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Transforming Financial Behaviour:
A summary

A report for the Consumer Financial Education Body

cfeb consumer financial education body

Contents

About this publication

We are committed to encouraging enquiry and debate among academics, practitioners and policy makers in all aspects of financial capability. To help this we commission research and publish papers on financial capability, extending across psychology, sociology, economics and other disciplines.

Our research papers are intended to stimulate interest, to challenge and to develop thinking. They may sometimes contain controversial ideas that reflect the authors' views and not necessarily those of the UK Consumer Financial Education Body (CFEB).

The purpose of this document is to summarise the key findings and proposals of the behavioural science research report, *Transforming Financial Behaviour: developing interventions that build financial capability*. CFEB commissioned the report to identify the most effective drivers for changing financial behaviour and consider ways in which these could be harnessed to improve financial capability.

It will be of interest to:

- those who design, market and buy financial products;
- independent financial advisers, money advisers and debt counsellors;
- policy makers working on personal finance, wellbeing and financial capability; and
- those who design and deliver financial capability initiatives.

Foreword

Right now, across the globe, economies are experiencing the effects of financial shock. Personal financial capability has a role in preventing the conditions that create shocks and in equipping us to cope with them when they happen.

Financially capable citizens are crucial to a country's long-term economic health. A population that keeps track of its money, makes ends meet, and plans ahead creates a strong foundation for economic growth. And consumers who choose financial products well and stay informed about financial matters encourage healthy financial services markets. On a personal level the ability to manage our own financial affairs brings us freedom, increases our life choices and contributes to our psychological wellbeing. By building our own financial resilience, we contribute to that of our families, communities and society as a whole.

Through the Delivering Change programme, nine million people have received financial information and advice in the last four years. We have just published the final evaluation of our Money Guidance Pathfinder[1]. It shows that three quarters of users find Money Guidance so useful they would recommend it to their friends, and that 20% take positive action after using the service. Our challenge now is to encourage even more people to act and to change their long-term financial behaviour. I believe that the annual family financial health check the Government has asked us to develop, which will build on our established Moneymadeclear service, provides an outstanding opportunity to do this.

This is why I am excited by the findings of the report, *Transforming Financial Behaviour*[2]. It shows we can use learning from psychology and sociology alongside more traditional policy interventions to foster behaviour change. Through applying and evaluating well-researched interventions we want to build on our expertise. I hope that together with our partners from government, the financial services industry, the third sector and consumer groups we can find practical ways to create an environment that supports enduring financial capability.

I encourage you to read the full report. I would welcome your reflections on it and your collaboration, as we take forward this ground-breaking work.

Tony Hobman

July 2010

Background

Choices matter

In a world in which individuals are increasingly required to take personal responsibility for their financial affairs, people need to be able to manage their money well. The cost of not having the necessary skills to make sound financial decisions is significant for individuals, but also for society as a whole.

- When people make bad decisions, or no decisions, there are often negative consequences for society generally. So an individual's inadequate provision for retirement creates a burden for the state.
- The absence of financial capability can divert economic resources from more productive uses. Where individuals become over-indebted many parties incur costs in trying to resolve the situation.
- Poor financial capability makes financial services more expensive for everyone. Firms have to spend more time educating consumers and developing systems to mitigate risks. The costs of this are passed on to all consumers.

Furthermore, our recent research on the relationship between people's ability to manage their money and wellbeing[3] demonstrates that poor financial capability can contribute to ill health, creating a further layer of personal and social costs. However, just as in the case of health, financial choices are complex and we find it difficult to engage with them. This can lead to inertia and increasing information asymmetry for consumers.

The role of CFEB

In the Financial Services Act 2010, Parliament gave the Consumer Financial Education Body (CFEB) the statutory responsibility to enhance:

- the understanding and knowledge of members of the public on financial matters (including the UK financial system); and
- the ability of members of the public to manage their own financial affairs.

CFEB has taken over the leadership of the National Strategy for Financial Capability from the Financial Services Authority (FSA) in partnership with government, industry and the third sector.

