

SESSIONAL MEETING DISCUSSION

## Money, Knowledge, and Power: Financial Literacy Working Party

[Institute and Faculty of Actuaries, Sessional Webinar, 14 September 2020]

**The Chair (Mr R. Merry, F.I.A.):** I would like to give everyone a warm welcome to today's Institute and Faculty of Actuaries (IFoA) Sessional Meeting where the Financial Literacy Working Party will be presenting. My name is Rob Merry and I am a member of the IFoA Life Board and the Life Lifelong Learning Committee. I will be chairing today's meeting.

I would like to welcome you all to what promises to be a very interesting and timely presentation. As COVID-19 continues to make radical changes to our lives and economies, financial literacy is going to be a key skill for many people as more and more people's livelihoods are dramatically changed. For those in the United Kingdom, it is a particularly timely session. Last week, a very famous commentator and advocate for financial literacy, Martin Lewis, presented a 1-hour television programme on this very subject matter and, probably, the timing of that is due to its importance.

I am pleased to see so many people join us today, with over 290 people booking to join. One of the advantages of having to use virtual meetings is improved geographic access to IFoA webinars. Today, we have people from all corners of the globe – from Canada, where they are just starting their day, across to Europe, the Middle East and Africa, and onto Asia, and in particular Australia, where their day is ending or has already ended. Unfortunately, one of the downsides of virtual sessions is how we need to deal with questions. I would encourage you all to raise questions using the Q&A box on your screens. I will use these to raise questions at the end of the session on your behalf. However, if your specific question is not covered, you can forward that to the IFoA and we will ask the Working Party to respond.

I would like to welcome the speakers today. First, I would like to welcome Chris Barnard. Chris is a senior actuary with Allianz SE in Munich, Germany. With over 25 years of experience in the insurance industry, Chris has worked in product development, pensions, finance, and business steering areas with a current focus on customer value initiatives. Chris has had several overseas appointed actuary roles and is a member of the IFoA Life Research Committee.

Joining Chris today, we have Danni Brotherston. Danni is currently Head of Advice, Policy and Development at St. James's Place Wealth Management, where she is responsible for overseeing and developing the firm's advice proposition. Previously, Danni has worked for Mercer in the Retirement and Investment Consulting division. Danni is a graduate of Cambridge University, having completed a Masters in Engineering, and also holds a M.Sc. from Imperial College. Danni is an actuary and Certified Enterprise Risk Actuary and sits on several IFoA working parties.

**Mr C. R. Barnard, F.I.A.:** I joined the Financial Literacy Working Party as I had been heavily involved in fixing many problems involving customers' misunderstanding of insurance products in my day job, where I am head of actuarial within a global life insurance function.

Our working party was set up in 2018 to research: first, existing levels of financial literacy; second, useful mechanisms that could help to improve financial literacy; and third, an overall approach that could improve the financial literacy of the general public. We have been able to draw from a broad range of experience and perspectives – from consulting, professionalism, education and research, and, of course, life insurance and pensions. From Tony Jeffrey in Ireland, to myself in Germany, and to Danni Brotherston, Peter Mansell, Jonathan Billing and Jonathan Wright in the UK.

We presented some preliminary thoughts at the 2018 Life Conference, and since then have worked on refining the research to a point where we are ready to present our ideas today and start engaging in more formal discussions.

We will start by looking at the current situation, why the profession should get involved, and why we decided to consider so-called vulnerable customers as a very special case. Then we will briefly discuss some of our proposals and their implications, before outlining some next steps and finally wrapping up.

The current level of financial literacy in the general public is shockingly low. We have shown that this is the case, not just in the UK, but also worldwide. In an opinion piece for *City AM*, past president of the IFoA, Jane Curtis, has said that, “Financial literacy for most of the UK remains poor. We have a large savings gap and a lack of trust in the financial services industry. These problems are exacerbated by gaps in the public's economic knowledge, including how much is required to provide their expected pensions, and confusion on how financial products work.”

To highlight some of the consequences, poor financial literacy can lead to incorrect financial planning and a savings gap, a lack of trust in financial services, and the very damaging psychological issues of a feeling of helplessness in times of financial stress and financial exclusion.

Jane Curtis goes on to mention some of the benefits of improving financial literacy, as “a more financially literate consumer is more likely to buy the right products at the right time for the right job, and to avoid being mis-sold to, or failing to make sufficient provision for his or her future.”

Regarding improving financial literacy, the then Financial Services Authority stated even earlier, in 2003, that “never has the need been so great or so urgent.”

The Working Party fully endorses these views.

Why should the IFoA become more involved in this topic? Well, surely, having a more financially literate public would be beneficial for the financial services industry, including insurance and pensions. Perhaps it would help to reduce the frequency of mis-selling and dissatisfied customers and to improve the very poor reputation of financial service companies, all of which is good for us. Importantly, the IFoA, as a profession, has a good reputation. We understand the topic well, and it would be difficult to argue that improving financial literacy was not in the public interest. Finally, we have many touchpoints as a profession across industry and society, with financial companies, industry bodies, regulators, education and research bodies, and the government. Our voice still counts for something with these parties.

