 9% of the population, keeping up is either a constant struggle or worse, with 3% falling behind, sometimes severely.

⁸ In general, it is rational for people to save more in some periods of their lives and spend more in others. However, statistical analysis demonstrated that the attitude of being a spender rather than a saver was highly associated with inability to make ends meet.



- **Making money last.** 31% of people say they sometimes run out of money at the end of the week or month, and 9% of people always run out.
- **Distribution by income.** It is striking that difficulty in making ends meet is not restricted to people with low incomes. Similar proportions of people on higher and lower incomes say that they sometimes run out of money at the end of the week or month.
- **Attitudes towards debt.** In general, people express rather cautious attitudes towards debt. In terms of unsecured debt, 61% strongly agree they would rather cut back on spending than accumulate debt on a credit card, and another 23% tend to agree. This was, broadly, borne out in practice: 21% say they have outstanding balances on their credit cards that they do not pay off in full each month.

Correlations

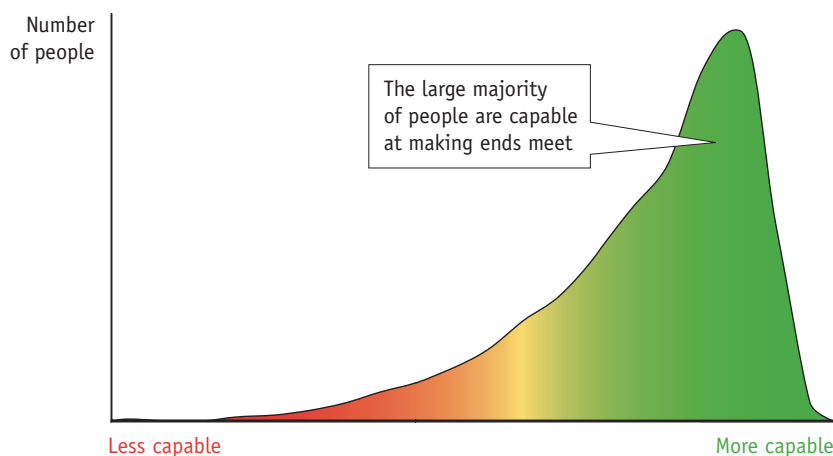
Ability to make ends meet correlates very strongly with increasing age. The under-40s perform less well than their elders, even allowing for differences in incomes or whether they own their homes outright. Those in their 20s perform least well of all age groups, while the over-60s are especially capable. Other groups tending to do better than most are home-owners and those with higher levels of education.

Among those who, on average, find it harder to make ends meet are young people, people who rent their homes, unemployed people, and people in households with children, particularly single parents.

Men and women tend to perform equally well at making ends meet.

Distribution⁹

The distribution of the overall scores shows that the large majority of people in the UK are capable at making ends meet, although it is worth noting that for some this might be because they are using debt to do so. However, there are quite a few who find it a struggle. There are even some at the far left of the distribution who are clearly experiencing significant difficulties.



⁹ See p9 for how this information is derived and how to read it.



Keeping track of your finances

Keeping track differs somewhat from other components of financial capability. For some people it is absolutely essential that they know the details of their day-to-day finances. For others, while doubtless desirable, it is not actually necessary. For some, if they decide to devote more of their time to managing their finances, keeping track would be an excellent place to start and could make the difference between making ends meet or not. For others, extra time might be much better spent on planning ahead or choosing products.

The key factor in determining the importance of keeping track for an individual is how tightly they are living within their income. Many, and particularly those on low incomes, need to keep track to avoid going over budget. People who have the luxury of an income which comfortably exceeds their outgoings can get away with keeping track less well.

Keeping track is likely to be somewhat driven by personality: some people are more meticulous, others go with the flow.

Summary

- Though the correlation is relatively weak, the people who are best at keeping track of their money tend to be slightly worse on average on the other components of financial capability. So, groups such as single parents, those living in social housing, the unemployed and people without current accounts all perform better than average.
- People on higher incomes are slightly more likely to be less capable at keeping track.
- Women on average out-perform men, even allowing for differences in income, employment status, etc.
- This component is less correlated with demographic factors such as age than the other components of financial capability.

