

Financial Capability: the Government's long-term approach

OFT response to HM Treasury consultation

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1 FINANCIAL CAPABILITY AND THE CONSUMER

- 1.1 The Office of Fair Trading (OFT) endorses the analysis that the growing complexity of financial issues presents the individual with increased challenges. We agree that factors such as increased longevity impose financial responsibility at an ever earlier age.
- 1.2 With its mission of making markets work well for consumers, the OFT welcomes the consultation's supply and demand side analysis. We support the view that supply-side interventions – for example, regulating the quality of information provision to minimise asymmetries – must be complemented by a demand-side focus. We agree that consumers empowered with high levels of skills and knowledge – financially capable consumers – can drive competition and benefit directly from markets that are working better. This complementary supply and demand side approach forms the core of the OFT's new 'whole market' approach to working.
- 1.3 We agree with the view set out in paragraph 2.39 that by definition, financial capability is a broad concept. We strongly endorse the view that financial capability encompasses both knowledge and skills. This complements our own skills-focused definition of consumer education, set out in *'Consumer education: a strategy and framework'*.¹
- 1.4 Whilst we welcome the consultation's analysis of supply and demand side interventions and its explicit recognition of the need to develop consumer skills, we feel that the proposals tend to conflate the concepts of advice and information provision and consumer education. We believe that the provision of passive, pre or post purchase advice and information is no more than a part of the consumer education toolkit. Information and advice provision is largely reactive, whilst consumer education programmes designed to secure long term improvements in consumer skills and knowledge can be a valuable proactive tool. The OFT believes that a long-term strategic approach to building financial capability

¹ *'Consumer education: a strategy and framework'*, OFT 753, November 2004

should clearly distinguish between these tools in order to use them to best effect.

- 1.5 We support the conclusion that in building financial capability, there is no quick fix.

2 IMPROVING CAPABILITY – PROGRESS TO DATE

- 2.1 We believe that the Financial Services Authority's (FSA) baseline survey provides an important evidence base for targeting and planning financial capability initiatives. We agree with its conclusion – and that of this consultation paper - that further steps need to be taken to improve levels of financial capability across the UK.
- 2.2 The consultation's contention that there is an abundance of work in this area is supported by our own evidence. We commissioned research from the Central Office of Information (COI) in 2006 to map current, nationally-scoped consumer education initiatives. The report,² published in April 2006, estimated a current spend of approximately £44 million on nationally scoped activities, with over 40 per cent of consumer education activity focused on financial subjects.
- 2.3 Our COI research also concluded that the financial subject area appears the most coordinated across the UK, with the FSA Financial Capability initiative taking the lead.³
- 2.4 In examining progress to date, the consultation identifies activities targeted at a range of life stages. We would emphasise the importance of embracing the concept of life long learning when developing the Government's long term approach.
- 2.5 A broad range of organisations currently contributes to work in building financial capability. The OFT recognises that effective partnership working will be a key element of success. In particular, we believe that industry has a critical role to play and that intermediaries will provide the principal channels for delivery.
- 2.6 We welcome the Basic Skills Agency's (BSA) work to develop financial literacy as a vehicle to teach literacy, language and

² 'Consumer education – Establishing an evidence base', COI, April 2006
www.of.gov.uk/shared_of/consumer_education/conedresearch.pdf

³ COI research, p.18

numeracy. The OFT recognises that the use of appropriate consumer contexts can provide a stimulating, relevant and engaging way of developing basic skills.

