

## EPFSF Briefing

# Financial Education and Financial capability

### Introduction

Until 2000, financial education hardly seemed to be an issue. Scarce literature existed mainly originating from the US or the UK. A 2005 OECD study<sup>1</sup> is presented as first international research. The scale of the question is vast but its perimeter imprecise. Callum McCarthy observed in 2005<sup>2</sup>:

*“A study by the Institute of Financial Services showed that eight from ten people did not correctly identify the term APR as describing the interest rate and other costs of a loan; five from ten people admit to not understanding financial products such as mortgages or ISAs.*

*A survey done for the FSA asked the question: “if the inflation rate is 5 per cent and the interest rate you get on your savings is 3 per cent, will your savings be worth as much in a year's time?” – one in five gave the wrong answer. “*

The importance of the topic has increased for various reasons. Demographic, economic and policy changes compel individuals to make more financial decisions, when some of them were taken for them in the past (i.e: pensions). Additionally, with the development of financial markets offers, consumers must chose from a much wider range of products. Many international and national surveys have demonstrated generally low levels of understanding of financial matters and basic economics. More worrying, individuals generally feel they know more about financial matters than it is actually the case.

There is to date no common definition of financial education, financial literacy and financial capability. This leads to a tendency to mix up terms and amalgamate education and information. Key elements of a working definition can be found for instance in OECD work, or in the UK where early research was conducted. The European Commission<sup>3</sup> defines **financial literacy** as *“the capability of consumers and small business owners to understand retail financial products, with a view to making informed decision”*. The FSA distinguishes **financial education** along three lines:

- Financial knowledge and understanding: the consumer knows and understands the different forms, use and functions of money (e.g. cash, cheques, credit cards, loans...)
- Financial skills and competence: based on knowledge, consumers' attitudes are influenced when using, spending and saving money;
- Responsibility: customers understand that their financial decisions will have an impact on others.

The **European Commission**<sup>4</sup> sees financial education as enabling individuals *“to be aware of financial risks and opportunities and make informed decisions in their choice of financial services. It is a life-long issue”*. Benefits are not limited to individuals but encompass the society as a whole and the economy. The HM Treasury defines **financial capability** as *“a broad concept, encompassing the knowledge and skills that people, including young people, need to understand to manage their own financial circumstances, along with the motivation to engage in financial decision-making”*.

National strategies greatly differ throughout the EU. Financial education is becoming a growing priority in certain Member States and at European level, signalling a shift from a curative approach to financial difficulties to a preventive stance. The European Commission supports financial education along a “bottom-up” approach, seen as a complement to measures aiming to ensure provision of information, protection and advice. A recent communication features basic principles based on best practices and announce a handful of initiatives, such as online education tools, including a programme for teachers.

<sup>1</sup> Improving Financial Literacy, Analysis of issues and policies, OECD, 2005

<sup>2</sup> Speech by Callum McCarthy, Chairman of the FSA, FSA Office of Fair Trading's European Competition and Consumer Day, 15 September 2005

<sup>3</sup> DG Markt invitation to tender, MARKT/2006/26/H, Annex 1

<sup>4</sup> see : [http://ec.europa.eu/internal\\_market/finservices-retail/docs/capability/communication\\_en.pdf](http://ec.europa.eu/internal_market/finservices-retail/docs/capability/communication_en.pdf)

To launch a European debate, questions to be discussed include, inter-alia, reflecting on best channels for successful delivery, best strategies to reach different target audiences, sources of funding and importance of resources devoted, program evaluation, sound data enabling comparisons at EU level, exploration of the relationship between financial education, information and advice, importance to include financial education in school curriculum, teachers training, leveraging on existing programmes ...

### **Selected issues**

#### **1. Importance of financial education**

Existing surveys converge to show that individuals generally lack adequate financial background and often believe that they are far more literate than is currently the case. At national level, a 2004 study<sup>5</sup> commissioned by the AMF in France finds out that 74% of interviewed said they were unable to read financial press, 58% unable to choose a financial product. As other illustration, the FSA, which has been granted statutory authority to promote public understanding of financial capability commissioned abundant qualitative and quantitative research, many of them based on focus groups. Among others, results showed:

- About eight in ten consumers said they tended to shop around but in practice hardly any of them had actually done so;
- Most consumers undertake little long-term planning or budgeting, and more decisions were rather reactive than pro-active;
- Young people's level of shopping around for financial products was very low in contrast to buying clothes or shopping.

At EU level, the European Credit Research Institute (ECRI)<sup>6</sup> held a seminar, co-sponsored by Visa Europe, which pointed to a major stake of financial education as "*aiming to change attitudes, whether in the area of money management, credit or consumption choices, through the establishment of new value priorities*".

#### **2. A multi faceted problem with a diversity of interested parties**

A range of different issues, audiences, actors are encompassed under the terms "financial education". There can be different needs to receive a financial education: learning how to manage money, plan its future, make choices or receive help. Recent research<sup>7</sup> shows the most common subject of financial education programmes are "money basics", such as how to use a bank account, followed by budgeting skills. Issues such as investment, savings, retirement, insurance and risk management feature far less highly, indicating that these may require far more attention in future.

