FINANCIAL REGULATOR
Rialtóir Airgeadais

Preliminary Report on Financial Capability in Ireland

June 2008

Contents

1. Introduction

The Financial Regulator has completed the fieldwork for its study of the financial capability of consumers in Ireland. This preliminary report gives an overview of the background to the project and the reasons why this research is being undertaken. We also report on progress to date and we set out details of how we will proceed from here.

This report contains some statistics from an early analysis of the dataset. These statistics give a sense of the relevance of this project to the development of policy in the area of financial consumer protection and education in Ireland.

2. Background

The role of the Financial Regulator is to help consumers make informed decisions on their financial affairs in a safe and fair market, and to foster sound and solvent financial institutions, which gives depositors, policyholders and other consumers of financial products confidence that their deposits, investments and insurance policies are safe.

In order to help consumers in Ireland make informed decisions, and also ensure that our regulatory approach and policy meet consumers' needs, we need to develop a greater understanding of their financial behaviour and attitudes and the processes by which they make financial decisions. Effective participation in our modern economy requires that people have access to financial services, and the ability and confidence to choose and use these services for their benefit and for the benefit of their families.

Increasingly individuals have to take greater responsibility for making financial decisions that affect their lives, and they need to plan ahead to make sure that their requirements are met. Taking out a mortgage to buy a house, taking out a pension, or saving for a rainy day are not simple matters, but they are challenges that very many consumers will face.

Consumers must have the capability to make good decisions on these matters.

Many financial contracts (e.g. insurance, pensions etc.) are long-term in nature, and the consumption of the service is at a time other than the point of purchase. If consumers have difficulty in ascertaining the quality of financial products at the point of purchase it may be some time before the consequences of a bad decision crystallise.

The Financial Regulator embarked on a major study to assess Irish consumers financial capability in 2007. Financial capability is a broad measure of the knowledge, skills, attitudes and behaviours necessary to manage personal finances and to choose and make appropriate use of financial products. It includes knowledge and understanding of financial products, terms and concepts. It also includes skills such as the ability to budget, search for good products and services and deal confidently with advisors. Attitudes are also important, such as the willingness to spend the time to keep track of finances, and avoiding financial disengagement, unrealistic spending habits and living only for today. Finally, actual behaviour in real life situations is probably the most reliable indicator of financial capability.

3. Objectives of the Financial Capability Study

Financial capability broadly indicates the ability of consumers to make informed decisions in relation to financial matters, and their awareness of the costs, risks and benefits of financial products[1]. The objective of this study is to measure (by means of an in-depth consumer survey) the financial capability of consumers in Ireland. At a more specific level, the survey seeks to measure the ability of consumers to:

- manage money, keep track of spending and live within their means;

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[1] Financial capability is referred to as financial literacy in some countries.

- plan ahead and make provision for future events including retirement;

- assess products and make choices between similar financial offerings; and

- get help and stay informed about financial products and services.

It is intended that the survey will be repeated at regular intervals in the future, for example every 5 years, to allow an analysis of changes over time and to ensure that consumer protection policy remains evidence based. Although the study may provide some indicators of the success of our activities, due to the wide range of socio-economic and cultural factors that influence financial capability, it is difficult to disaggregate the effects of any single factor from those of others. In short, it is not possible to use the measurement of financial capability in the Irish population as a way of reliably measuring the effectiveness of some of the initiatives of the Financial Regulator.

4. Purpose of this project

The project has been undertaken for a number of reasons:

1. To give us greater insight into the overall level of financial capability in Ireland, so that we can refine our consumer communications and education strategy and make more focused use of our resources. Until this survey was conducted no comprehensive data was available to indicate how well or poorly people in Ireland as a whole, or specific sub-groups of the population, fare in relation to managing their financial affairs in a wide spectrum of areas. The survey will inform us of correlations between levels of financial capability and such factors as gender, age, income, and experience with financial products, and identify which groups or sub-groups have least financial understanding and so are at greatest risk. By measuring the level of absolute financial capability at periodic intervals, we can gain better insights into how sections of the community are

gaining a better understanding of financial products and how we can best target our resources.

2. To inform our broader consumer protection policy and regulatory work. Over time increased knowledge about the consumers we are seeking to protect, their levels of understanding of financial matters, what they rely on and give emphasis to in making decisions, and their vulnerabilities should assist us to make sound, fact-based judgements when reviewing existing or developing new consumer protection initiatives.