Perhaps we are overselling the importance of financial literacy. After all, improved financial literacy surely cannot be the solution to all of our problems. Well, let us be clear that, and the Working Party agrees with this point, it is very important to realise that improving financial literacy is not a silver bullet. We cannot just increase financial education and awareness, and then wash our hands and imagine that the public will be able to look after themselves in all situations, particularly when buying ever more complex financial products.

Improving financial literacy makes sense most of all in the context of a financial environment that can be navigated reasonably and fairly by as many people as possible. Perhaps the best way of thinking about this is to consider both absolute and relative measures of financial literacy. We can all agree, surely, that it would be good if everyone was a bit more financially literate, for example, if the bell curve of financial literacy outcomes – a so-called “financial literacy IQ” – was absolutely shifted to the right.

However, that would still leave millions of people on the left of the distribution who would be relatively less financially literate and relatively less financially capable, many to the extent that they could actually start being termed “vulnerable customers”. Such vulnerability would definitely increase in the context of buying insurance products, for example, because of the increasing complexity of our products and the asymmetry of information that exists between insurance companies, distributors, and the customer.

The Working Party really struggled with this point, and ultimately we felt that we should expand the scope of our research to allow for this as best as we could. So in the end, we decided to address the topic of vulnerable customers as a priority within our research, as we shall shortly see.

**Miss D. Brotherston, F.I.A.:** How do we propose to improve financial literacy? Before I jump into the specifics, I just wanted to set the scene around the importance of education.

The Organisation for Economic Cooperation and Development (OECD) are advocates of improved financial literacy. Through a number of studies they have carried out, they have highlighted some concerning findings. For example, they found that, on average, fewer than half of adults achieve the minimum target score on financial knowledge. Furthermore, around one-in-four students are unable to make even simple decisions on everyday spending, while only one-in-ten can understand complex issues such as income tax. So, they recognise the importance of focusing on financial literacy from a young age, and that the provision of high-quality targeted financial education in schools and throughout life is essential to developing knowledge and skills.

We, as a Working Party, fully support this and believe that, in a frequently changing marketplace, consumers of all ages can really benefit from ongoing financial education. This is because, ultimately, financial literacy is a lifelong requirement that will vary for individuals at different life stages. So, information and education need to be targeted and age-appropriate.

It probably comes as no surprise, therefore, that our first key conclusion is around financial education. As Chris (Barnard) said, improved financial education is not a silver bullet, but it must be part of a series of measures to help consumers make better choices and, in turn, improve financial outcomes. Given the evidence we have found around the low levels of financial literacy and how they are scarcely improving, this is an area that we believe has to be taken seriously. Research shows that students exposed to financial education are more likely to display positive financial behaviours, and, actually, most financial habits and attitudes towards money are formed as early as the age of seven. For these reasons, we concluded that financial education should be mandatory in the school curriculum, and it needs to start at primary school.

This is something that was also supported by the House of Lords Select Committee on Financial Exclusion. Simply adding this to the curriculum, however, is unlikely to make the improvements needed. We must go further and ensure that schools are not only adequately resourced but also have teachers who have received specialist financial education training. This last point is really important, because other research shows that this additional step really helps with the motivation of students, which in turn improves their engagement on the subject.

While schools have a really important part to play in this space, financial education cannot just stop when someone leaves school. It needs to continue to be made available throughout their life. But how do we go about doing this? There is clearly a need for some new and creative thinking here. Some sources that we have put forward that could provide a role in this space include public service broadcasters, other media, regulators and industry bodies, to name but a few.

As Chris (Barnard) alluded to, whilst we quickly realised that improved levels of, and access to, financial education is valuable in itself, it is also important to have delivery mechanisms and content that target specific audiences, vulnerable groups in particular. The definition of a vulnerable customer is someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care. Vulnerable groups of people are most at risk of making poor financial decisions, and this could have negative

consequences on a whole range of things, from savings and debt levels through to retirement and financial inclusion more generally. Whilst it is not a new concept, it is one that is rising in importance against a backdrop of an ageing society, and the impacts data use could have on financial exclusion.

Financial firms should be expected to take particular care to ensure that vulnerable customers are treated fairly, as they may be more likely to experience harm. Although measuring vulnerability is subjective, the lower the level of financial literacy and the more complex the financial product, the more vulnerable the customer. For this reason, great care is needed with complex products, and they should be designed for a specific target market and customer need.

Whilst we are on the topic of complex products, despite certain rules being brought in to protect consumers, inappropriate financial products continue to be promoted. Hence, we believe that the Financial Conduct Authority (FCA) ought to make earlier use of its early intervention powers.

Another of our key conclusions was to introduce a mandatory product certification on all retail financial products. We felt that a named actuarial risk or compliance specialist of sufficient standing should be required to certify that product terms and conditions, and marketing information presented to customers, are fair, not misleading, and understandable to the target market. This product certification should ideally be a principle-based requirement rather than one based on a set of fixed rules that would potentially need to be amended or modified over time. This named specialist would be responsible for the framework for evidencing the certification and would need to be able to defend such certification if challenged to do so.

We could imagine that certain products that meet specific requirements for simplicity and understandability could be Kitemarked, which would allow an easier product certification based on a “safe harbour” concept for such products. Further research into this concept of a stronger product certification regime would clearly be required, but the Working Party would be supportive of this and believes that the actuarial profession is ideally placed to contribute to, or even take a lead, in this research.