Differentiating more capable and less capable

Statistically the following behaviours and attitudes are the strongest indicators of capability at keeping track.

More capable
Checks the amount of money in current account (or in-hand, for cash budgeters ¹⁰) frequently
Checks receipts against his/her bank statements as opposed to simply glancing over the entries or just checking the final balance
Knows current account balance (or in-hand, for cash budgeters) to an appropriate level in line with his/her income
Budgets to ensure that sufficient funds are available to cover uneven expenditure (eg utility bills, TV licence)

¹⁰ Cash budgeters mean those who do not have, or do not use, a current account.



Key findings

- **Knowing bank balance.** 7% of people say they have no idea of their current account balance to within £500; 21% know to within a pound or two, with teenagers and retirees (ie the age groups most likely to have limited incomes) having the most precise knowledge.
- **Checking bank balance.** 38% of people say they always check the balance on their bank account before taking out money. This differs by gender, with 41% of women and 35% of men always checking the balance. Of the 14% of people who never check their balance before taking out money, the gender difference is smaller: 13% of women and 15% of men.
- **Monitoring withdrawals.** 43% of people maintain no record of withdrawals from their current account (or day-to-day spending for cash-budgeters), just out-numbering the 42% who do keep receipts from ATM (cashpoint)/cashback withdrawals.
- **Reviewing bank statements.** Most people pay some attention to their bank account statements: only 6% appear to ignore bank statements altogether, while 42% say they keep and check receipts against statement entries.
- **Preparing for upcoming expenditure.** 10% of people say they make no provision for planned expenditure, for example quarterly or annual bills. A further 40% claim they have no need to plan as they either have no bills to pay or could easily find the money without planning, while 37% put money aside so they will have enough to pay for bills when they become due.

Correlations

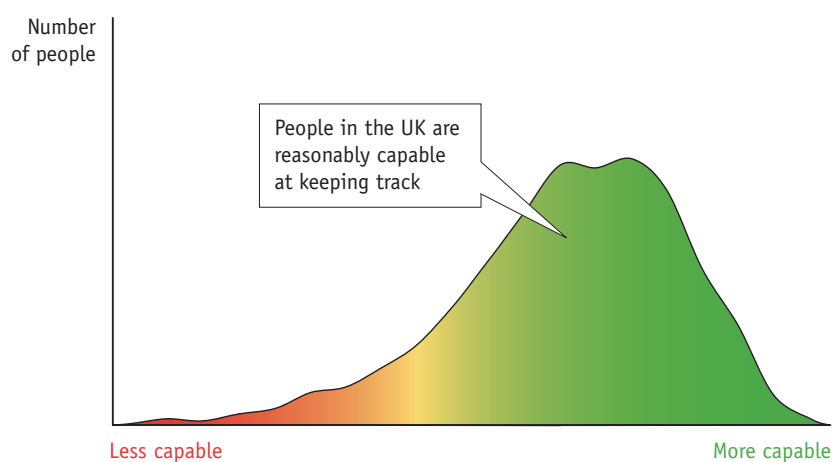
There is no clear or strong relationship between age and keeping track of money, implying that being a careful record keeper is not a skill that is learnt over time. Those who tend to score highest in this area are those who do less well at making ends meet. People who have no access to a current account, tenants, lone parents and the unemployed perform markedly better than average at keeping track.

The lack of correlation with demographic factors, which is in contrast to the other components of financial capability, reinforces the view that keeping track may only be an important component for certain people, ie those who are most in danger of running out of money.

Women perform, on average, better than men on this component.

Distribution

Most people in the UK are reasonably capable at keeping track of their financial situation. However, there is more variation in the scores on this component compared with making ends meet. This reflects that for some people it is absolutely essential that they know the details of their day-to-day finances. For others, while doubtless desirable, it is not actually necessary.



Planning ahead

A key component of financial capability is the ability to make adequate provision for the future. The Survey suggests that this is an area of major concern.