Working with the financial services industry and other partners, we provide financial information, education and advice to people, including at key stages in their lives. This is done through www.moneymadeclear.org.uk, face-to-face and over the phone, workplace seminars, training key frontline workers and a comprehensive range of printed guides. We also work in partnership with trusted intermediaries like youth workers, midwives and student money advisers to reach key target groups. Rigorous evaluation of our work

demonstrates that these interventions have a positive impact on individual financial capability.

Behavioural economics and financial capability

In 2008, the FSA commissioned a literature review of the lessons from behavioural economics for financial capability[4]. It highlighted the importance of psychology in understanding financial behaviour. This year CFEB commissioned this further report, *Transforming Financial Behaviour*. It explores in more detail the potential for interventions that change the decision making environment. This process is called 'choice architecture'. Used carefully, it appears to offer the prospect of helping people make better choices.

The full report is available from CFEB's website at www.cfebuk.org.uk/pdfs/Trans_fin_behav_reportJuly2010.pdf. It contains an academic literature review, case studies and expert interviews relating to behavioural economics. Its key findings and recommendations are set out in this summary document.

The report: Key findings and recommendations

1. Literature review: behaviour change in finance

What is behavioural economics?

Behavioural economics seeks to apply the lessons from psychology to the laws of economics. The ground-breaking work of the psychologist and Nobel Laureate Daniel Kahneman and his colleague Amos Tversky demonstrated that the classic economic laws of rationality do not lie at the heart of human decision making[5].

Our behaviour is not guided by a kind of super-computer that can analyse the cost and benefits of every action and determine maximum wellbeing. Instead, it is led by our adaptable, sociable, emotional, instinctive brain which uses mental heuristics – 'rules of thumb' – to deal with the myriad choices we face. Generally these serve us very well, but they can sometimes lead to misperceptions and misjudgements. So the mental shortcuts that enable us to cope with a complex world can sometimes get us into trouble, both as individuals and collectively.

The report's authors explain that psychologists are converging on the view that two processes operate in the brain. One is reflective (controlled, effortful, deductive, slow and self-aware), and the other is automatic (uncontrolled, effortless, emotional, fast and unconscious).

In real life, the distinction is not so clear-cut: a dynamic mix of both reflective and automatic processes generally governs our behaviour. When driving a car, for example, we can focus on the radio and apparently drive on autopilot. Our reflective system is ignoring everything but the radio, but our automatic system is not because if we hear the sound of a horn we break off from listening to the radio and focus all our attention to the situation on the road.

Changing behaviour

Two general models for population-wide behaviour change have emerged in recent years:

- interventions that aim to change behaviour by providing information, education and tangible incentives; and
- interventions that change behaviour by changing the environment within which the person acts.

Traditional public policy interventions tend to use the first model. It is presumed that consumers will consciously analyse the information and incentives available to them and act in ways that reflect their best interests.

In contrast, the second model relies on environmental changes to alter behaviour. It focuses on the sub-conscious, 'fast and frugal' processes that psychologists generally agree can influence our judgments and decision-making almost unknowingly. This model recognises that what appear at first glance to be irrational or inconsistent choices may be the result of evolved responses to environmental and social influences.

“what appear at first glance to be irrational or inconsistent choices may be the result of evolved responses”

Lessons for policy makers

Policy-makers attempting to change behaviour need to understand how the reflective and automatic systems work, and how they affect behaviour. The report suggests that the most effective policies will be those that combine more traditional interventions: regulation, information and education, with the creation of contexts and environments that encourage the automatic system to support behaviour change.

The literature review focuses on research relevant to financial behaviour. It looks firstly at research into changing behaviour by influencing the reflective process through providing information, education and advice and trying to change beliefs. Evidence suggests that interference from the automatic process can hamper or help these interventions. In particular, reflective interventions appear to be more effective when individuals actively seek them. The main focus of the report, however, is on the automatic process and how this drives behaviour.