The Working Party would also support the introduction of a duty of care on financial firms through regulation, which would require them to exercise reasonable care and skill when providing a product or service. This is not a new concept, and already exists in other markets. Again, it is something that was also recommended by the House of Lords Select Committee on Financial Exclusion. If this were introduced, firms would be required to anticipate customer detriment and give greater emphasis on meeting the needs of customers. We expect that this would then reduce the likelihood of mis-selling and the need for regulatory intervention.

There are, of course, advantages and disadvantages in introducing a duty of care, and some argue that a legal obligation on firms may discourage innovation and reduce the complexity of products. However, we believe that, if a firm's culture is set up to ensure that the duty of care is driven throughout the organisation, then this should actually lead to a reduction in the amount of compliance already in existence within a firm. Furthermore, the introduction of a duty of care would increase opportunities for firms to innovate and compete without the unnecessary burden currently required by compliance with a number of rules all intended to achieve the single purpose of fair treatment of customers. Ultimately, we believe that introducing this duty of care would build trust between a firm and its customers, which in turn should improve level of trustworthiness in the market – something that is desperately needed.

So, what are the implications of our proposals? We strongly feel that our recommendations will deliver multiple benefits, both generally and specifically for the vulnerable amongst us. The benefits of taking action to improve financial literacy are clear. If we raise financially capable consumers, they will know when and how financial institutions can help them. They will be less prone to buying products that do not suit their needs and more inclined to engage proactively with the financial services sector. Simply put, people who understand their financial circumstances and are well versed in personal finance are more likely to make sensible choices and adequate provision for their futures. They will also feel less helpless in times of financial stress.

In addition, because a capable customer is a less vulnerable one, this should mean that, over time, regulators will have less need to intervene with detailed rules in the retail market. There is one thing that still remains to be said. There is no magic bullet to solve all of the issues raised. We hope, however, that the research and ideas presented in our paper will help the profession take the next step in making improvements in this area.

**Mr Barnard:** In our paper, we outlined some fundamental principles of managing money as a framework for helping financial literacy. This was intended as an initial discussion piece. We acknowledge that there would be challenges to be overcome in agreeing content, presentation and wording and in achieving consistency with other areas of our profession's principles and practices. One of the main reasons for doing this was to raise our voice as a profession in order to increase awareness of the importance of basic financial literacy. Another reason was to stimulate and engage in debate on what the profession can do in the future to help improve financial outcomes for our customers.

We decided to focus on five principles, which include the following: plan for spending; plan for emergencies; plan for borrowing; plan for saving; and plan for advice.

We do believe that the profession has much to offer, and believe that there should be an emphasis on what we see as traditional actuarial strengths of attention to risk and return, certainty and uncertainty, and that these principles can be applied beyond the traditional actuarial domain of longer-term financial planning. The Working Party would be grateful for your feedback and suggestions on these financial principles, either during this meeting or by email at any time.

We mentioned a couple of times that we should increase the profession's voice and presence in this area. We believe that the profession has a duty to advocate for improved financial literacy and that this topic is in the public interest, and in the interest of the profession as a whole. To this end, we recommend that the IFoA establish a permanent financial literacy practice area, panel or member interest group that can act as a supporting voice, a sounding board and a trusted partner with suitable organisations that are active in this area.

We would also suggest that there should be at least two sub-areas to focus on: first, vulnerable customers; and, second, women's financial literacy. Unfortunately, some research indicates that women have weaker financial skills than men, even after considering variations in age, country, education and income. Once again, we are happy to receive your feedback on these next steps.

In conclusion, the Working Party want to make it clear that financial literacy is an incredibly complex arena. While we do not have a magic bullet to solve all of the issues that we raise, we demonstrate how financial literacy levels and the protection of vulnerable customers could be improved if the ideas and conclusions of our research are followed. We look forward to working together and continuing to make a contribution in some of these key areas mentioned.

**The Chair:** Thank you for that interesting presentation. The good news is we have had a lot of questions online. A couple of themes from the questions are around adequacy of material to equip those that, in the teaching profession, improve the level of financial literacy.

From your perspective, have you seen any examples of good material that teachers could use? If there is not good material, who do you think would be well placed to fill that gap, and to get it into the educational process, so that this specialism, or aspect of teaching, can be introduced competently into the curriculum for schools?

**Mr Barnard:** During our research, we found that there is an abundance of resources available to help with financial literacy, from books for children and books for adults to countless websites and apps of varying levels of complexity. There are numerous organisations and charities that have worked in this area, for example, RedSTART, run by Robert Gardner, with whom we engaged. We should not forget that financial education has been part of the National Curriculum since 2014.

We do not believe that there is a lack of resources, rather a lack of delivery and engagement with the existing resources.

In some areas, we think that things can be improved. First, we agree with the House of Lords that financial literacy and financial education should be added to the primary school curriculum. Second, if we are going to take seriously the educating of our kids in schools, then we need to make sure that we give it more care and attention, and it is not just considered a last thought behind all other subjects and all other materials. Schools should provide dedicated sessions run by specially trained teachers, and that last point is really important, as Danni pointed out.

Research carried out by the What Works Fund has shown that providing specialist financial education training to teachers is valuable and has a clear positive impact for teachers and students, in particular improving outcomes across students' mindset and skills. So, if we are going to promote financial education in schools and make this mandatory, let us do it properly. Let us not just treat it as some kind of burden or annoyance, but at least ensure that the teachers have specialist training so that they can impart the right knowledge to our children.