Summary

- The majority of people in the UK are not planning ahead sufficiently, and are likely to be storing up problems for the future. 39% of people say they tend to live for today and let tomorrow take care of itself.
- Unexpected financial setbacks are surprisingly common. In the last three years, 28% of people have experienced a large unexpected drop in income¹¹, and 21% have faced a large unexpected expense¹². Approximately one quarter of people facing these events had fallen into arrears on credit commitments for at least three months over the last five years.
- Nonetheless, most people are unprepared for the unexpected: 70% have made no personal provision to face a drop in income, and 55% do not think they have sufficient provision to face an unexpected expense.
- 81% of the pre-retired do not think a state pension will provide them with the standard of living they hope for in retirement. Nevertheless, 37% of these people have not made any additional pension provision.
- This is not a case of people not planning ahead simply because they do not have enough money. The Survey finds many people at all income levels who are not planning ahead, while also providing plenty of examples of people with very low incomes who do so.
- This component is more strongly linked with age than any other. There is a clear and steep scale: the under-20s perform worse than the under-30s who perform worse than the under-40s and so on.

¹¹ Caused by incapacity to work (through accident, illness or disability), redundancy, drop in income following relationship breakdown or death of a partner.

¹² Defined in the Survey as “an expense equivalent to your whole income for a month, or more”.



Differentiating more capable and less capable

Statistically the following behaviours and attitudes are the strongest indicators of capability at planning ahead.

More capable
Has made sufficient provision for an unexpected major expense or significant drop in income
Would be able to make ends meet for twelve months or more if income dropped unexpectedly
Holds some general insurance
Has made provision for his/her retirement
Takes the attitude, "I make sure I have money saved for a rainy day" and is willing to consider trade-off in current standard of living in order to plan for retirement

Key findings

- **Attitudes vs. behaviours.** Planning ahead is an area where people's actions do not necessarily match their words. 75% of people say they always make sure they have some money saved for a rainy day. But, when we look at how many actually make provision for a drop in income or an unexpected expense, we find most do not. Nearly half of all people have no savings at all.
- **Frequency and impact of financial setbacks.** 28% of people experienced a large unexpected drop in income over the last three years. The proportion of people who have had this experience varies little by income or education levels, suggesting that nobody can afford to be complacent. Of these people, 27% had fallen into at least three months arrears on a credit commitment in the last five years, compared to 10% who had not experienced an income drop. 21% of people have faced a large unexpected expense over the last three years, and 24% of these people had fallen into at least three months arrears. All sorts of factors can lead to these financial setbacks, including divorce, a death in the family, and the loss of a job.
- **Provisioning for financial setbacks.** When asked how long people expect to be able to make ends meet if faced with a large drop in income, 39% say they would manage for over 12 months, which seemed reassuring. But of these, 45% have made no actual provision, which suggests that at least some may be unduly optimistic about their ability to get by in the face of a setback.
- **Providing for retirement.** 81% of the pre-retired say the state pension will not provide them with the standard of living they hope for in retirement. Nevertheless, 37% of these people have made no additional pension provision whatsoever. Of those who have not made additional provision, only 28% blame lack of income, with 26% claiming they have never thought about it or have just never got around to it, and another 29% saying they have not been in their job long enough or do not have a job. Only 42% of the pre-retired have a current personal or occupational pension, with 28% having a pension they have paid into in the past. Meanwhile 42% agree with the statement, "I would rather have a good standard of living today than plan for retirement".



- **Prospects for the retired.** 21% of people already retired do not find their income sufficient to give them the standard of living they hoped to have. This prompts concern because the current generation of the retired includes beneficiaries of the generous defined benefit pensions that were the norm during their working lives, but which are increasingly rarely offered to today's workforce. As things currently stand, the problems that today's pensioners face could be magnified for tomorrow's pensioners.
- **Insuring against setbacks.** Product holdings bear out these findings on general levels of planning ahead, with only 61% of people having a savings account and 66% having home contents insurance.
- **Living for today.** Encapsulating these findings is the statistic that 39% agree strongly or tend to agree with the statement, "I tend to live for today and let tomorrow take care of itself". The worry is that some people may find this approach serves them poorly in future.

