



Fair Banking: the road to redemption for UK banks

by

Antony Elliott



CSFI

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Fair Banking: the road to redemption for UK banks

By Antony Elliott

Preface

Antony Elliott is an odd bird – a senior banker, with long experience in both retail banking and the hedge fund industry, who is genuinely committed to changing the industry that has served him so well.

His campaign (crusade may be the proper word) is to get the financial services industry to take the welfare of its consumers more seriously. He makes a powerful comparison with the automobile industry; retail banks, consumer finance companies and credit card companies – if unchecked – behave like manufacturers who produce cars that go faster and faster, but without improving the brakes or providing airbags. What he and the charity he has set up, FairBanking, want to do is “nudge” the banks in the direction of greater responsibility towards their customers.

This report is the result of a great deal of research that Antony and his FairBanking team have carried out into what they call Financial Well-being. Perhaps the most striking conclusion they reach is that the most important component of Financial Well-being is not something as simple as the level of income (important though that obviously is). It is the perception of being “in control” of one’s finances – rather than money being in control of the individual or family. What he proposes is a suite of relatively simple products that would go a long way to enabling customers to get a much better handle on their finances - to their benefit and the benefit of their families, and to the benefit of the financial institutions that offer such products.

This is not an “anti-bank” diatribe, though Antony genuinely believes that, for many financial institutions, their approach to customers is ethically indefensible. What it reflects is a belief that banks have a privileged position vis-à-vis their customers, particularly poorer customers, and that there is a moral imperative for them to work to improve the Financial Well-being of those customers.

In various places in this report, Antony has acknowledged the help he has received from his colleagues at FairBanking, and the assistance he has had with the statistical work on which his conclusions are based. I would like to add to that my thanks to my colleagues at the CSFI, who have worked hard to turn this report around quickly. It is important that the message gets through to a government that has made greater financial inclusion a key part of its agenda.

Andrew Hilton
Director
CSFI

Foreword

FairBanking believes that banks should deliver financial well-being to their customers. As a charity, FairBanking aims to achieve this by developing commercially viable bank products, processes and marketing approaches which help customers embrace better money management—and then by measuring success.



Concerned with the rising level of consumer debt, FairBanking's founder Antony Elliott, a banker since 1981 and a group risk director at a major retail bank for 10 years, investigated why individuals get into too much debt. Recommendations from his research published in 2005 sought to diminish the number of middle income households likely to land in financial difficulty.

Despite wide acceptance of his findings, banks hesitated to implement the proposals. His concerns mounted and led to the creation of FairBanking shortly before the collapse of Northern Rock.

This report

This first research project commissioned by FairBanking targets the drivers of financial well-being for two key groups—young workers and families. Findings about financial well-being both inform and surprise, going against conventionally accepted thinking about money management practices.

These consumers express strong opinions on the bank products they want. The report recommends several specific features, which would enhance the financial well-being of bank customers and maintain bank profits.

Creating an index of financial well-being, the report enables banks to assess existing product and evaluate the impact of proposed offerings. Consumers can test their behaviour and money management practices, learning which changes could most improve their financial well-being.

FairBanking Trustees

Acknowledgements

This report is the culmination of a journey of more than five years. There have been many people who have made this report possible. I would like to acknowledge them below with considerable gratitude:

- It was Rob Parsons of the Christian charity, Care for the Family, who encouraged me to become interested in the issue of families in debt as I was leaving Abbey National at the end of 2003.
- George Guernsey identified that the original work into why households get into debt could be an opportunity for new banking products or consumer tools. His insights have been contributory gems to the research.
- Charles Adriaenssens and his team at Iris Concise have done a very professional job on the research programme. Particular mention to Sharron Worton, Kate Downer, Damian Frankcom and Philippa Bloom who contributed well beyond the call of duty.
- A special mention to John Osborne who not only created the demonstration products and the FairBanking website, but produced all the charts in this report.
- Professors James Devlin and Christine Ennew of the University of Nottingham for reviewing the regression analysis and providing the data on the trust index.
- Dr Ivo Vlaev, Senior Research Fellow, Imperial College, London generously contributed to the section of the report on behavioural economics. He gave valuable input to the quantitative questionnaire and helped strike a balance between academic rigor and readability.
- Dr Nick Groom for his critical review of the entire report.
- Thanks to Richard Silman of Ipsos Mori for providing the graph on the Economic Optimism Index.
- Thanks to Nick Watkins and Matt Howley at GfK NOP for contributing the analysis on the size of the population that would be covered by the index. The Financial Research Survey may have been the only way of being able to get this type of breakdown.
- Hugh Smallwood imaginatively created the cartoon illustrations.

Finally, I offer a debt of gratitude to my family. My wife, Deborah, has been the backbone for the whole endeavour. Holly and Laurence have adjusted well to my unusual style of working.

**Products in
the interests
of customers**

Summary

Background

A crisis hit the UK banking system after the collapse of Northern Rock in September 2007. Banks have since been exposed as a major contributor to the economic recession. In a number of areas, they have been found wanting. The common factor has been their desire for short-term profitability at the expense of risk control; plus, there has been no real constraint on bank growth.

Now, the crisis is causing fundamental questions to be asked about the purpose of banks, how they should be regulated and the true measure of performance for a well-run bank.