Developing a framework

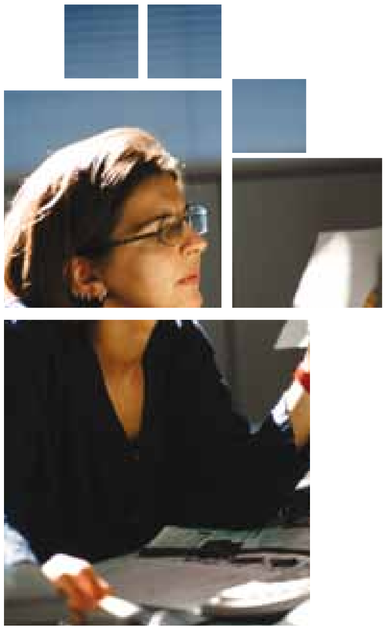
Recent research undertaken for the UK Government's Cabinet Office on influencing behaviour through public policy sets out what appears to be the most robust effects operating largely (but not exclusively) on the automatic system.[6] It proposes each effect be seen as an element of a framework – called MINDSPACE – for checking that policy interventions take automatic processes into account.

Transforming Financial Behaviour's authors have used MINDSPACE as a framework for reviewing literature that directly implicates improving financial capability. They draw on research into financial, health, and risk management behaviour. In the light of the literature review, the authors conclude that all the MINDSPACE elements are relevant for encouraging financially capable behaviour.

MINDSPACE elements

Messenger	We are heavily influenced by who communicates information.
Incentives	Our responses to incentives are shaped by predictable mental shortcuts such as strongly avoiding losses.
Norms	We are strongly influenced by what others do.
Defaults	We 'go with the flow' of pre-set options.
Salience	Our attention is drawn to what is novel and seems relevant to us.
Priming	Our actions are often influenced by sub-conscious cues.
Affect	Our emotional associations can powerfully shape our actions.
Commitments	We seek to be consistent with our public promises, and reciprocate acts.
Ego	We act in ways that make us feel better about ourselves.

2. Suggested interventions



Financial Capability in the UK: Delivering Change[7] identified five key components of financial capability: making ends meet; keeping track of your finances; planning ahead; choosing financial products; and staying informed about financial matters.

The research team sought to identify practical interventions that may be particularly effective in relation to improving financial capability. A long list of possible interventions was developed. Through discussions and debate amongst the team the list was refined to ten to explore further in expert interviews and case study reviews. Interviews were conducted with 21 experts from four groups: financial advisors, providers, consumer help organisations and CFEB/FSA.

For each of the interventions we have summarised below the relevant academic evidence and then highlighted some of the views expressed by the experts. A comprehensive description of the findings is set out in the full report.

Intervention		MINDSPACE category
1	Use the best person or channel to provide education/information.	Messenger
2	Provide incentives to change behaviour.	Incentives
3	Use mental accounting to encourage provision for unexpected outcomes.	Incentives
4	Provide relative information on peer group, i.e. people like you.	Norms
5	Use a default behaviour to encourage action.	Default
6	Provide feedback to encourage money management.	Salience
7	Present outcomes in such a way that invokes particular feelings or influences behaviour.	Priming/Affect
8	Make a commitment to an action or behaviour.	Commitment
9	Set realistic targets and goals.	Commitment
10	Financial health checks that challenge negative self-beliefs and norms.	Ego

Encouraging the allocation of money to a ‘rainy day’ mental account may safeguard that money to be used for emergencies only.

Intervention 1: Use the best person or channel to provide education/information

Research suggests that sometimes the perceived expertise of the person delivering the message is more important than communication skill. The perception of expertise may be linked with trust. Evidence suggests that people in lower socio-economic groups are more sensitive to the messenger being someone like them (in age, gender, ethnicity, social class/status, culture, profession, etc.). ‘Word of mouth’ messages seem to be particularly effective for young people and those with financial difficulties. It may be possible to encourage this effect, by interventions relating to social norms.

Interviewees said that trust and rapport are crucial.

> ‘If you are being provided with information from an individual/organisation that you trust, you’ve overcome many of the barriers already.’ *FSA/CFEB*

Intervention 2: Provide incentives to change behaviour

Even small incentives can make a big difference. Since the cost to individuals and society of poor financial management is high there may be an economic case for using incentives to encourage improved money management. However, the expert interviews and the case studies suggest that incentives should be approached with caution. There was considerable concern about the use of negative incentives, such as high penalty charges.