Correlations

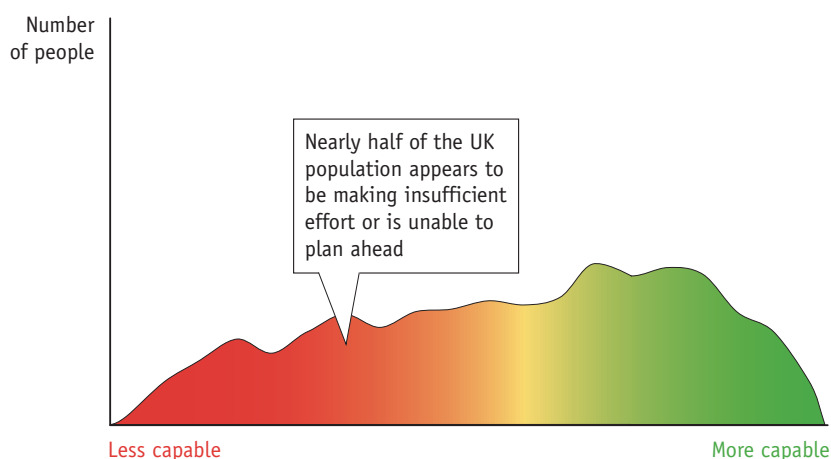
Capability in planning ahead is stronger in people with higher levels of education and improves markedly with age. There is a clear and steep scale: the under-20s perform worse than the under-30s, who perform worse than the under-40s, and so on. This is true even when all factors such as income levels, employment status etc are stripped out.

Although the data show that people with higher incomes are likely to be better at planning ahead, it also tells us that, on average, they are only slightly better: plenty of higher earners are not doing well on this component.

Women do slightly less well than men, while people who rent rather than own their homes, and particularly those in social housing, are especially prone to poor planning.

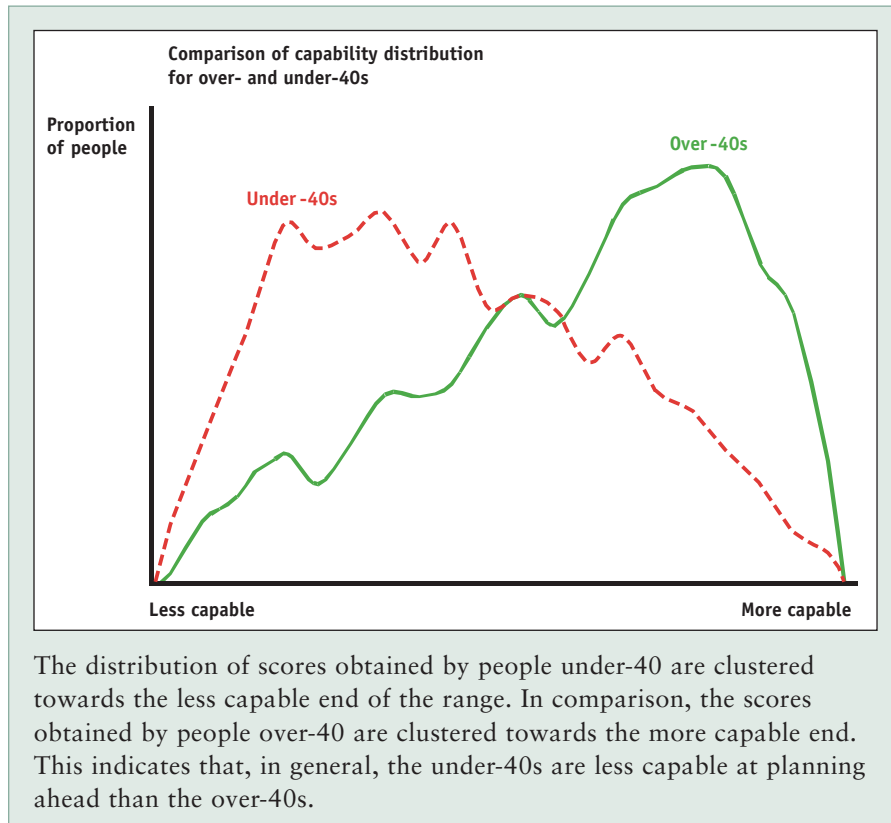
Distribution

The distribution of scores on the planning ahead component is particularly striking. The distribution is fairly flat, reflecting considerable diversity in capability. While a number of people are clearly taking considerable efforts to plan ahead, it is just as common for people to obtain less capable scores. Approaching one half of the UK population appears to be making insufficient effort, or is unable, to plan ahead and make adequate provision for the future.