This report argues that the problems banks can cause when allowed to operate in the private sector without clear notions of the public good require a re-think of their role. Banks are beginning to offer products that help consumers manage their money, but the impact of these is low at present. At the same time, many consumers are focusing more on getting value for money. This changing environment means that the time is ripe for banks to offer products that are demonstrably in the interests of their customers.

The author of this report, Antony Elliott, has a long track record in the industry. A banker since 1981, he was Group Risk Director of a major UK retail bank for more than 10 years until 2003. Following this, he conducted his own research into why people get into too much debt. This resulted in recommendations to stem the number of middle-income households that are likely to get into financial difficulty. The report (published by the CSFI) was widely publicised, but its recommendations have been slow to be implemented.¹

Objectives

The two objectives of Antony's latest report are:

- to develop a measure of how satisfied young workers and families are with their financial circumstances, creating indices of financial well-being; and
- to propose specific products that retail banks should offer if (as they claim) they are genuinely seeking to address the financial concerns of their customers.

1. Nevertheless, it evolved into the idea of a charity, FairBanking, which was formed in September 2008. The charter for this was drafted before the collapse of Northern Rock, so its creation was not a knee-jerk reaction to the current crisis. FairBanking commissioned the research contained in this report. Given the part-nationalisation of the UK banking system and the stated objectives of the government in terms of access and reform, this is a good time to consider the banking system of the future.

Aimed at the young and families

The report identifies actions that banks could take for the benefit of their customers, particularly those who are not good at money management.

Young workers and families with young children are the two groups surveyed. Their financial decisions have important consequences for them and their children. All interviewees had gross household incomes in the range of £15,000 to £60,000 and at least one household member in full time employment. The two groups are:

- Young workers: Aged 18 to 29, they may be single, married or co-habiting, but they have no children.
- Families: Aged 25 to 39, they may be married, co-habiting, separated, widowed or divorced, and they have at least one child under 16 years of age living at home.

An internet survey of 654 people was conducted in November/December 2008. It took approximately 30 minutes to complete, with over 300 from each group being covered. The battery of questions was then used to develop an index of Financial Well-being (a “Money Worry” index) and to obtain reactions to specific financial services products. The quantitative study followed qualitative research that had been conducted in July/August 2008 to develop the questions contained in the survey.

Although these two groups are the subjects of the research, it is likely that the conclusions apply more widely to adults in working households with this range of household income between the ages of 18 and 39 – approximately 20% of the UK adult population. If this assumption is correct, the research is directly relevant to around nine million people.

Definition of Financial Well-being (‘FWB’)

A definition of Financial Well-being was developed for this report. It is important because it provides focus as to whether the bank products being described are adding to consumer benefit:

The level of FWB is determined by the extent to which a household with income above the poverty level is *not worried because it is exercising sufficient control to have enough money*:

- *to pay for essentials;*
- *to have some left over for luxuries;*
- *to service its debts;*
- *to have savings for the unexpected; and*
- *to save regularly.*

How can banks help improve FWB?

Control is the significant factor

Banks can measure financial well-being using the FWB index, and should implement the following four key recommendations:

1. Encourage greater financial control by households in the UK: The conclusion of the research is that the FWB of households would be increased if banks developed products and internal processes that enabled customers to experience a greater sense of overall control of their money. Control is by far the most significant factor in driving financial well-being for the groups surveyed.
2. Keep the unsecured debt-to-gross income ratio (DIR) as low as possible: For the family group, the DIR is a major factor in determining financial well-being. It is not a step change; but a gradual deterioration in FWB occurs as debt increases. The ratio is not as significant for young workers, but this does not mean that the young worker would not benefit from keeping it low. Banks can improve the financial well-being of customers by assisting them not to borrow more than they need, and by making it easier to repay debts.
3. Encourage young workers to think of their money in “pots” put aside for different things: The extent to which young workers are able to plan in relation to money will have an effect on their financial well-being. The FWB of young workers would be improved if financial products were offered in a way that helped them “to think of their money in pots”, i.e. to divide expenditure into categories (rent, petrol, going-out, saving for holidays etc.).
4. Encourage families to adjust non-essential expenditure to life events: This is a significant factor in the FWB of families. The implication is that they need to understand the discretionary component of their expenditures. Furthermore, they need to understand the consequences of life-events such as having a child, moving house or a reduction in household income. It is likely that the earlier adjustments are made in the family budget to a life event, the better it will be for the financial well-being of the household. The banking industry could help families by providing products that assist in achieving this objective.

Adjust early to life events

Proposed financial products from banks

Banks have been allowed to encourage poor financial management – and have taken advantage of customers who do not manage their money well. Loans are often granted too easily, unjustifiable penalty charges are paid primarily by those least good at money management, expensive payment protection insurance is sold under cover of a loan product, and obsolete accounts are exploited to the disadvantage of sleepy savers.

Too many innovations benefit the bank - not customers

In the corporate world, banks have been the equivalent of car manufacturers producing faster and faster cars without investing in improved brakes. Banks offer products that require more knowledge from customers, but they have not provided the tools for customers to make decisions. No wonder so many customers have spun off the financial road.

Arguably, too many banking innovations of the last ten years have benefited the bank rather than the financial well-being of the customer. In the last couple of years, however, there have been developments from some banks/credit card companies in the US and UK that should improve the FWB of customers. These include expense management, budgeting, saving and debt reduction tools. They are not yet widely available in the UK. Nevertheless, there must be some demand, otherwise major institutions would not have made the necessary investment. The technology involved is not new. The costs are not huge; indeed, they are well within the normal budget allocated for routine product enhancement.