3 MOVING FORWARD

- 3.1 The OFT endorses the consultation's conclusion that there has been substantial progress to date in building financial capability.
- 3.2 We agree that policy developments such as pension reforms offer significant opportunities to build on this work.
- 3.3 We welcome the commitment to take an evidence-based approach to setting priorities and to secure a substantial increase in 'measured levels' of financial capability. We believe that evidence-based targeting and effective evaluation are essential in underpinning a strategic approach.
- 3.4 We welcome the commitment to increase efforts to integrate financial education into basic skills learning and promote the use of financial education as a route to numeracy skills.
- 3.5 The OFT agrees that widening access to generic advice is a valuable supply-side lever. However, we believe this is just one component in a whole-market approach which should focus on developing long-term improvements in consumer skills and knowledge.
- 3.6 Recognising the progress already made by the FSA in implementing its strategy for financial capability and complementing the work of the FSA Steering Group is to be commended as a sound basis on which to build effective working across Government and develop a long-term approach.
- 3.7 The OFT's consumer education strategy recognises the importance of ensuring that consumer education has a focused, coherent approach and a strategic voice. We therefore welcome the proposal to set up an informal Ministerial group. The OFT believes that such a group would be well-placed to coordinate departmental activities and speed progress in building financial capability. We would welcome the opportunity to input into the work of the group.

4 FINANCIAL CAPABILITY AND THE OFT

- 4.1 We note that the consultation states that the Enterprise Act 2002 sets out a duty on the OFT to provide consumer education and information. The Enterprise Act provides merely that the OFT has a discretionary power to publish educational materials or carry out educational activities, or support others in carrying out such activities.⁴
- 4.2 Under the Enterprise Act, the OFT has a regulatory role in working with the supply side of the financial services market to ensure the provision of good quality information to consumers. This role may be extended when the Consumer Credit Act 2006 comes into force.
- 4.3 The focus of our supply-side role is primarily in regulating the quality of pre-purchase information. We believe that the market place for post-purchase information and advice is a crowded one. We do not see a leading strategic role for ourselves in the provision of post-purchase information and advice. Our strategic approach is to avoid duplication and we believe that coordination of this area of activity is a job for the FSA as lead regulator.
- 4.4 The OFT's consumer education strategy seeks to improve the coordination of consumer education activity across the UK and make the best use of available resources. Working through the Alliance for consumer education, we are committed to reducing duplication of effort, signposting high quality activities and areas of expertise – and promoting partnership working.
- 4.5 The OFT and FSA have common consumer education interests. We share a vision of skilled and confident consumers making informed decisions about the products and services they buy. We worked closely with the FSA in developing our own consumer education strategy. The FSA is a member of the Alliance and is

⁴ s.6(2)(a) and (b) Enterprise Act 2002.

represented on our Planning Group. We issued a joint statement⁵ to explain the complementary nature of our work in 2005.

- 4.6 The OFT recognises the FSA's lead role in building financial capability in the UK. We are committed to signposting the FSA's work through the Alliance and to working together to maximise our effectiveness and the efficient use of resources.
- 4.7 This commitment to complementary work on consumer education forms part of a broader commitment to collaborative working set out in a joint FSA and OFT Action Plan⁶, published in April 2006.
- 4.8 Since publication of the Plan, substantial progress has been made in strengthening FSA-OFT liaison and communications arrangements, which have a particular impact on the FSA's financial capability work and our own consumer education objectives.⁷
- 4.9 Current OFT consumer education activities – including the development of toolkits to support the delivery of literacy and numeracy skills in the further education sector – will necessarily touch upon elements of financial capability. So too will our future work in raising consumer awareness of saving choices in relation to Christmas hamper savings schemes.⁸ The OFT will continue to liaise closely with the FSA, Alliance members and stakeholders in order to focus resources and deliver maximum impact.

⁵ *'OFT and FSA joint statement'*, 2005

www.of.gov.uk/of_at_work/partnership_working/consumer_alliance/alliance/joint-statement

⁶ *'Delivering better regulatory outcomes – A joint FSA and OFT Action Plan'*, OFT 838, April 2006. www.of.gov.uk/shared_of/about_of/of838.pdf

⁷ *'Delivering better regulatory outcomes – an update'*, OFT 879, November 2006. www.of.gov.uk/shared_of/about_of/of879.pdf

⁸ Joint HM Treasury and Department of Trade and Industry (DTI) Ministerial statement at the Launch of the financial inclusion strategy and Farepak report, 28 March 2007.