Capability in planning ahead is strongly correlated with age



Choosing financial products

Being able to make informed choices about financial products is an important component of financial capability. People need an understanding of risk: both what risks they face, and the trade-off between risk and reward. This needs to be complemented by a good general awareness of the types of financial products that can help them achieve their goals, for example how protection products can mitigate setbacks and how exposure to different asset classes can help to spread risk.

Summary

- People were scored on their ability to choose financial products only if they had personally bought one in the last five years. 74% had done so. Even so, these people generally choose poorly.
- People often do not understand the risks they are taking on: many people who say they want to take no risks with their savings in fact take on material risks, while others insure themselves against risks they do not face. Plenty do not use insurance in situations when it might benefit them to do so.
- People do remarkably little shopping around for financial products meaning that they may not be getting a good deal. Many choose products for reasons other than price or product features (eg taking a credit card just because it is offered with a current account).



- Most people buy products based solely on product information and/or advice from friends, relatives or sales staff. Over four million people bought their most complex product¹³ without considering any other options at all.
- People usually learn from experience: in general, the more products they have bought, the better they are at choosing. However, the under-30s are particularly prone to choosing poorly, even if they are experienced buyers.

Differentiating more capable and less capable

Statistically the following behaviours and attitudes are the strongest indicators of capability at choosing products.

More capable
Seeks advice from an appropriate professional adviser before buying financial products or actively shops around
Doesn't just rely on the information that accompanies the product to inform his/her purchasing decision
Compares products from multiple providers either personally or through an appropriate professional adviser
Compares products on features and price rather than making a choice based on brand image
Reads terms and conditions in detail

Key findings

- **Participation in the market.** 26% of the population have not personally bought a financial product in the last five years, because they have stayed with a pre-existing product, are too young to have engaged with financial products, rely on someone else, or are financially excluded.
- **Understanding of risks.** A significant minority of people seem not to understand the risks they face. 43% say they are not prepared to take any risk at all with their savings. 40% of people who own an equity ISA do not know that the cash value of their investment is directly affected by stock market performance, while 15% of people who own a cash ISA think that it is. In contrast, we found examples of people insuring themselves against risks they may not face, eg 9% of people who rent from a private landlord hold buildings insurance.
- **Use of financial products to mitigate risks.** Over 10% of home-owners do not have buildings insurance, and just over a third of renters have home contents insurance.
- **Use of advice when purchasing.** When asked for the main source of information that they use, 42% say they relied on product information and/or advice from friends, relatives or sales staff, 21% take no advice at all, and only 21% conduct an active search for the best buy or consult an appropriate professional adviser. 13% buy the product without considering any other options.
- **Price insensitivity.** Only 37% of savings account holders choose their account based on the interest rate paid. 49% of savings account holders cannot estimate the current level of interest. 49% of people choose a credit card based on the interest rate, and 11% simply choose it because it came with their current account.

¹³ We asked people about a maximum of two products purchased within the last five years. If more than two had been purchased, people were asked about the two most complex product types from a hierarchy of investments, mortgages, payment or income protection, credit cards, unsecured credit, general insurance, savings accounts and current accounts.



- **Inertia after purchase.** There is considerable inertia in the market for financial products: once people have bought a product, they tend to stick with it. This is true even in product categories typically seen as very competitive, such as car insurance, or where the value to the average household of shopping around is very high, such as mortgages. Of those who have car insurance, 48% have taken out a different policy or have actively considered switching in the last five years. The comparable figure for mortgages is 42%.
- **Use of credit.** The great majority of the population do not regularly sign up to new credit cards: only 20% have taken out a credit card in the last five years. Personal loans are less prevalent (held by 14% of the population compared with 56% for credit cards) though the market is growing. 21% hold credit cards which they do not pay off in full each month.

Correlations

Experience counts in choosing financial products: the number of different types of products people have bought is by far the best indicator of how well they choose, and much stronger than income, for example.