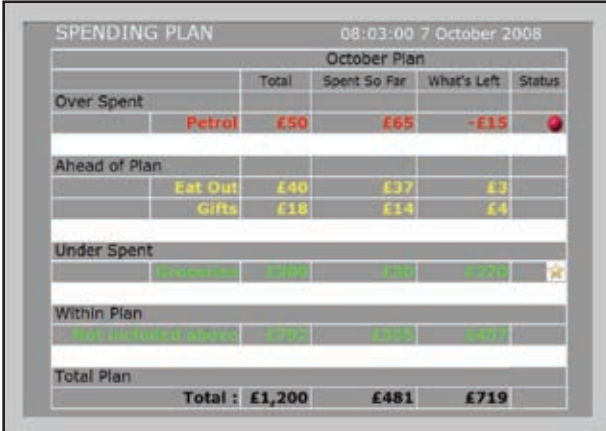
The economics for the bank ought to be compelling in that customers who find these tools helpful are unlikely to want to switch bank. From a risk control perspective, customers who are able to better manage their money are also less risky.

So, having confirmed the potential to improve FWB, how can banks help?

Three specific products were tested in this survey to discover how likely they are to be used (if available), and to find out which features have immediate appeal. These products could be offered separately, or as an integrated suite. The customer interface screens would vary according to the preferences of the customer, but the basic engine would be the same. By the standards of product research, all three were highly rated by respondents:

1. **Income/expenditure management tool**: This is a tool that groups all expenditures for a month. The customer can establish “targets” by expenditure category, e.g. petrol, supermarket shopping, clothes etc. It could be offered in two versions, one more “visual” than the other:

Version 1 – Income/expense management tool



SPENDING PLAN		08:03:00 7 October 2008		
October Plan				
	Total	Spent So Far	What's Left	Status
Over Spent				
Petrol	£50	£65	-£15	●
Ahead of Plan				
Eat Out	£40	£37	£3	
Gifts	£18	£14	£4	
Under Spent				
Expenses	£300	£30	£270	★
Within Plan				
Not included above	£700	£100	£600	
Total Plan				
Total :	£1,200	£481	£719	

Version 2 – Income/expenditure management tool





Forty six percent of respondents thought this tool extremely or very useful. A very high level (c.70%) of respondents thought that at least one of the above versions was either extremely or very clear.

2. **Savings tool:** This is a tool to help a customer build savings for a specific item – perhaps with a picture of the item to keep the saver motivated and a gauge to see progress. Money would be put into a separate pot from the main bank account – and there would be an occasional reminder to check that these are genuine savings (i.e. that the customer is not increasing debt elsewhere to fund this):

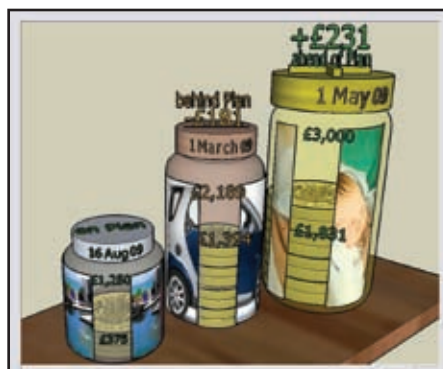
Version 1 – Savings tool

SAVING PLANS

08:03:00 7 October 2008

Saving		Plan		Actual		Month's	Balance		From Plan	Status
for	Priority	Total	Dates	Sept	Oct	Interest	Current	To Go	£	
Baby	Gold	£3,000	01/05/2009	£200	£200	£12.21	£1,831	£1,169	£231	
Holiday	Silver	£1,250	16/08/2009	£125	£125	£2.19	£375	£875	£0	
Car	Bronze	£2,189	01/03/2009	£187	£200	£6.97	£1,394	£795	-£181	
Total : £6,439				£512	£525	£21.36	£3,600	£2,839	£50	

Version 2 – Savings tool



In the new world, banks will improve customers' well-being

Forty nine percent of respondents thought the tool extremely or very useful and, around 70% thought that at least one version was extremely or very clear.

3. **Debt reduction tool:** The goal would be to reduce overdraft and/or credit card debt. The bank would provide current overdraft details, and the customer could add other debts, setting a target reduction.

Fifty seven percent of respondents thought the tool extremely or very useful.

The technology is available to enable all these tools to operate via current accounts, something that all participants used. They would need to be simple, but if they were, it is almost certain that a large number of households would use them. This would include a proportion of lower and middle-income households that really need help managing their finances.

FairBanking intends to help banks deliver 'healthy' products and processes such as these. The hope is that banks will emerge from the current debacle not only better managed, but also offering significantly better services to customers. In the new world, banks will demonstrably improve the financial well-being of their customers.

The regulatory implications of this research are not developed in this report. Given the part-nationalisation of the banking sector in the UK and the poor performance of banks in delivering products/services that improve the FWB of customers, there could be a role for government. For instance, banks might be required to produce evidence that the products/services they offer are increasing FWB by using the FWB Index. After all, water companies must invest in improving the infrastructure, car companies must invest in safety, pharmaceutical companies must prove that the drugs they sell are in the public interest; why should banks be able to hide behind compliance to sell intrinsically poor products?