Interviewees had mixed feelings about incentives.

> ‘We offer incentives to switch current account and it does work…but I’m sceptical about using incentives to change long term behaviour.’ *Provider*

> ‘Most people I know of that put money into pensions would not do so unless there was tax relief – they would use savings.’ *Adviser*

Intervention 3: Use ‘mental accounting’ to encourage provision for unexpected outcomes

We appear to allocate money to mental accounts and then resist transfers between them. Encouraging the allocation of money to a ‘rainy day’ mental account may safeguard that money to be used for emergencies only. Identifying the best level of saving for a rainy day is a similar challenge to identifying the right level of insurance. Research shows that the amount of insurance a person considers necessary is influenced by framing and priming.

Interviewees’ experience is that it is particularly difficult to persuade people to save for the unexpected.

> 'You are asking them to become receptive about something that hasn't happened. They become receptive when it has.' *FSA/CFEB*

> 'Young people are pretty short-term, and if they are doing any future planning it's about securing a better job.' *Consumer help*

Interventions that combine mental accounting with commitment, priming and effect may work best.

Intervention 4: Provide information on relevant peer groups

Social norms have a significant effect on behaviour and interventions that harness them have been successful in a number of areas. Most are based on communicating what other people like you do in a given situation. The literature review, interviews and case studies suggest that consumers may have little sense of financial capability norms. Identifying and communicating positive norms may be very effective.

This suggested intervention was well supported by interviewees, although failure to keep up with presented norms might be demotivating.

> 'If you are on the margins, you can look at people who have managed to save for something.' *Consumer help*

> 'If you present an option that people interpret as a norm, they will go for it and think that it's rational.' *FSA/CFEB*

> 'You could compare your goal to people who have the same goal… and view your performance relative to the best and worst performer and that would help you keep on track.' *Provider*

Intervention 5: Use a default to encourage action

Harnessing inertia can be an effective strategy. Considerable impacts have resulted from changing defaults on retirement saving and benefit entitlements. There may be scope to use defaults in other ways. For example, a default that provides balance information automatically after every account transaction might encourage people to keep track. A default to setup a regular deposit transfer when opening a savings account will make regular savings more likely.

Interviewees see these as useful for those who otherwise would not act.

> 'Compulsion is the next step down the line, but defaults are helpful to establish regularity in people's lives' *Adviser*

Default financial health checks were seen as very positive.

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Social norms have a significant effect on behaviour and interventions that harness them have been successful in a number of areas.

Our attention is drawn to what is novel and seems relevant to us, and we have limited attention spans.

'The relationship…revolves around a financial health check, and if you can maintain a relationship with a consumer and get them coming back, it's an incredibly helpful thing for both sides.' *Provider*

Intervention 6: Provide salient feedback to support money management

Our attention is drawn to what is novel and seems relevant to us, and we have limited attention spans. Making relevant information salient is desirable, because we are unlikely to search for it, and that could lead to inaction or poor choices.

'Often consumers do not know what they spend their money on…they underestimate what they spend…trigger figures can help the consumer be realistic…enabling them to realise that they spend £150 on petrol rather than £50.' *Provider*

Feedback mechanisms that tell customers how they are doing financially may support behaviour change. For example, getting feedback that tells you whether or not you are on target, when saving for a particular goal.

Information might be made more salient by presenting it differently. For example, sums of money expressed in terms of the number of working hours they represent, or debt repayments showing the amount of debt costs saved.

Interviewees reported that feedback has the most impact when it is specifically targeted. Frequency and simplicity are important factors.

'You present a particular issue, and then deal with that.' *Consumer help*

'If my credit card bill hits £100 text me…a trigger so you don't spend any more…it enables you to make an informed decision.' *Adviser*

Feedback would be useful for long-term savings plans. If people can see their money is doing something in relation to their overall objectives, then they will feel more positive about 'locking away' a certain proportion of their discretionary income.