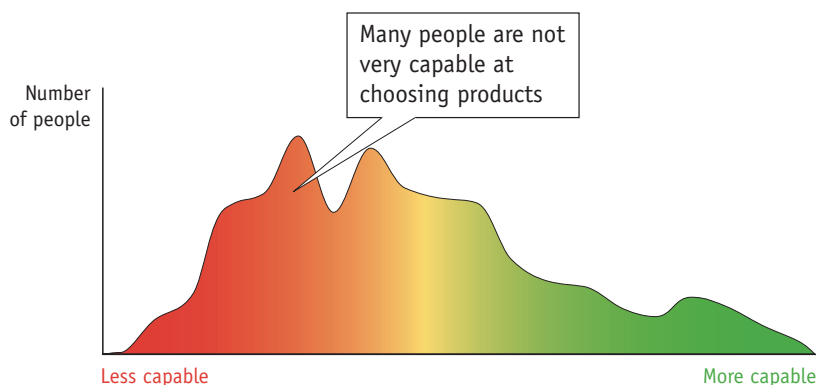
The under-30s perform well below average, even allowing for other factors, which is concerning given the demands they face. The retired as a group score well above average, but those over 70 are almost as weak as 18-19 year olds when all other factors are taken into account.

Women are somewhat less capable at choosing financial products than men, even allowing for other factors such as income. Renters, and particularly those in social housing, perform substantially below average. But there is no evidence that groups such as the unemployed and single mothers, who are typically below average on other components, are more capable or less capable when it comes to choosing products.

Distribution

The distribution of scores for choosing products only includes the 74% of people who have purchased a financial product in the previous five years.

The distribution of scores shows relatively few people demonstrating behaviours that would be considered more capable. Even of those who have bought financial products, approximately one third are clearly not very capable at choosing them.





Staying informed about financial matters

The final component of financial capability is having some knowledge of financial matters and keeping abreast of financial developments.

Summary

- 72% of people think it is very or quite important to keep up with financial matters, although 12% of these people say that they are not doing so. 78% of people keep up with at least one financial indicator¹⁴.
- 19% stay informed primarily through specific financial information sources (eg the financial pages of a newspaper); most rely on general newspaper, television and radio content.
- In a short quiz, people generally did quite well at reading bank statements and making basic calculations, but were much less sure on questions about risk.
- The under-40s generally perform less well than their elders, even allowing for the fact that they typically earn less and have less experience of dealing with financial institutions.

Differentiating more capable and less capable

Statistically the following behaviours and attitudes are the strongest indicators of capability at staying informed.

More capable
Monitors many financial indicators such as changes in the housing market, stock market and interest rates
Checks these financial indicators frequently
Has a good level of applied financial literacy
Thinks it is reasonably important to keep up to date with financial matters

Key findings

- **Attitudes to keeping informed.** 72% of people agree it is very or quite important to keep up with financial matters, although 12% of these people say they are not actually doing so. 78% of people keep up with at least one financial indicator but 22% keep up with none. Only 9% think it is not important at all.
- **Indicators watched.** People are much more likely to keep up with macro-economic measures. 46%, the highest proportion, keep up with interest rates: many also keep up with tax rates, changes in the state pension, benefits and tax credits, and the state of the housing market. Only 11%, the lowest proportion, keep up with best buys in financial products.
- **Sources of information.** When asked which sources they use to keep informed about financial matters, people say newspapers generally (41%) and television or radio programmes (39%). 19% keep up to date by reading the financial pages of newspapers, and only 7% do so by tuning in to specialist programmes on television or radio. This shows that most people absorb financial information while reading, watching or listening to other things that interest them.

¹⁴ Specifically, we asked about changes in: interest rates; the housing market; state pension, benefits and tax credits; taxation; inflation; the stock market; the job market; and best buys in financial products (listed in descending order of frequency with which people keep up to date).



- **Results of the Money Quiz.** The Survey includes six questions to test applied financial literacy in a Money Quiz. The average score was 4.9 out of 6.
 - When asked to read the final balance from a bank statement, 91% were able to do so. 7% of those who use a current account got this wrong.
 - 85% were able to say whether or not there was sufficient money in the account to cover a specified Direct Debit.
 - 79% of people were able to correctly answer a question testing understanding of the effects of inflation on savings¹⁵.
 - 75% of people answered correctly two questions testing interpretation of graphs showing relative returns on different types of investment.
 - 90% correctly answered a question testing basic arithmetic¹⁶.