5 OUR RESPONSE TO SPECIFIC QUESTIONS RAISED IN THE CONSULTATION

Scope

Have all the required policies and programmes been captured?

- 5.1 The six areas of activity set out in the proposals are broadly defined and appear to cover a wide range of life stages. However, they appear to have been distilled from the consultation's attempt to map the existing range of policies and programmes. While this is a plausible way to coordinate current activity, we are concerned that it may not be a sufficiently strategic and long-term approach. A more strategic, evidence based approach (see following comments) might disclose important gaps. As an example, the proposals do not appear to recognise the financial literacy needs of those currently in retirement (rather than those planning for retirement), who face difficult decisions in relation to issues such as equity release.

To what extent should the Government adopt.. a wider definition of financial capability?

- 5.2 The OFT's own consumer education strategy recognises that consumer skills are generic. We use them in a wide range of situations. We believe the same is true of financial skills and that to this extent, a broad working definition is needed. However, in developing generic financial skills, we must have regard to the wide range of contexts in which they will be used. Programmes must be tailored to both the context and the delivery channel. For practical purposes, it may be necessary to define the scope of the Government's long-term approach more tightly.

Building evidence

Which programmes or initiatives.. have been particularly effective in raising levels of financial capability? What can the Government learn from these..?

- 5.3 This question highlights what we believe is a significant gap in the evidence base. The research we commissioned to map existing, nationally-scoped consumer education activity in the UK revealed that there is currently no evaluation of consumer education initiatives beyond simple estimates of units distributed.⁹ There appears to be no evaluation of the effects of initiatives on skills and knowledge levels, consumer confidence and behaviour – or of impact on markets. As part of our work to develop pilot toolkits to support literacy and numeracy skills delivery, we plan to develop an evaluation methodology to address this gap. Until then, we have no evidence on which to identify initiatives that have been particularly effective.

What other information might policy makers need to inform future work in this area?

- 5.4 The FSA's baseline survey concluded that there is no single indicator of financial capability. The survey's identification of the four domains – 'managing money', 'planning ahead', 'choosing products' and 'staying informed' - offers a useful indicator of the characteristics of a financially capable consumer. The data analysis also offers a useful insight into current skills levels and the correlation between skills level and consumer type. However, we feel that further work needs to be done to produce a model of what a 'financially capable' consumer would look like – and perhaps to build a range of profiles of financial capability. *The Adult Financial Capability Framework*¹⁰ provides a useful starting

⁹ COI research, p.23

¹⁰ *The Adult Financial Capability Framework*, 2nd edition, The Basic Skills Agency and Financial Services Authority, March 2006

point. We see further value in extending this work beyond an analysis of actual/desired skills and knowledge levels to consider other factors that drive consumers' decision-making processes. In particular, we believe that the model of a financially-capable consumer should be informed by further work on consumer psychology and behavioural economics. A sophisticated model of financial capability would enable initiatives to be better targeted and more readily evaluated.

Coordination

Is a central coordinating role function needed in addition to the work of the National Strategy and the proposed Ministerial group..?

- 5.5 The OFT believes that effective central coordination is vital to the success of a long-term approach to building financial capability. It is important that the coordination function be sustained. Our own experience indicates that coordination is resource-intensive. Whilst the proposed Ministerial group will offer a valuable strategic vision and voice, we are not clear that it will be best placed to focus on detailed activity on a sustained basis. This function might be met by a developed National Strategy. We believe that the OFT's Alliance for consumer education has a role to play, with the Alliance's mapping work offering a starting framework for coordinating financial capability activity across the UK.

Generic advice

- 5.6 The OFT agrees that widening access to generic advice is an important tool in raising levels of financial capability. We welcome proposals to provide consumers with reliable information and advice through the extended provision of personalised, unregulated financial advice. We are, however, unable to comment on the boundaries of such advice or potential funding models.