'Brilliant, all of a sudden, all of that money that goes out of my account at the start of every month that I don't get to spend is doing something." *Adviser*

Intervention 7: Present information that evokes particular responses

Tests show that responses change if people are first exposed to priming stimuli such as words, sight, or sensations. We know priming influences immediate behaviour, but not whether it has a longer-term effect. Emotional effect is a powerful force in decision-making. It is rapid and we can experience an emotional reaction before knowing what we are reacting to.

One technique used is encouraging people to visualise their future. This could be in a negative as well as positive way; for example asking someone to imagine what their spouse's life might be like if they were to die suddenly. Another is to share case studies about people who have saved successfully as a way of inspiring others.

Involving consumers in designing the way information is delivered (co-production) could prevent priming and affect being misused.

> 'Having people determine the way messages should be presented… they have a huge contribution to how we understand what they want to hear.' *Provider*

Emotional effect is a powerful force in decision-making.

Intervention 8: Make a commitment to an action or behaviour

People can feel overwhelmed by having to take decisions that will shape the remainder of their lives. This leads many to put decisions off until too late.

> 'If you're trying to plan for people you want to see them much earlier in life than [when they are approaching retirement]…often we're seeing people and we can make sense of their money but we have no great ability to shape things.' *Adviser*

We seek to be consistent with our public promises, and to reciprocate acts. Many people are aware of their will-power weaknesses (overspending, overeating or drinking) and use commitment devices to achieve long-term goals. Commitments can alter behaviour and overcome procrastination, and they appear to be more effective as the costs of failure increase.

Commitments could also be used in relation to financial capability, such as committing to regularly check statements or have a financial check up. Commitments have been shown to be more effective if they involve a public statement and/or have sanctions attached. The choice of individual or network to which a commitment is made may also influence its effectiveness.

> 'Having someone talk to me about whether I've actually followed it through, and supports me to follow it through.' *Consumer help*

Intervention 9: Set realistic targets and goals

The goal-based savings products in the case studies show that realistic goals seem to have a positive impact on saving. Whether it is through binding behaviour or creating structure for individuals, realistic target setting may have significant results for creating financially capable habits.

Financial health checks could be designed to counter beliefs and norms that have a negative effect on financial capability.

Interviewees saw encouraging commitment and setting realistic goals as inextricably linked with small steps and budget planning as key strategies. Breaking goals down into stages lessens the intangibility of the future objective and makes it more accessible. For example, asking young people to think just five years into the future and then putting in place steps to achieve their short-term goals.

> 'It's all about small steps, moving in the right direction and changing behaviour in a way that is evolution rather than revolution.' *Consumer help*

> 'If you told a young person that they could save £144 a year, they may think it's impossible, but if you translate this to cutting out one or two cans of fizzy drink a day, it becomes more achievable.' *FSA/CFEB*

Intervention 10: Financial health checks that challenge negative self-beliefs and norms

Self-beliefs seem to be self-fulfilling. For example, individuals with a low literacy identity often believe they are less financially capable than they really are. In addition, the desire for self-consistency can lead us to choose products, and make assumptions about norms (e.g. a 'cool' person holds many credit cards and does not save) that are not necessarily in our interests.

Financial health checks could be designed to counter beliefs and norms that have a negative effect on financial capability. Improving financial capability should lead to changing self-beliefs and a greater confidence to engage with financial decisions.

Interviewees strongly supported the use of financial health checks in general. Several experts mentioned the importance of reviews to take account of transitions and life events and ensure that goals remain appropriate and achievable.

> 'We need to find more engaging ways of doing this…people who you want to give a review to do not come into our branches.' *Provider*

3. Case studies from the financial services sector

The report examines a number of financial products that apply learning from behavioural research, and are focused on three key elements of financially capable behaviour. Each product was analysed using a methodology based on the MINDSPACE framework and each was found to be using several behavioural strategies simultaneously.