Young people on average scored lower on the quiz than others, while people with higher incomes consistently did better than people with lower incomes.

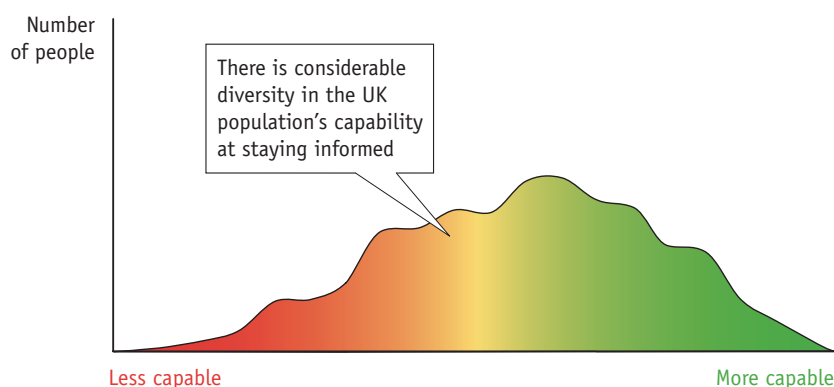
Correlations

There was a strong correlation between keeping well informed about financial matters and both income and general levels of education. Again, retired people show stronger capability on this component.

Men significantly outperform women on staying informed, even after we stripped out other factors, such as differences in income. The under-40s generally perform less well than their elders, although the over-70s perform worst of all age groups. Those in social housing and single parents typically perform worse than average.

Distribution

The distribution of scores for the staying informed component shows considerable diversity in people's behaviours. Unlike the distributions for making ends meet and keeping track, the vast majority of people are clustered towards the middle of the distribution.



¹⁵ The question was: "If the inflation rate is 5% and the interest rate you get on your savings is 3%, will your savings have at least as much buying power in a year's time?"

¹⁶ The question asked whether a discount of £30 on a television originally priced at £250 was better or worse than a 10% discount.



Next steps

The need for intervention

The Survey confirms a clear need for the FSA and others to take action, particularly to help people plan ahead more effectively and make better product choices.

A lack of financial capability matters for individuals, but it also matters for society as a whole:

- When people make bad decisions (or simply no decisions), there are often negative consequences for society generally. A classic example is that when people do not save enough to maintain an adequate standard of living in retirement, the state (and therefore the taxpayer) may have to make up the difference.
- The absence of financial capability can divert economic resources from more productive uses. For example, if somebody becomes over-indebted, they, their debtors and any voluntary organisations to whom they turn incur significant costs to resolve the situation. These resources could be more productively used elsewhere, particularly in preventing financial crises happening in the first place.
- A lack of financial capability makes financial services more expensive for everybody. Financial services firms have to spend more time educating consumers and regulators have to impose systems to mitigate the risks inherent when consumers who are not financially capable buy products. The cost of these activities is passed on to all consumers in the form of higher prices for products and services.

It is therefore in everybody's interest that action is taken to improve financial capability among all sections of society.

Some groups are particularly vulnerable, as the Survey reveals. Many people, particularly those on low incomes, lack access to mainstream financial services: 1 in 12 people in the UK do not have access to a bank account of any kind¹⁷. Households that suffer from financial exclusion have limited financial choices and often incur higher costs (by, for example, having to use more expensive forms of credit). This can cause greater financial strain, trapping some in a cycle of poverty. While other factors have a significant influence on this, improving the financial capability of more vulnerable people – particularly in planning ahead – must be a priority.

Action is also needed to mitigate the effect of a possible future downturn in economic conditions. As things stand, this could result in a substantial increase in the number of people in financial difficulties, since many are only just making ends meet, even against a relatively benign economic backdrop. Again, we know that many people are not planning ahead adequately, even to the extent of setting aside a little money for a rainy day.

The National Strategy for Financial Capability

Meeting this challenge requires a broad range of organisations to work together. The FSA plays an important coordinating role through its leadership of the National Strategy for Financial Capability.