Introduction

This report consists of four sections:

- The Financial Well-being (FWB) or ‘Money Worry’ index: This explains how separate indices were created to measure the overall FWB of two groups of respondent – the young worker and the young family member. What is particularly significant is the importance attached by both groups to having control over their finances; control appears even more important than the overall level of available money.
- Financial product solutions: This section includes details on three financial products that would be of immediate benefit to people who want to manage their finances. It also highlights products that are currently on offer from banks and credit card companies in order to emphasise the practicality of the proposals.
- Lessons from behavioural economics and further research: Banks have made use of economic psychology to maximise returns from their customers. This section looks at ways that behavioural economics can be harnessed for the benefit of bank customers. Much of it is commonsense – asking how customers can ‘prime’ their behaviour in the right direction, ensuring products are straightforward, encouraging take-up etc. The important point is that financial product providers have an obligation to improve their offering – and that includes improving their safety. At the moment, banks are like automobile manufacturers who spend money developing cars that go faster without developing better brakes.
- Trust in banks and financial capability: Banks need to grow trust by demonstrating that they are acting in the interests of their customers and sharing their values. Customers need to feel their bank is working in their best interests. Banks will need to demonstrate that they really do have customers’ interests at heart. Many target customers should be as well-disposed towards new tools offered by the banks as before the credit crunch. Of course, banks would benefit from closer association with any initiative that would be a genuine benefit to clients.

**Banks selling
‘faster cars’
but without
better brakes**

All of this, clearly, fits within the UK government’s agenda for better financial education and greater financial inclusion. The credit crisis and the resulting partial nationalization of the UK banking sector provide a unique opportunity for putting what might otherwise be radical ideas into practice. It would be a great pity to waste a good crisis.

1. The Financial Well-being (or 'Money Worry') index

1.1 Research approach

The objective of this report is to identify whether banks can improve the well-being of their customers. Given that the services of banks revolve around the management of money, it is a measure of household financial satisfaction that has been the focus of this research. If the key components that affect satisfaction with financial circumstance can be identified, it may be possible to influence them to improve the level of financial satisfaction for individual households.

Two sections of the population were chosen, both with an annual household income in the range of £15,000 to £60,000:

- Young workers: Aged 18 to 29, they may be single, married or co-habiting, but have no children; and
- Families: Aged 25 to 39, they may be married, co-habiting, separated, widowed or divorced, they have at least one child under 16 years of age living at home.

A diary of expenditure

Both of these groups are of interest – young workers owing to the money management challenges they face as they enter the workforce, and the family because of the challenges of balancing the various demands of family life. As for the research undertaken:

- Qualitative research: During July/August 2008, a series of interviews was held with people who managed their household finances. The process was a structured one-hour interview. The interviewee then kept a diary of expenditure for a week, and this was followed by a further one-hour interview to consider the diary and ask further questions. The purpose was to determine questions to be asked in the quantitative study. A grid of responses was produced, looking for common themes.
- Quantitative research: An on-line survey of 654 people was conducted between mid-November and early December 2008 (see [Appendix 1](#) for demographic tables). Respondents were split almost equally between young workers (334 respondents) and families (320 respondents). The survey took almost 30 minutes to complete. The only other criteria for inclusion were that all respondents should have a current account and that there should be approximately equal numbers of men and women respondents.

**65 per cent
thought the
economy
would get
worse**

- Analysis: Regression techniques (see [Appendix 2](#)) were used to identify the key factors for the Financial Well-being indices for both young workers and families. Regression analysis is a statistical technique that uses the responses to attitudinal statements and other factors (such as income and unsecured debt) to identify whether any are statistically significant drivers of the outcome. In this case, the dependent variable was the response to the question “how satisfied are you with your overall financial circumstances?”, with the answer on a seven-point scale.

1.2 Respondents’ view of the economy

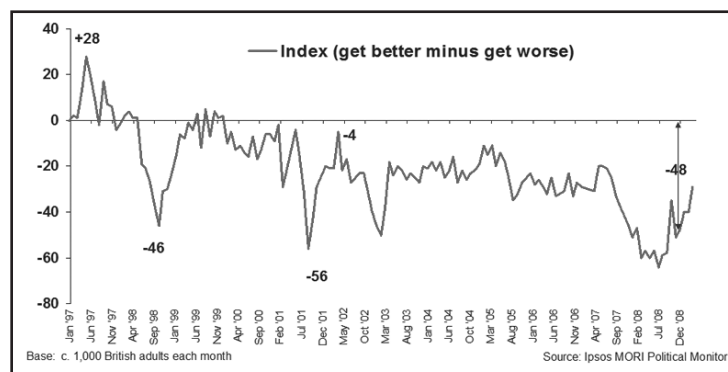
Given the volatile state of economic expectations, it is important to understand the view of the economy held by participants in November/December 2008.

Two questions were put to participants before conducting the rest of the survey:

- “Do you think that the general economic condition of the country will improve, stay the same or get worse over the next 12 months?” Sixty five percent of respondents considered it would get worse, 17% that it would improve and 18% that it would stay the same.

Ipsos MORI uses this measure to create an index of Economic Optimism (measured as the percentage who think the economy will improve less the percentage who think the economy will worsen), which is calculated monthly. The index is produced in Chart 1, showing the -48 score at the time of the survey. The index was at -51 in mid-November and improved slightly to -48 in mid-December, the same as this survey. Since then, the index has improved slightly following significant government action:

Chart 1: Ipsos MORI Economic Optimism Index “Do you think that the general economic condition of the country will improve, stay the same or get worse over the next 12 months?”