3. To raise the profile of financial capability generally among policymakers, influencers and the public, and more specifically, to inform the development of national financial education policy initiatives, including, in particular, the work of the National Steering Group for Financial Education which has been established under the aegis of the Financial Regulator and which is supported by consumer and industry bodies, community organisations, other public bodies and government departments.

5. International best practice

Recognition of the importance of measuring the financial capability of consumers is becoming increasingly common internationally among financial regulators and other agencies with responsibilities in the area of financial consumer education and protection. The United Kingdom, France, the United States, Australia, the Netherlands and Singapore have all undertaken or are planning exercises aimed at measuring financial capability. Their common objectives have been to gain greater insight into the knowledge, skills, attitudes and behaviours of consumers and to use the findings to:

- develop more targeted communications programmes aimed at improving consumer financial capability;
- inform regulatory policy;

- develop coordinated action plans, either alone or in partnership with industry and other consumer bodies, to target improvements in financial capability; and

- to influence government policy in relation to education and other initiatives aimed at ensuring consumers become more financially capable.

In both the United Kingdom and Australia, the research has led to major government and industry programmes in financial education, as well as the planned introduction of financial literacy into the formal school curriculum. The impact of the research appears to have been to help transform what was a general concern about the need to improve financial capability into a more widespread realisation of the size and seriousness of the problem of low consumer financial capability. The research has also yielded a large body of factual data on which to base appropriate solutions.

The European Commission has also taken a number of initiatives in the area of financial capability and education, including a conference in Brussels on financial education in March 2007, a communication from the Commission on good practices in relation to financial education in December 2007, research into financial literacy schemes conducted in 2007 and the decision to establish expert group on financial education to advise the European Commission.

The Commission has also created the 'Dolceta' website (Development of On-Line Consumer Education Tools for Adults) that includes modules on personal finance.

The Organisation for Economic Cooperation and Development (OECD) has also undertaken work in this area as part of a broader project on financial education. The OECD’s “Recommendation on Principles and Good Practices for Financial Education and Awareness” published in 2005, and the more recent establishment of the International Network on Financial Education are initiatives in this area. The Financial Regulator will use its participation in the OECD's International Network on Financial Education, and our contacts from the International Forum on Financial Consumer Protection and Education[2], to evaluate our work compared to that of our peers.

6. Survey development and fieldwork

The Financial Regulator appointed an independent market research agency to undertake the fieldwork following a public tender. The in-depth survey was modelled on a similar survey carried out by the Financial Services Authority (FSA) in the United Kingdom in 2005. Whilst a degree of consistency and thus comparability with the FSA study has been maintained, it was recognised that on the one hand some of the questions in the FSA's study were specific to the United Kingdom and therefore had to be removed, while on the other hand the situation in the Irish market would require that questions that dealt with particularly Irish circumstances would have to be devised and included in the study[3]. As a result a considerable number of changes were required in order to ensure the questionnaire was appropriately focussed on the Irish market.

Changes to the questionnaire were made by the Financial Regulator in consultation with a market research consultant, and an academic institution, both of whom had worked on the UK study.

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[2] This forum is an organisation comprised mainly of financial regulators that have a particular mandate in the area of financial consumer protection and education. It provides a structure within which members can freely discuss financial consumer protection and education issues with a view to promoting standards for fair and equitable treatment of financial consumers, and contributing to enhanced levels of financial literacy.

[3] For example the questionnaire included some questions about SSIAs (which were specific to the Irish market) and it was also amended to accommodate the greater role of credit unions in the Irish market. Additional work was required to make sure references to product names, social welfare benefits, tax provisions etc were accurate. Questions in the FSA template dealing with UK products such as ISAs/TESSAs etc were omitted.

The Financial Regulator's preferred way to conduct this research was to use Computer Assisted Personal Interviewing (CAPI[4]), as was the case in the FSA study. For a large-scale project of this nature, with a large number of lengthy and relatively complex interviews being conducted this is undoubtedly the most efficient means of data collection.

As with any large study, comprehensive piloting of the survey and methodology was necessary in order to identify any issues that might impact on data quality and restrict efficient data collection. Two phases of piloting were undertaken in July and August 2007, in urban and rural locations, resulting in a survey that was a much easier experience for respondents and interviewers. The average survey length was 47 minutes.

The survey fieldwork was conducted between October 2007 and January 2008. No interviewing took place over the Christmas period, between 20th December and 2nd January.

The principal objective of the survey was to deliver data that allows for the reliable analysis of financial capability by demographic factors such as income, age, gender, socio-economic status, including education level, and geographic location. To meet this objective over 1,500 interviews were conducted with a representative sample of the Irish population aged 18 and over.