With our partners, we have devised a seven point programme, including projects specifically targeted at the groups that the Survey highlights as having the most to gain from improved financial capability. We will see financial capability education, information

¹⁷ *Promoting Financial Inclusion* (HM Treasury), 2004. This is corroborated by the Financial Capability Survey finding that 11% of people do not have a current account.



and advice reaching further into UK schools, Higher Education institutions, organisations that help young and often excluded adults, and the workplace. We will complement this with a range of resources designed to help all consumers become more confident and capable. Details of the seven point programme are given in our document *Financial Capability in the UK: Delivering Change*¹⁸.

In the three years since we launched the National Strategy for Financial Capability, many hundreds of thousands of people have received help, education and advice that was previously unavailable to them. With the sustained and relentless implementation of our new programme, we will now extend this to reach millions of people across the UK.

¹⁸ *Financial Capability in the UK: Delivering Change*, 2006 (available at http://www.fsa.gov.uk/pubs/other/fincap_delivering.pdf).



Appendix

What are the next steps with the Survey?

- We will continue to analyse the data, particularly to understand more about the needs of groups who may be more vulnerable.
- We will repeat it in the next four to five years as one of the measures to assess the impact of initiatives to improve levels of financial capability.
- We will share our data with a wide audience, through the Economic and Social Research Council Data Archive, so that others can gain insights in the areas of greatest interest to them.

Methodology

Measuring financial capability raised a number of key issues: what is financial capability, how would we develop a measure of financial capability and how could we measure it in practice? We tackled these questions through a significant programme of developmental work, and we appointed a team from the Personal Finance Research Centre led by Professor Elaine Kempson to help with the design phase and to carry out the subsequent analysis of the Survey data. Professor Kempson is a leading authority on financial capability issues and has extensive experience of working on quantitative surveys and national data sets. The outcome of the development phase has been reported on separately in FSA Consumer Research Paper 37 – *Measuring financial capability: An exploratory study*¹⁹.

We were clear at the outset that we would require a representative quantitative survey of the UK population. A number of design factors required careful consideration including boosting numbers in key sub-groups (the devolved UK administrative regions and ethnic minorities), and deciding on which sampling method to use. We set out these and other points, including the need for extensive piloting, in a formal specification of requirements for the quantitative data collection phase.

We appointed BMRB²⁰ to carry out the data collection stage. The research design was based around a random location sampling method developed by BMRB. It is a relatively sophisticated form of quota sampling which avoids most of the biases of simple quota methods by minimising interviewer discretion about where to interview. This process was conducted separately for the four countries of the UK, in order to provide a minimum of 3,100 interviews representative of the English population, 500 interviews representative of each of Scottish, Welsh and Northern Irish populations, and at least 400 interviews with ethnic minority groups. In the end 5,328 interviews were conducted. Full details of the fieldwork research methodology are contained in a separate methodological report²¹. We have also published the questionnaire used in the fieldwork²².

In order to subject the research methods and findings to independent external scrutiny, we established a panel of experts made up of individuals from key research organisations²³. Panel members attended meetings in their own right rather than as representative members of organisations. The panel's remit was to scrutinise the research methods and outcomes at key stages of the research process.

19 Available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr37.pdf>.

20 Examples of BMRB's previous work include the Skills for Life Survey for the Department for Education and Skills and the British Crime Survey for the Home Office.

21 *Consumer Research Paper 47a – Financial Capability Baseline Survey: Methodological Report*, 2006. (available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr47a.pdf>).

22 *Consumer Research Paper 47b – Financial Capability Baseline Survey: Questionnaire*, 2006 (available at <http://www.fsa.gov.uk/pubs/consumer-research/crpr47b.pdf>).

23 The Scottish Executive, the Department for Education and Skills, the Department for Work and Pensions, the FSA Consumer Panel, Brunel University, King's College London, IFF Research, the British Bankers' Association, Henley Centre Headlight Vision, and Citizens Advice.

Keep in touch

We will be reporting on further developments on the FSA's website at:

www.fsa.gov.uk/financial_capability

Comments or questions on the Survey can be sent via the website or by email to:

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or by mail to:

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