**Miss Brotherston:** I think there is also a consistency point. Chris (Barnard) mentioned several organisations that we came across who were doing this work already and delivering really great material to children, be that in primary schools and/or secondary schools. That is great if you, as a child, go to one of those schools that engage in one of those programmes. If you do not, then you are not obtaining access to the same material, teaching and training as other children potentially are being given. Having something in the curriculum, especially with teachers that have been trained in this topic, provides a better level of consistency across all schools, and therefore all children.

**The Chair:** The focus on your answer to that question was very much around financial literacy in schools and making sure we empower our younger people so they are prepared for life. A lot of comments and questions relate to how we pass on that ability or that skill to people that are no longer going to school? We are talking about people that are working or retired.

Specifically, we have received quite a few questions around, from an insurance perspective, when the best time is for improving financial literacy. Lots of people have pointed out that the point of sale is a really good opportunity for this. If that is the case, then why have we, as an industry, failed to do that? Or have we been doing it well?

**Mr Barnard:** Like I said before, there is enough material and enough resources available for people to engage with the topic. The websites that we mentioned earlier, the apps that we mentioned earlier, are available across all age ranges and all life events, for retirees as well as young kids. There are some very specialist websites, which are funded, I believe, publicly – I may be wrong there – such as the Money Advice Service, and Pensions Advisory Service, which do provide very good material.

I believe one of the issues is that many millions of people do not really realise that there is a problem. It is a difficult one to self-analyse and self-reflect on. Most people say they are a good driver and they are a good judge of character. Probably most people think they understand enough about money and can spot a scam if it comes towards them. So, there may be a feeling, with many people, that there is no need to engage with this topic. It is rather dull for most people.

In terms of in which parts of the sales process, or which part of the insurance process, we should engage with the customer and make them aware of the product that they are buying and understand the product that they are buying: I think that ideally would be point of sale, at least for advised sales. That can also be done for non-advised sales.

We have various rules which have been implemented in the UK around target market, around know your customer, and around providing a suitability assessment. One of the main factors to consider in the suitability assessment is the knowledge and experience of the customer and their ability to absorb risks and absorb losses.

So, I think that is an ideal opportunity to try and ensure that the customer has really understood what they have bought. I think in some cases, products are very complex and are providing very highly non-linear or highly geared outcomes, such as structured notes or very complex financial instruments. There should be a rebuttable presumption that the customer simply does not understand the product, unless they have a financial qualification of some kind – if they are an actuary, for example.

I think we have to be very careful that we not only dot the i's and cross the t's during the sales process, that we follow the rules and the compliance rules, but also try to ensure that the customer has understood what they have bought, at least in terms of what they pay in, what they can get out, including the worst case scenarios.

**Miss Brotherston:** I agree with pretty much everything you have just said. It is definitely something that we need to do more of. It is clear that people, especially when they are thinking about their own finances, do not know enough. How would you educate them? I do not know the answer. We definitely need to really think about it. I think part of the issue is that people do not like talking about money and their finances. I can remember reading that people were more comfortable talking about things like sex than about money, which seems crazy.

On the point around point of sale, I totally agree. One of the challenges though, is the amount of literature and documentation you already receive at the point of sale. I suspect that this is incredibly overwhelming for people, let alone putting an education piece on top of that. So, we need to think about the best way in which we position all of this material.

**Mr Barnard:** Absolutely.

**The Chair:** Certainly, in the UK, we have had BSI Kitemarks for those products that are explained in a way that is accessible. We have had the Clear English Society providing feedback and giving their assurance to product literature in the industry in the UK. However, we still seem to not quite be able to get the right information across at the right time. Can you give us some examples of where the industry has failed so badly that the level of trust, or the level of understanding, has resulted in adverse outcomes, either for firms or for the policyholder? What is the consequence of the lack of financial literacy, particularly in relation to insurance products?

**Miss Brotherston:** Yes. An example is the Payment Protection Insurance (PPI) scandal. And there is just this horrible level of mistrust, generally, with financial services. Now that PPI is over, I was listening to the radio the other day and someone was saying, "Have you invested in something and you have lost some money, because we might be able to get some money back for you?"

It is almost this portrayal that, if you invest in something or you purchase a financial product, something bad is going to happen, or you should not trust it because you will have paid too much in charges, or you have invested in the wrong thing.

I think part of the reason that people take that view is because they do not actually understand what they are doing. Somebody tells them it is a good idea or they see an advert and they go, "Great, let's do it". They do that rather than taking the time to seek advice if they do not know. They may not know that they could seek advice. There is also obviously a challenge around the cost of that advice.

To really understand and feel comfortable in purchasing financial products is synonymous with having sufficient financial knowledge and education.

**Mr Barnard:** From my side, I remember the pension mis-selling scandal. I even worked on the topic in 1998 for around a year in my last company. It was clearly the case that some people should not have moved out of their final salary scheme and bought a personal pension. Not just to an actuary, but it should have been obvious to some reasonably educated person from the general

public that this was a bad deal. You would lose contributions from another source. But people did not realise that this was happening.