- “How do you think your personal financial circumstances will change over the next 12 months?” Younger people (aged 18 to 29) were significantly more optimistic than the family group (aged 25 to 39). The group of families was less optimistic of their personal position (the “get worse” percentage is higher by about four percentage points) than that age group generally (compared with the Ipsos MORI survey), potentially reflecting the extra challenges facing those with children. On the other hand, young workers were more optimistic about their personal position (the “get worse” percentage is lower by about four points) than that of the age group in general, potentially reflecting that all the respondents were employed with an income above £15,000:

Table 1: Change in personal financial circumstance in next 12 months

Respondents	Get Worse (%)	Get Better (%)	Stay the same (%)
Family with child(ren)	40	19	41
Young Worker	25	27	48

1.3 What proportion of the adult population is covered?

GfK NOP has supplied information on the relevant population group. There are around 49.5m people in the adult (over-16) UK population. Young workers with a gross income of £15.5k to £75K represent about 5%. The survey group, therefore, represents around 2.5 million adults in the young worker category. Families (using the same income range) represent about 9.0% of the adult population. The survey, therefore, represents about 4 million adults in the family group.

The results are unlikely to change significantly for young workers with children; if the 18 to 25 year-old workers with children were included, this would add around 1% to the relevant population. Similarly, it is unlikely that the results would be significantly different for workers aged 25 to 39 without children. This would add about 4.0% to the relevant population.

In conclusion, widening the income range from £60k to £75k (i.e. higher than the FairBanking survey), the directly relevant population of the two groups would be about 6m adults. If the broader definition is considered, it represents about 18-20% of the adult population, or around 9 million people.

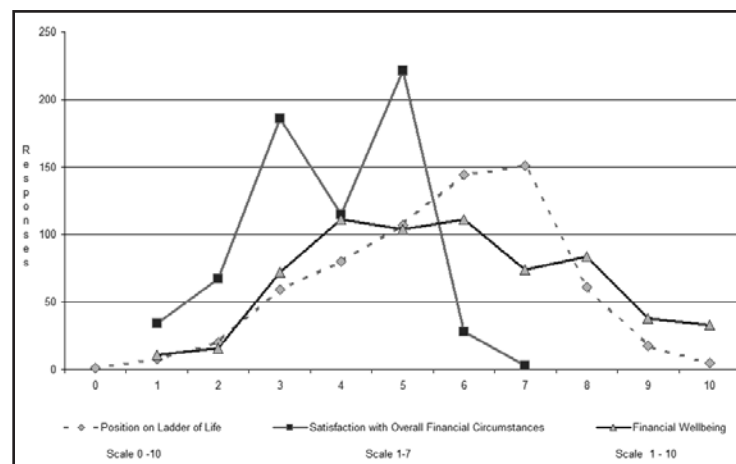
**Of relevance
to up to 9m
people**

The economics of happiness

1.4 Financial Well-being – what is it?

This research is a modest contribution to the economics of happiness. When respondents were asked (on a scale of 1 to 7) how satisfied they are with their overall financial circumstances, there was a wide range of answers from ‘very satisfied’ to ‘extremely dissatisfied’. The psychological literature² describes satisfaction or contentment as being one component of happiness or well-being. A recognised question is to ask on which step of the ladder are you if 10 represents the best possible life for you. The answers to three questions regarding satisfaction with financial circumstances, ladder of life and financial well-being are illustrated in Chart 2. There was a high level of correlation between the answers to these three questions (see Appendix 2).

Chart 2: High correlation of position on ladder of life, financial satisfaction and financial well-being



Clearly, there is more to our happiness than finance. But to achieve satisfaction in this important area will lead to us moving further up the ladder to achieving the best life we can have. The link between financial capability and psychological well-being was explored in an FSA paper.³ It uses data from the British Household Panel Survey (1991-2006) to show that one additional serious financial problem affects life satisfaction by the equivalent of divorce/separation.

Every person interviewed for this research was asked for a definition of financial well-being, to compare with the definition from the qualitative study – i.e. *having enough money left over for non-essentials “to live your life”*. The following elements dominated the 654 responses:

2. ‘Authentic Happiness’. Martin E.P. Seligman (Nicholas Brealey Publishing, 2002)

3. Financial capability and wellbeing: Evidence from the BHPS. Prepared for the Financial Services Authority by Mark Taylor, Stephen Jenkins, Amanda Sacker of the Institute of Social and Economic Research, University of Essex (May 2009)

Enough money. . . but for what?

- Enough money to pay for essentials with some left for non-essentials (luxuries) – 78%
- A lack of worry about finances, feeling secure – 31%
- Ability to save (contingency savings, pension, saving for future purchases) – 17%
- Not too much debt – 16%

Based on these responses, a household with high financial well-being would *not be worried because it would be exercising sufficient control to have enough money to pay for essentials, to have some left over for luxuries, to service its debts, to have savings for the unexpected and to save regularly.*

This does not seem too ambitious a definition at first. However, there are a number of challenges that a household will need to attend to in order to keep well-being levels high. The key questions appear to be:

- How does a household exercise control?
- What is an essential?
- What is a luxury?
- What is manageable debt?
- How much contingency savings should be kept?
- How can savings (including pensions) be managed?

These can be challenging questions, especially when life events cause the situation to change. There are no obviously right answers and, at first sight, the easiest solution would simply be to focus on getting more money. That, however, would not solve the problem. The statistical analysis that follows shows the most important factors that determine financial satisfaction for young workers and families.