7.1 Some preliminary findings[5]

The questionnaire explored four key areas:

1. Day-to-day money management: How do people budget and live within their means?

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[4] Computer Aided Personal Interviewing is a software code written to direct administration of the questionnaire and reduce errors. Each question and all responses allowed in a range are pre-coded to aid completion. In addition, 'jump to' loops are built into the code to guide the interviewer on which sub-parts of the questionnaire are relevant depending on the response to a particular set of questions.

[5] **Note**: The figures quoted in this section are preliminary results, drawn from a database that we are continuing to audit. As such they may be subject to revision in the final report.

2. Planning ahead: How do people provide for unexpected expenses? Do they plan for short and long-term financial needs, including retirement?

3. Choosing and using financial products: What factors influence people's choice of financial products? How much do people shop around? Are they aware of price?

4. Getting help, staying informed: Do people use advice? How do they use it? Do people keep up to date with matters that affect their financial well-being?

This report sets out some high-level findings to key questions which were asked under these headings.

7.1 Managing money, keeping track of spending and living within means.

It is essential that consumers are equipped with the necessary skills and aptitudes to manage their money, budget appropriately and live within their means. Over 70% of consumers state that they do some planning for things like utility bills, travel tickets, insurance, etc. Many others do not need to plan for these expenses either because they are too young to have regular commitments of this nature or because they are confident that they will always have sufficient funds to meet expenses of this type.

On a slightly more worrying note, initial data from the study showed that 37 per cent of consumers say they have at least some degree of difficulty keeping up with bills and credit commitments, and this figure rises to 60 per cent and 66.2 per cent for divorced and separated people respectively. 13 per cent of the population have found themselves in financial difficulties within the last five years (i.e. 3 or more months behind payments with regular commitments) – this rises to 20 per cent for those aged between 21 and 35, and to 36 per cent and 26 per cent respectively for divorced and separated persons.

Some regional variations can be observed, for example across the whole population, 59 per cent of people say that they never run out of money before the end of the week/month, however only 45 percent of people in Dublin can say this, while the figures for the rest of Leinster, Munster and Connaught/Ulster are 63 per cent, 65 per cent and 66 per cent respectively.

Turning to product ownership, some of the initial findings are that approximately 17 per cent of people don't have a current account, and over 61 per cent don't have a credit card. 43 per cent have an account with a credit union, and 40 per cent have some level of life insurance cover.

When it comes to being aware of their rights, 27 per cent say that they have no idea how to make a complaint to a financial services firm and 26 per cent say that they have just some idea of what to do. Consumers are much more confident about their rights when it comes to complaints to shops and suppliers about the quality of goods or services with just 9 per cent saying that they have no idea how to make a complaint, and a further 17 per cent saying that they have just some idea of what to do. Interestingly, consumers in Munster seem more confident about making complaints than those living elsewhere:

Complaint to a financial services firm

	Total Pop.	Dublin	Rest of Leinster	Munster	Connaught/ Ulster
I know exactly what to do to make a complaint	**16%**	11%	13%	26%	13%
I have a good idea of what to do	**30%**	26%	27%	33%	34%
I have some idea of what to do	**26%**	24%	34%	21%	25%
I have no idea of what to do	**27%**	37%	25%	20%	26%
Don't know	**1%**	1%	1%	1%	2%

Complaint about the quality of goods or services

	Total Pop.	Dublin	Rest of Leinster	Munster	Connaught /Ulster
I know exactly what to do to make a complaint	**30%**	22%	29%	42%	30%
I have a good idea of what to do	**44%**	43%	43%	37%	50%
I have some idea of what to do	**17%**	20%	18%	16%	15%
I have no idea of what to do	**9%**	15%	10%	4%	5%
Don't know	**-**	-	-	-	-

7.2 Planning ahead and making provision for future events including retirement.

One of our key messages to consumers in helping them to manage their financial affairs is to stress the importance of planning and budgeting, and of the benefits of having a contingency for a "rainy day".

Our research shows that 25 per cent of respondents (or their partners) have, over the past three years, experienced a large and unexpected drop in income (due to, for example, a drop in wages/income or benefits, separation expenses, etc.). Again looking over the past three years, 16 per cent have experienced a major expense (equivalent to the whole income for a month) that was not expected.