After that, we had the endowment mortgage mis-selling scandal. The PPI scandal has currently cost around £40 billion in fines. I think there is a Financial Conduct Authority (FCA) website where, every month, another chunk of money is shown, for fines that month. It is around £300 or £400 million per month, even now. We do not know when that is going to end.

I remember, in one of my other Working Parties, where I was a Life Research Committee representative, we referenced a survey carried out in the UK where the insurance industry was ranked bottom of all the industries, even below journalists and professions which usually get a bad rap. So, I think this general drip, drip, drip of bad news, bad advice, fines, mistrust, bad reputation, has created a reputation that we cannot recover 100%. But we can at least start, I think.

**The Chair:** On that subject, I will have to disclose that I worked for Equitable Life for 24 years, until 2014, so I am no stranger to mis-selling of one form or the other. In certain circumstances, if I reflect on that time, I can see that the industry and particular firms have not behaved appropriately. Therefore, redress is a fair outcome.

However, I am also conscious that there have been cases where regulators have held companies to standards that are prevailing in the current time, but those standards did not apply at the point of sale. So, they retrospectively applied those standards, and if companies could not justify that they met those standards at the point of sale, they were asked to redress. In terms of the balance, then, I am interested in your views of the fair levels of financial literacy so that people can make fair decisions around what they buy. How do the obligations of firms fit into that, so that firms can appropriately clarify the level of risk that policy holders are taking?

**Mr Barnard:** We believe that it would be better to have a situation where these bad events did not happen, rather than let them happen and then apply a retrospective judgement, which is very costly to the industry.

In terms of the level of financial literacy, we do know that the basic level of financial literacy in the general public is very low. We do know that insurance has an asymmetry of information problem. The manufacturing and the distribution side knows more about what is going on in the product, in the financials, than the customer. Very often, the customer is, I would not say doing badly but maybe, doing worse out of all the three parties, compared to the shareholder and the distributor.

It can be a presumption that most people simply do not understand – I would not say all – financial products or even semi-complex financial products. That should be the level, I think, we should be looking at.

A second point is, when I joined working life in 1994 I joined a company where some of the products were still from the seventies, and they were incredibly simple. There even were products where you could invest in one fund, and there was no fund choice. Or a traditional fund, where you would have a bonus rate, and then traditional bonuses, where you would have illustrations. There was a certain level of expectation around what you would get back.

I believe, in the chase for yield, in the chase for customers, and in the chase to make yourself look different from your competitor in an ever more stratified business environment, the complexity of products has increased – the complexity of payments, the complexity of options, and the flexibility around the product. In order for the shareholder to make their return in a reasonable way and still fund a reasonable commission payment, there are often little features that the customer is never going to understand, but which provides a margin to the shareholder.

That might all be reasonable if the customer can understand, very simply, what they put in and what they get out, in a reasonable way, including in a worst-case situation. If they cannot understand even that, then I do not think we are going to have a very satisfied customer at the end of the day. I do not know anything about an engine of a car, but I know what a car is and how to drive a



car. So, I am not saying that the customer has to understand the engine of the insurance products, but I believe, at least, what goes in, what comes out, with a reasonable level of certainty, and, in a worst-case situation, what they can get back, is a starting point on the information provision side.

**Miss Brotherston:** We are becoming better at this. A lot of it is to do with the way in which we communicate what something is doing. As Chris said, if a customer can confidently say, “I understand what I am paying for, what I am going to get out of it,” then that feels like a decent level of knowledge. It is when people do not understand what they are purchasing, what the benefits really are, or what they are paying for it, that we run into really big trouble.

**The Chair:** I totally agree with what you said. A couple of the people have pointed out that there is a need for trust in imparting the right information so people can make informed choices with a reasonable sense of knowledge of the risks. For example, if you bought a packet of cigarettes, it would be obvious that packet of cigarettes is a huge detriment to your health and could result in lung cancer and other major medical outcomes.

Do you think we are good enough, particularly in those complex contracts, at making it absolutely clear what the risks are in a short digestible form? In some cases, illustrations can be eight pages long, with lots of complicated information, and even if you make quite clear statements, quite often they can be very difficult to pick up for the uninitiated, who may be faced with looking at eight pages of gobbledygook.

**Miss Brotherston:** This is the challenge. Going back to one of the points that Chris made, clarifying what might happen in a worst-case scenario is important. A challenge with illustrations is that you can have a model that says, “in this scenario, you are going to end up with £1 million, but in this scenario you will have nothing.” The customer might think, “Okay. Great. What do I do with that sort of information?” That is challenging.

**Mr Barnard:** The worst-case scenario, excluding default, is always an interesting one. At least it would uncover where you have some kind of protection or guarantee, excluding default of the company.

In terms of complexity, the insurance distribution directive on the sales process helps a little. You have to have a target market for your product. You have to have a process in your company that ensures there is a target market for your product, and a negative target market, in some cases. If you attack the target market, you have to look at the level of knowledge of the customer and their ability to bear risks. With this kind of knowledge, an advisor should be able to provide a product that meets the needs of the customer and about which the customer should be able to understand the basics.

With regards to very complex financial products, with very highly geared non-linear pay-outs and with the most bizarre constructions imaginable, I would say that those should not be sold to a retail customer, unless there is something exceptional – a disclaimer, a signature of the customer, or evidence of a high-level of financial literacy, something like a financial qualification. We have to think around these levels of protection as well, not just provision of information.