1.5 Key factors in the Financial Well-being (or 'Money Worry') index

The young workers in the sample were aged from 18 to 25 with a household income between £15,000 and £60,000. They were either single (38%) or married/co-habiting (62%). The respondent and/or his/her partner was working full-time.

Among families in the sample, the person answering the survey was aged from 25 to 39, and had at least one child under the age of 16. Almost all were married or co-habiting (98%). The families had one child (40%), two children (46%), or three or more (14%). The respondent and/or his/her partner was working full time, with a gross household income between £15,000 and £60,000. Respondents either had sole responsibility for household finances (27%) or joint responsibility (73%). All respondents had a current account.

There are four statistically significant factors that drive FWB for each of the two groups, Young Worker ('YW') and Family ('F'). The following illustrations summarise the factors and are detailed in [Table 2](#):

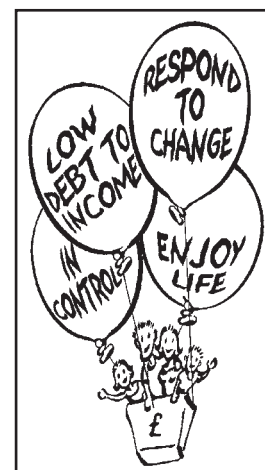
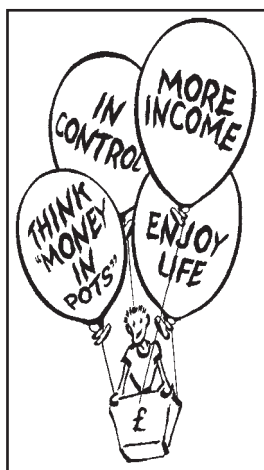


Table 2: Factors driving Financial Well-being

	Young Worker	Family
Factor 1	Control of overall finances	Control of overall finances
Factor 2	Gross income	Ratio of unsecured debt to gross income
Factor 3	Think of money in terms of "pots" put aside for different things.	Better to live life and enjoy it rather than worry about money.
Factor 4	Better to live life and enjoy it rather than worry about money.	Adjust the amount of money spent on non-essentials when life changes.

The detailed analysis behind these factors is contained in Appendix 2, with further information available through the FairBanking website. Factor 1 is twice as important as any other factor. Factor 4 is statistically significant, but represents only about one-third of the importance of Factor 1.

1.5.1 Being in control of overall finances (Factor 1 for young workers and families)

This is twice as important as the next most important factor (income or ratio of debt to income, as explained below) in determining financial satisfaction.

What does being "in control" look like?

The attitudinal statements that contribute to control are illuminating. They include:

- being “on top” of monthly expenditures;
- knowing the detail of one’s financial situation at all times;
- spending within one’s means; and
- having a high degree of comfort dealing with financial matters in general.

This factor ought to be measurable, and ought to be possible to influence positively. The banking industry, armed with this knowledge, ought to be able to ensure that its products are designed to meet a need for greater FWB. This does not just relate to the problem of debt, but also to the complexity of having multiple bank accounts, savings accounts, loans and credit cards.

The following charts clearly illustrate that the more the respondent agrees with the statement, the more likely that he or she will have a high level of FWB:

Chart 3: Being in control of overall finances and FWB – Young worker

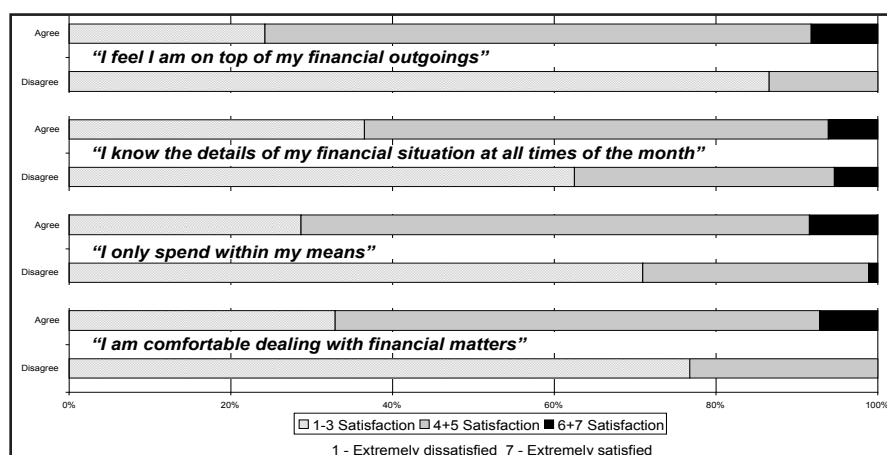
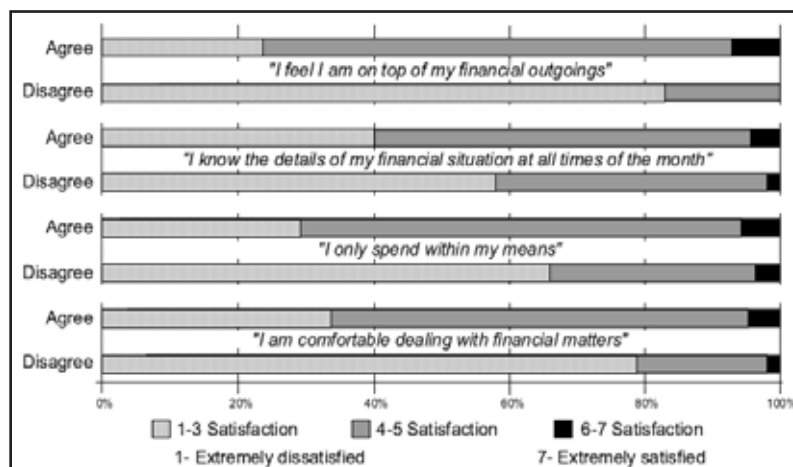