Needs depend on age, personal situation, gender... They are evolving and cannot be apprehended in a "one-size fits all" approach. The 2007 Evers and Young research finds out that current main target groups are children and young adults. Only few schemes seem to be aimed at specific public, such as pre-retirement, women, ethnic minorities, people on low income... The European Commission considers financial education should be promoted at all stages of life on a continuous basis, and be specifically targeted to meet the specific needs of citizens.

Financial education can be provided by a variety of actors ranging from financial supervisory authorities to adult literacy agencies, debt advice clinics, social workers, financial industry federations, individual firms, housing authorities and others. A number of financial services companies have already developed programmes aimed at improving financial literacy and financial capability.

A 2007 survey mapped out that national authorities are the drivers of programmes in 11 Member States. It also noted that financial services providers operate one of out six schemes.

<sup>5</sup> Etude Sofres sur l'éducation financière des français, see : [http://www.tns-sofres.com/etudes/comfi/091204\\_educfinanciere.htm](http://www.tns-sofres.com/etudes/comfi/091204_educfinanciere.htm)

<sup>6</sup> European Credit Research Institute workshop, Financial Capability: empowering European consumers, June 2006, see: [http://www.ecri.be/ecri/public/FinCap\\_Workshop\\_1\\_papers.pdf](http://www.ecri.be/ecri/public/FinCap_Workshop_1_papers.pdf)

<sup>7</sup> Evers Jungs research and consulting, Survey of Financial literacy schemes in the EU27 see: [http://ec.europa.eu/internal\\_market/fin services-retail/docs/capability/report\\_survey\\_en.pdf](http://ec.europa.eu/internal_market/fin services-retail/docs/capability/report_survey_en.pdf)

### 3. Overview of existing measures in Member States

There is a great disparity in the provision of financial education in Europe. Evers Jung study found that most schemes were in the UK (32% of core schemes), Germany (22%), Austria (10%), the Netherlands and Italy. By contrast, Bulgaria, Latvia, Luxembourg, Slovenia and Romania seem to be solely covered by trans-national EU programmes. The survey records that 2/3 of existing schemes target children and young adults.

The study selected 10 case studies covering a variety of groups, methodologies and Member States, to provide an overview of existing strategies. These covered schemes for specific population such as children, elderly, or financial literacy at the work place. Certain programmes are designed for migrants in Germany or underachieving groups. In terms of channels, a UK web-based scheme and a trans-national web-based scheme ("Dolceta") and a multi-channel one in France are presented. Finally, as regards providers, the survey shows examples of schemes delivered by public authorities in Hungary, or financial services providers in the Netherlands. This first EU-wide survey shows that many initiatives are already in place: out of 800 questionnaires sent throughout Europe by the consultat, 154 programmes could be identified. Furthermore, desk-research confirmed that a number of existing programmes had not been referenced.

Looking at measures in place, some common features can be identified, such as efforts to introduce financial education in schools and in national curriculum (i.e.: UK, Italy, Hungary...), web-based information with simple and user-friendly material and efforts aimed at raising public awareness.

### 4. EU strategy

As part of its retail financial policy strategy, the European Commission wants to bring financial education forward. DG Education is involved on measures to improve education, particularly in relation to improving young people's reading abilities and adults' lifelong learning. DG Sanco and DG Markt are also active. A full day conference was organised in March 2007. A Communication<sup>8</sup> on financial education was issued in January 2008 together with a study surveying existing schemes. The Commission supports financial education delivered as close as possible to the citizens, namely through Member States, national and regional authorities, NGOs & the financial services sector.

The Communication sets out economic, societal and personal benefits of increased financial literacy. It presents basic principles based on best practices. These include active promotion of financial education at all life stages on a continuous basis, education in economic and financial matters starting as early as possible, beginning at school. It recommends national authorities to consider compulsory financial education in schools' curriculum, raising awareness on understanding of financial issues and risks. Trainers should receive sufficient resources and training. When delivered by financial providers, education should be supplied fairly. National coordination between stakeholders should be promoted, to achieve a clear definition of roles, facilitate sharing of experiences, rationalise and prioritise resources. International cooperation between providers should be enhanced to facilitate exchange of best practices. Schemes should be evaluated to be brought into line with best practices.

As part of future initiatives, an online reference database of financial education programmes and research should be issued, the existing "Dolceta" online education tool enhanced to help teachers to incorporate financial matters into school curriculum. The Commission will monitor progress.

### Conclusion

This policy strategy to engage in a shift from curative to preventive measures to empower and protect consumers should be welcomed. The stake is about changing people's attitudes towards money spending. It is therefore a long-term strategy. It can be questioned whether financial education must be seen as a complement to measures aiming to ensure the appropriate provision of information, protection and advice as the European Commission sees it, or whether financial education is not rather a deeper element, forming the basis for a lighter need of information, and arguing the case for a better distinction between education, information and advice.

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<sup>8</sup> see : [http://ec.europa.eu/internal\\_market/finservices-retail/docs/capability/communication\\_en.pdf](http://ec.europa.eu/internal_market/finservices-retail/docs/capability/communication_en.pdf)

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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