**The Chair:** Thank you. We have had quite a lot of questions around expenses from an insurance product point of view. Two key observations are coming out. One, if there is improved financial literacy, would that not reduce the industry's opportunity for making profit? Particularly at a time when profits are hard to come by, when the returns are very low, would that not be a problem?

The other thing that has raised is that the cost of bringing up the level of literacy, in order for people to make informed choices, will have an impact on expenses and, therefore, on the return on those policies. Could you just comment on both of these aspects of financial literacy and the impact they have on expenses?

**Mr Barnard:** Our view is if you have a more financially literate public, you will have people who will be able to better plan their financial resources, on both the income side and the expense side. They will have an awareness of the importance of saving for things like a rainy day and for saving for a pension, even if it is a little amount.

There may be some pressure on margins, in the sense that more financially savvy people may shop around for products, for example. I think the market will increase, with the number of customers coming in and deciding that it makes sense to invest for the future, and save for the future, and protect their families. I think there are trade-offs.

In terms of the costs of raising the level of financial literacy, if you want to do something good like this, it will cost money, and it will take time. We are not talking about something that can be done this year or maybe even in the next ten years. In Sweden, for example, financial literacy has been in the school education curriculum since 1920, and there was a very common cultural theme of having school savings clubs since around the 1880s. So, it has taken 140 years to get from that situation to where they are now and, very often, the Nordic countries score very highly in financial literacy, as they do score highly in many other things. This is something that will take time and, if we do it properly, it will be worth the investment. But we cannot expect, within a very short time, that people are going to be very financially literate.

**Miss Brotherston:** Just to add to the margins and the expenses point, ultimately, if people know what they are purchasing or buying into, then, hopefully, there will be fewer complaints. Firms will be less likely to have to redress. Potentially, that could balance out the cost of ensuring that clients are more financially literate.

**The Chair:** We have had quite a few questions in terms of geography. You have mentioned examples of other countries with good attitudes towards financial literacy. Do you think financial literacy is a function of a culture in the first place? In the wider context of attempting to bring about more equality between the different sectors and cultural groups within our society, do you think there is a need to focus financial literacy on those groups that, we hope, will have better outcomes going forward? An example group is women, who are expected to increase their share of the future wealth. Are there cases in the different cultures within our countries and across the globe where that is being done well?

**Mr Barnard:** That was a long question. One part was around whether financial literacy a function of culture. This is not my area of expertise, but if culture is a function of education, then I assume that financial literacy will be, in some form, a function of the culture.

There are clearly some cultures that are slightly more conservative, and some which are not. Those which are slightly more conservative may put a value on financial literacy more than others. I mentioned Scandinavia earlier. Norway, Sweden, and Denmark always rank highest for financial literacy in the global surveys that are being carried by entities such as Standard and Poor's. I mentioned Sweden with their long history of financial education being in the school curriculum, and the school clubs, but this is the case in Denmark as well.

One of Denmark's largest savings banks is called Danske Bank; I think it is one of the largest banks in the Nordic region. I was very impressed by the material that was available on their website. They were providing very good material for children, adults, parents, and even teachers, with teaching resources, gamification, and apps for managing finances. I was really impressed by what they were offering as a private bank. I think financial literacy and culture are intertwined.

The second part of the question was, should we focus on certain groups more? We have mentioned the issue around vulnerable customers and that the frameworks should allow for them as well, rather than just educating them. For example, we mentioned women. The global survey carried out by Standard and Poor's found a very strong, worldwide feature that women tended to have lower levels of financial skill than men, even after adjusting for various other factors. If that

is the case, then we need to do something about that. I am not sure what or how. In terms of making sure that this trend does not continue to emerge in the current young generation of people, we can start by starting very early in school, and providing good quality financial literacy teaching to children to primary school and beyond, with specialist teachers. That is very important.

**The Chair:** The final question is a specific question in relation to the UK in particular. We have seen a shift from defined-benefit (DB) to defined-contribution (DC) pension arrangements. With that has come a significant shift in the risks that individuals are taking. Do you think we did enough to demonstrate those risks to the people as they took them, so that they are aware of the potential impacts and outcomes of those risks? For example, in relation to taking investment risk, longevity risk, do we feel that people are fully aware that they are taking those risks?

**Miss Brotherston:** Good question. Actually, it links into another Working Party I sit on where we are looking more around the retirement space. I think there is a big gap with pension freedoms. The flexibility is painted in a positive light, because retirees can take an annuity if they want, but they do not have to. Why would they, because everybody hates them, right? People just think that they can spend their money any way they like, without realising that this money has to last them until they die.

How long are they going to live for? People always under-estimate their longevity. Then there is the whole sequence of returns, i.e. if you experience poor returns when you start withdrawing money from a DC pot, that can have huge impacts on the longevity of their fund. It is quite complicated to understand. There are also factors like inflation, of which people quite often underestimate the impact.

So, pension reform was a positive news story about additional flexibility and so on, but that may have downplayed the risks associated with having all of that flexibility. We almost ignored talking about it, or certainly the government did when they announced pension freedoms.