Chart 4: Being in control of overall finances and FWB – Family



**More content
on a tight
budget**

The primacy of “control” is surprising. However, the author has had the privilege of interviewing many people in depth on their money management. Below are quotes from two people for (unpublished) research into the effect of an Individual Voluntary Arrangement (‘IVA’). This is a form of bankruptcy that requires the borrower to pay what he or she can afford over a five year period, i.e. an enforced budget:

- 25 year old woman earning £20,000 – “I know down to the last penny what leaves my account. Before I didn’t. All I did before was make sure that all my direct debits and standing orders – like my mortgage and my water and my electricity... they had been paid. The actual amount I wouldn’t have known. But now, I know everything down to the last penny. I can literally go to the end of the month and know I’m going to have £2 left in my bank account. I’ve learnt that the little things that you think that you need in life – there’s things that you pay out for and you think they’re an absolute necessity, but when they’re gone there isn’t any change. You don’t need to pay for everything. There are ways of getting things free. All you have to do is ask and do the groundwork to find them.”
- 32 year old man with a partner and two children – “I didn’t concentrate on my finances – that’s one of the reasons why it got out of control. I didn’t check where all the money was going and how much I was taking on. (Now) I keep one of them little notebooks and at the end of the month I put exactly what I’ve earned and write next to it what’s going out – either electricity, mortgage, IVA money. And at the end of it, I know exactly what I’ve got left and I can’t spend any more and I can’t spend any less. That’s the way I look at it now... And in general, I think it’s better. It’s silly things like our children now – the way it is now – they only get sweets on a Friday. But by Friday it’s sweetie day. Beforehand, Daddy would come home and bung them sweets because it was easy. But now it’s something to look forward to and that’s the same way I look at it now. If I want a new video player and it takes me two years to save up for one, at least I’ve paid for it”.

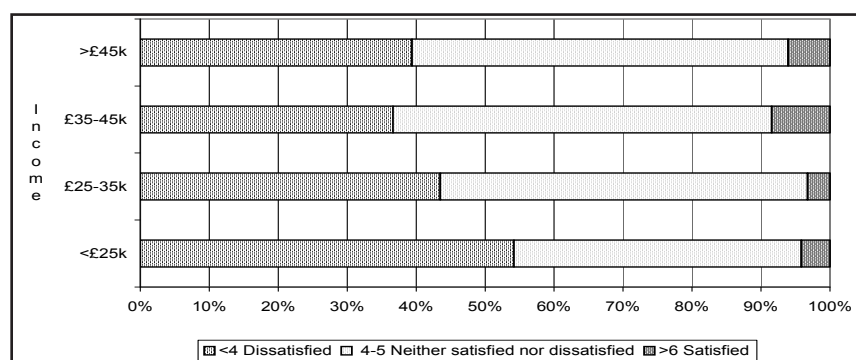
The striking thing about these two people (and many others interviewed) is that they are more content on a tight budget than they were when spending freely, but without control. When measured by the amount spent in a year, they will have experienced a deterioration in lifestyle, but their overall well-being appears to have risen.

1.5.2 Gross Income and unsecured debt to gross income ratio (‘DIR’) (Factor 2 for young workers and families)

Gross income and young workers: It is not surprising that gross household income should feature in determining financial well-being, although it is less important than overall control of finances. For young workers, the higher the level of gross household income, the greater the level of financial well-being. It is surprising that gross income is not a significant factor for families. It is also a surprising finding that, for young

workers, the unsecured debt to gross household income ratio is almost statistically significant. This is developed in the next section. The following chart illustrates the relationship between financial satisfaction and income for young workers:

Chart 5: Gross income and FWB – Young worker

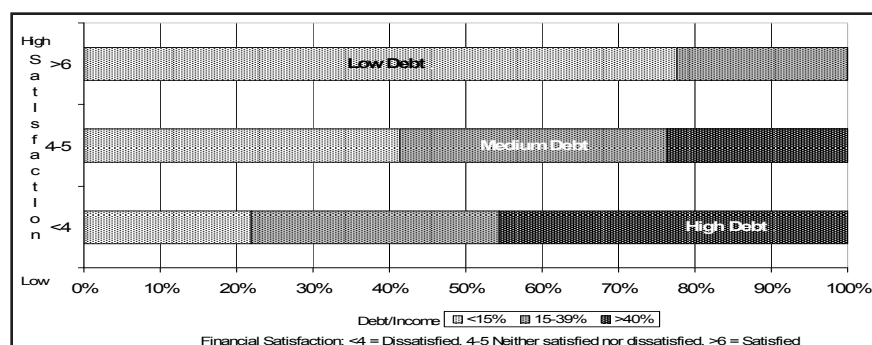


Unsecured debt to household income ratio ('DIR') and families: It is surprising that this is such a clear factor in financial satisfaction for families. Numerous questions in the survey produced answers that were significantly different depending on the level of unsecured debt as a percentage of gross income (see Appendix 3). It is not simply that there was a break point at which the debt burden became too great.