“the pots create a negative incentive that discourages using the money for other purposes”

‘Making ends meet’ products

These are accounts designed for those who have been in, or are approaching serious financial difficulty. The Secure Trust Bank ‘Prepaid Current Account’ and RBS/NatWest ‘Money Manager’ proposition divide the customer’s expenditure into separate ‘pots’ for bills and discretionary spending. There is a default in that the customer is assisted through the set up process to mange their money in this way. Once set up, the pots create a negative incentive that discourages using the money for other purposes. The customer makes a commitment to allocate an amount for paying regular bills and this includes an amount to enable debt repayment to take place. The combination of interventions appears to improve customers’ ability to make ends meet.

Over a six month period, customers using the Money Manager proposition reduced their overdrafts, on average, by almost half and increased their savings from zero to around 15% of what their overdraft had been at the outset. Early evidence from Secure Trust Bank shows take up from socio-economic groups A, B and C as well as D and E.

‘Keeping track’ products

An O2 product, ‘Load & Go’, and Barclaycard’s ‘mybarclaycard’ both use innovative ways of providing relevant feedback (salience) to help customers keep track. Load & Go sends an instant text message when a purchase is made. The customer knows immediately how much is left on the card and can access the information at any time. Mybarclaycard lets customers search and display transactions by retailer, commodity and over time. They can focus on just one expenditure category or a combination. However, simply providing information may not be sufficient to change behaviour; further insights are likely once data has been analysed on customer behaviour.

A consistent message used in marketing Load & Go is ‘never overspend’. This may act as a form of priming that encourages people to take control of their finances rather than just seeing the card as a method of spending.

Feedback from O2 suggests that customers are using the product as a tool to control spending. Money is loaded onto the card and is spent over a period of time. Most customers have a clear goal (commitment) not to spend more than the amount loaded onto the card either over a period of time or on a certain type of expenditure. One group of customers is permitted to have a weekly or monthly load from a current account. This regular commitment is popular and normally started shortly after the account has been set up. The large take-up of customers using the card in this way may indicate that demand for control-type tools exists.

‘Planning ahead’ products

The report considers two goal-based savings products, ‘Goal Saver’ provided by Saffron Building Society and ‘Your Saving Goals’ from RBS/NatWest. Both providers report higher than average levels of saving through these accounts.

Both accounts require customers to set a goal and make a commitment to regular saving. The goal is reinforced by attaching a name or a picture to the account, which may harness emotional affect. Opening the account for a specific purpose creates an incentive not to use the money for other things. As people tend to discount the future and so undervalue the benefits of saving, this kind of incentive appears to be helpful to them.

Account opening is designed as a smooth process that leads from setting a goal to setting up a regular payment. The default is to set up the payment when opening the account and this significantly increases the number of customers that do this. The accounts give salient feedback on progression towards the goal, and suggest corrective action if saving is falling behind.

Next steps

Many of CFEB's products and programmes already contain behavioural features that enhance their effectiveness, for example using trusted messengers like midwives, youth workers and employers to pass on information. In the light of this report we will evaluate other features we might add. Where we are developing new products we will seek to embed effective choice architecture at the design stage.

Through this summary document we are seeking your views on the interventions identified in the report, *Transforming Financial Behaviour*, and what further research and testing might be useful for us and for our partners in industry, government and the third sector. Our goal in this – as in all we do – is to work collaboratively and efficiently to build enduring financial capability and resilience in the UK population.

We would very much welcome your feedback on what you have read in this document and whether it chimes with your experience. In particular, we are interested in:

- What, if any, behavioural strategies do you use in your work, and what evidence do you have to support them?
- What are the bridges and barriers to using this approach to transform financial behaviour?
- How can CFEB collaborate with the financial services industry and other stakeholders to understand and harness behavioural strategies to improve financial capability?

You can submit your views in writing to sarah.smith@www.moneymadeclear.org.uk or to CFEB, 25 The North Colonnade, Canary Wharf, London E14 5HS. We would be grateful to receive your response by 30 September 2010.

For an electronic copy of this document or to find out more about CFEB's work, visit www.cfebuk.org.uk

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An independent body helping consumers understand financial matters and manage their finances better

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