On the shift from DB to DC pension, obviously, the benefits of a DB pension are great. You get an income for the rest of your life, your spouse will probably get, say, half of what you were getting as well, if you die before they do. With DC, it is great that people are contributing into a pension, say through auto-enrolment, but do people actually understand the level of savings they need to fund their retirement? I am not sure they do. They might just assume, "I am paying whatever I am being told to pay, so that will be fine. I can still get £50,000 a year when I retire, right, until I die?" Again, this links back to education around how much people need, the risks associated, and so on.

**The Chair:** On that note, I did learn something from Martin Lewis' programme on financial literacy the other week. The broad rule of thumb for putting away money for your retirement should be taking your age which you start to contribute, divide it by two, and contribute that amount, in percentage terms, until you retire. I thought that was quite a good ready reckoner and a very crude, but very effective, way of articulating how much you need to put in your pension scheme.

Anyway, I would like to say thank you to both Danni (Brotherston) and Chris (Barnard) for a very interesting paper, an interesting presentation, and for replying to the many questions that have come through. Like I say, there have been a number of other questions, so we will try to compile those, obtain some answers to them and share those after this session.

Thank you to everyone else for joining us.

**Mr Barnard:** A big thank you, Rob (Merry), for managing the meeting. We want to also thank Mairi Russell for supporting our Working Party over the past couple of years, Nicky Lovie-Lewis for giving us a lot of support in the past few months, and also for Jemma Smith for running the technicalities of the meeting so well.

### Additional Questions and Responses from the Working Party, Sessional Webinar, 14 September 2020

The following questions were raised during, or immediately after, the Webinar. The Financial Literacy Working Party provided the response.

**Mr J. P. Kemp, F.I.A.:** (1) As you mentioned, we are not expected to be our own doctors or lawyers. Are you suggesting that we should be our own financial advisers? Is there a space for a publicly funded National Financial Advice Service?

(2) If adding financial literacy to the school curriculum is to be mandatory, what should be removed to make space for it? How do we weigh the relative merits of different subjects in the curriculum?

(3) One attitude is that, if I am buying a new central heating boiler, I do not want to learn everything there is to know about central heating boilers. I just want someone to tell me what to buy. Why are financial products different?

**Response:** (1) We are saying the opposite: providing financial education is not enough for customers to decide on complex financial products. In our paper, we describe several possible mechanisms for providing financial guidance, and the idea for a publicly funded National Financial Advice Service requires further consideration.

(2) The Working Party does not have a recommendation to make regarding the overall school curriculum. This is probably part of a much bigger discussion around having an education system suitable for the 21<sup>st</sup> century, part of which should include life skills – financial education being one of them.

(3) People generally understand that they are paying for something that will heat their home; they know what they are getting for their money. The problem with complex financial products is that the customer may not even understand what they have bought. But let us be clear: we are not saying that the customer needs to understand how the product works (the financial and actuarial “engine” of the product), but rather should be able to understand: (a) what they are paying in; and (b) what they will potentially get back, including in a worst case (barring default of the company) example. If even financial experts find it difficult to understand some of the pay-out profiles of complex financial products, what hope is there for the general public?

**Mr M. Slee, F.I.A.:** (1) I totally agree that this has to start with financial education at school. Once you get past the basics, there is still considerable risk that it will be seen as pushing various investment routes and discouraging others. How would you ensure the education is fair and objective?

(2) Call me a cynic but the discussion is heading to: how do we explain our products fairly so we can sell them? Should not the focus be on how do we improve financial literacy with no ulterior motive?

**Response:** (1) This is all about the design of the syllabus, and what should be included. Allowing for appropriate consultation should help to ensure a fair and objective education.

(2) The Working Party support improving financial literacy, full stop. We also consider that, however much financial literacy is improved, there will always be vulnerable customers who need special consideration. To be clear, a financially literate public may be more inclined to plug some of the existing savings and protection gap and plan better for their retirement, but this was not the primary focus of our research.

**Mr J. G. Spain, F.I.A.:** Financial products are too often mis-sold. When a bad sale is identified, the vendor may pay some compensation, but is not prevented from doing the same thing again, when he may also have to pay some compensation but there are no other penalties. This suggests to me that the industry does not want consumers to buy the right products.

**Response:** We are not sure that it is as simple as this. Surely the many tens of billions of pounds in fines and redress over the past decades due to mis-selling would be better spent elsewhere? Ultimately, the public buying more suitable products and planning better for their future (which may lead to a smaller savings gap, protection gap and better retirement planning) would be good for the industry. But it is a difficult problem to solve and will take time.

**Mr P. G. Telford, F.I.A.:** (1) Is money as important as English, Mathematics and Science? Should it be measured in key stage tests at school?

(2) The Plain English Campaign worked wonders for product literature and contracts. It cannot fix issues with the products themselves. Do we need a “Plain Products Campaign” and someone like Martin Lewis (who does not do advertisements) to endorse it?

**Response:** (1) We argue that financial literacy, including “knowing that you do not know” is an important life skill. We would not necessarily rank subjects, rather we advocate an approach that ensures a reasonably balanced curriculum including life skills.

(2) This is another good idea that could be researched further.

**Online questioner:** Should there be a suitable entry-level qualification for staff involved in customer literature production to help ensure it meets requirements? This qualification could vary for banks, insurance companies, etc.

**Response:** This is an area that requires further consideration. Our proposal for product certification would provide some assurance that product terms and conditions and marketing information presented to customers is fair, not misleading, and should be understandable to the target market.