We also asked if the household income was to drop by a quarter tomorrow, and this lasted at least three months or more, for how long would the respondent (and their partner) be able to make ends meet. The responses received are as follows:

Less than 1 week	1%
1 week to 1 month	8%
1 month to 3 months	19%
3 months to 6 months	22%
6 months to 12 months	13%
12 months +	25%
Don't know	12%

Concerning planning for retirement, over half of the respondents clearly had no idea of the current value of the minimum State pension that an individual could receive. When told what that pension amount is, 66 per cent said that this would not give them (and their partner) the standard of living they would hope for in retirement.

7.3 Assessing products and making choices between similar financial offerings.

As we have already noted, individuals increasingly have to take greater responsibility for making financial decisions that affect their lives. The ability to make good choices is therefore clearly a competence that consumers need to possess.

Our research shows that 25 percent of the population have received professional advice in relation to planning their finances in the past five years. Delving a little deeper into this, we find that mortgages and pensions are the two issues on which the greatest number of people have received professional advice (9 per cent each) followed by life insurance (7 per cent).

Regarding attitudes to financial advice we noted the following results:

Please tell me how strongly you agree or disagree with the statement:	Agree Strongly	Tend to Agree	Tend to disagree	Disagree strongly	Don't know
"I've got a clear idea of the sorts of financial products that I need without consulting a financial adviser".	22%	41%	23%	11%	3%
"I would trust financial advisers and accept what they recommend".	7%	46%	28%	13%	5%

Consumers were also asked about their attitudes to risk, and specifically about how much risk they were prepared to take that they might lose some of the money they put into a savings account or investment. Broadly speaking it is clear that consumers are very risk averse, and that such appetite for investment risk that may exist diminishes noticeably as consumers get older.

Consumers attitude to risk and the percentage breakdown by age:

	Total Pop.	18-20	21-24	25-34	35-44	45-54	55-60	61-64	65-74	75+
No risk at all.	**44**	25	41	40	35	47	57	47	57	74
Low risk.	**27**	25	25	27	32	27	23	33	27	18
Low to moderate risk.	**12**	16	13	16	16	10	7	11	7	1
Moderate Risk.	**10**	18	12	9	12	12	9	5	2	1
Moderate to high risk.	**2**	1	3	2	1	2	2	1	-	-
High risk.	**1**	4	-	2	2	1	-	-	1	1
Don't know.	**3**	11	5	3	1	1	1	3	5	4

The initial data suggests that many consumers have difficulty in understanding the nature of the risks that their savings and investments are subject to. For example:

- Only 36 per cent understood that the value of a tracker bond would be directly affected by stock market performance;

- Only 21 per cent understood that the value of an endowment policy would be directly affected by stock market performance; and

- Only 17 per cent understood that the value of a unit trust would be directly affected by stock market performance.

All of these investment products are likely to be affected by stock market performance. The value of a savings/deposit account is not likely be directly affected by stock market performance, nevertheless 7 per cent thought that it would be.

The data suggests that while many consumers do shop around for value in the market there is also considerable scope for developing awareness of the benefits of shopping around, and also getting consumers to act on that awareness, thus exercising buying power. The responses of consumers to the question of whether or not they had (within the last five years) shopped around before buying one of the following financial products were as follows:

Product	Percentage that had shopped around
Mortgage	65%
General Insurance	53%
Investment Product	39%
Life Assurance	39%
Credit Card	29%
Savings Account	24%
Loan	18%
Current Account	17%

7.4 Staying informed about financial products and services

Initiatives that aim to enhance the financial capability of consumers must be accompanied by measures to encourage them to maintain that capability and to remain informed about the world of financial products and services as it affects them.

62 per cent of respondents thought it was very important or quite important to keep up to date with what is happening with financial markets generally. The issues that consumers were most likely to personally keep an eye on included the housing market (39 per cent), interest rates (37 per cent), inflation (35 per cent), and taxation and State benefits (both 30 per cent).

Consumers were asked how they tended to monitor financial issues. The most popular sources of information were newspapers (but not the financial pages) at 49 per cent, and television (other than specialist personal finance programs) at 44 per cent. Across the population 10 per cent use the internet to stay informed, though this is higher for consumers in their twenties and thirties.

8. The next steps

We will now commence a more detailed analysis of the dataset. In this further analysis we will devise a scoring mechanism that will help to identify relative strengths and weaknesses under the four broad headings referred to in this preliminary report. We also wish to be able to understand better the demographic profiles of people that are more likely to display higher or lower levels of financial capability.

The Financial Regulator intends to publish its final report on financial capability toward the end of 2008.

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