**Mr M. G. White, F.I.A.:** (1) If financial advisers were only permitted to charge on an hourly rate – in other words, look more like other professions, such as lawyers – would that not transform the industry in terms of trust?

(2) One aspect which is not featured in the paper is the possibility of financial coaching as part of meeting people’s needs. This involves a limited number of hours with a coach, for a fixed fee per hour. The coach is not able to make product recommendations.

**Response:** (1) The cost of advice should be commensurate with the service provided. The key point here is that customers should know how much they are paying, and for what. In other words, regardless of how a financial adviser chooses to charge for their time, it is important that their fees are clear and transparent and clearly outline what service is being provided.

(2) This is an interesting idea that probably requires some further research.

**Mr A. D. Horn, F.I.A.:** (1) Is there an opportunity to develop products to fit “robo-advice” solutions?

(2) There have already been a number of initiatives to improve financial education and product presentation/communication (Savings and Long-Term Risk (SALTR) project, Raising Standards, simple products, etc). We should identify what has changed to effectively build on this, for example, improved capacity for robo/online solutions?

(3) Is the biggest opportunity for improving financial literacy in advised sales or non-advised sales?

**Response:** (1) Yes, and this is happening in many markets.

(2) The Working Party agree with this.

(3) There are opportunities in both channels. A more tailored approach would be available in the advised channel, whereas a simpler approach would be necessary for non-advised sales.

**Mr G. D. McInally, F.F.A.:** The pensions industry has transferred investment and longevity risk away from companies and onto individuals who, we know, are ill-equipped to understand or manage those risks. Should we have done more to protect the public interest given our knowledge of low levels of financial literacy?

**Response:** In hindsight, this would seem to be the case. Looking to the future, however, focusing on how we can upskill individuals on this topic is important, and the Working Party believe improved financial literacy can go some way in achieving this aim.

**Mr I. G. Murray, F.F.A.:** As actuaries following the Actuaries' Code, should we not be encouraging our employers or shareholders to act with integrity and not exploit financial illiteracy to produce extra profit? Treating Customers Fairly is a key regulatory consideration – should financial literacy not look into this?

**Response:** It is not clear that Treating Customers Fairly principles fully remove a conflict of interest between the firm and the customer. Introducing a duty of care would add a safety net to prevent getting around the rules that are there to protect customers. It is a positive obligation that aims to ensure that people are not reckless or incompetent and should promote more reasonable behaviours within firms.

**Mr H. L. T. Duckers, F.I.A.:** The recommendation that a duty of care be introduced refers to several countries that have introduced this feature. Is there any evidence that this works better in those countries than the current UK system?

**Response:** Many countries have introduced a duty of care fairly recently, often in response to major scandals in their markets. Recent history suggests a reduction in such scandals. We would say that the UK has not performed particularly well over the past decades when it comes to sizeable financial scandals.

**Dr R. T. Haestier, F.I.A.:** Should this be delivered at Key Stage (KS) 3/4 as its own subject, within maths, or possibly within the Personal, Social, Health and Economic (PSHE) curriculum?

**Response:** The Working Party does not have a recommendation around how this should fit in the school curriculum, as this is probably part of a much bigger discussion around having an education system suitable for the 21<sup>st</sup> century, part of which should include life skills (such as financial education). It is important to note, however, that we feel it should start to be delivered in primary school (i.e. from KS1).

**Dr A. Carr, F.I.A.:** Is there not already a British Standards Institution (BSI) simple product Kitemark? How does what the Working Party propose differ?

**Response:** As far as we understand, the BSI Kitemark for financial services is fairly new. The Working Party supports the use of appropriate kitemarking that could be used to indicate products that were suitable for a wide range of potential customers.

**Mr S. Smithson, F.I.A.:** Is it logical that detailed financial advice is often given for taking out a mortgage – which is secured and which has affordability checks and makes a lot of sense – but financial advice is rare for taking out a credit card which is unsecured and may not be suitable.

**Response:** The size of a mortgage is very large up-front, whereas a new credit card's limit is often fairly small (but could rise in future). The Working Party agree that, perhaps, it should be a bit

harder to obtain your first credit card, and care should be taken as soon as there are problems with payments. But this is also a cultural thing. In some markets, it is difficult to obtain a credit card, and in some cases the credit card is treated more as a “delayed-debit” card, with the outstanding balance paid off automatically at the end of each month. Any late payment would be treated fairly seriously, and immediately in such cases.

**Mr R. K. Chaurasia, F.I.A.:** Can we use messages for insurance products similar to health warnings on tobacco products, for example, “this product is suitable for . . . and not suitable for . . .” to help customers take right financial decisions?

**Response:** This is an idea worthy of further consideration. Such simple disclosure may be more appropriate for the general public compared with the (often boilerplate) reams of disclosure required at the moment.

**Mr H. Vignalou, F.I.A.:** I fully support the duty of care from financial services providers and was wondering whether the profession could lobby actively for such changes.

**Response:** The Working Party has recommended this. We will engage further on this topic in the coming months.

**Online questioner:** Does the Working Party have any ideas or thoughts on how to tackle the financial literacy gap for women, particularly if there are projections that 70% of future wealth over the next two generations will be inherited by women?

**Response:** The Working Party did not research this in detail, rather noting that this was a problem that would require further work. We hope that the profession will give further consideration to this growing problem.