The relationship identified in this survey is significant since, as it has been noted in previous research it is difficult to get an accurate reply to questions on unsecured debt.⁴ It is likely that the ratios understate the level of debt as a percentage of income, since many people underestimate the level of debt owed. At the end of 2008, there is no doubt that the level of debt as a proportion of income was a very significant factor in well-being that out-weighed absolute income. Even at low levels of debt as a proportion of income, well-being decreases as the ratio rises:

Many people underestimate their level of debt

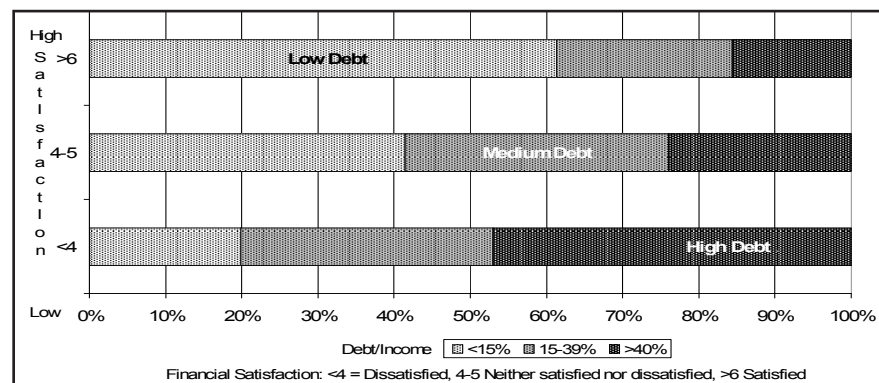
Chart 6: Financial satisfaction v debt income ratio (%) – Family



4. British household indebtedness and financial stress: a household-level picture. Orla May, Merxa Tudela and Gary Young. Bank of England Quarterly Bulletin (Winter 2004)

By way of comparison, Chart 7 illustrates the same relationship for young workers. Young workers appear to be better able to cope with higher debt levels, and the DIR is not a significant factor in the Financial Well-being Index. It is not possible to say whether this is a temporary phenomenon, but the implication is that as young workers move to the family life-stage, the debt acquired becomes a more difficult problem:

Chart 7: Financial satisfaction v debt income ratio (%) – Young worker



1.5.3 “It is better to live your life and enjoy it rather than worry about money” (Factor 4 for young workers and Factor 3 for families)

For this factor to come through as significant in the context of financial well-being is surprising. The following charts show that a small number of people with high levels of well-being agree with this statement. This is sufficient to make it statistically significant for both groups:

Chart 8: “Live your life and enjoy it rather than worry about money” v Financial Satisfaction – Young worker

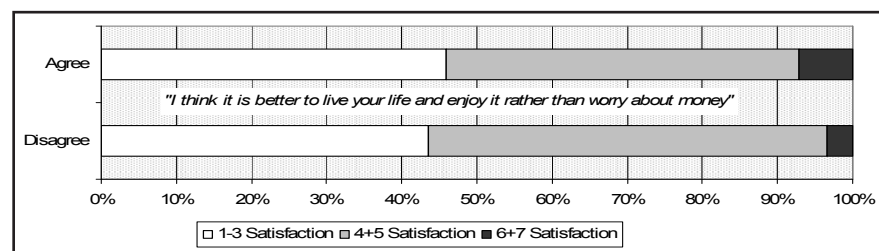
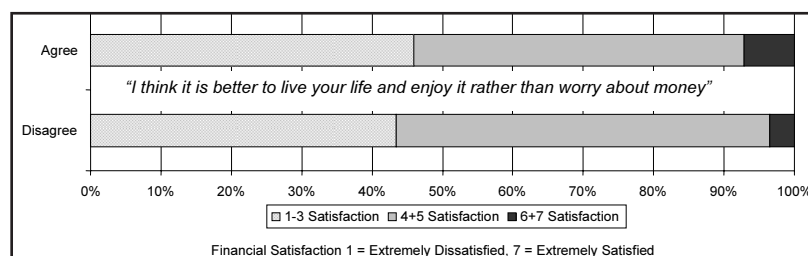


Chart 9: “Live your life and enjoy it rather than worry about money” v Financial Satisfaction – Family



Putting financial matters into perspective

The suggestion is that people can gain financial well-being by believing that money is an enabler of the good things in life. If you agree with this statement, you are more likely to have high FWB; if you disagree, you are more likely to have low FWB. At its most extreme, this attitude could lead to reckless financial behaviour. However, when balanced with good control of finances and/or low debt, it should allow people to put financial matters into perspective. The implication is that, in order to achieve a high level of FWB, strong agreement with this statement needs to be balanced with a level of control that ensures that money worries do not interfere with the ability to live life and enjoy it. Strong agreement in isolation from control may mean that temporary financial satisfaction is obtained, but at the expense of financial difficulties in the future.

The following table shows that, unlike many of the other statements, there is no relationship between this statement and the debt:income ratio:

Table 3: Relationship between agreement on statement “I think it is better to live your life and enjoy it rather than worry about money” and debt:income ratio

Mean score*	Debt: income ratio				
	Up to 5%	5 to 14%	15 to 39%	40 to 59%	Over 60%
Family	2.8	3.05	3.02	2.89	3.00
Young worker	3.3	3.15	3.26	3.3	3.39

*Mean score on agreement with the statement by unsecured debt:income ratio

The factor is less than half as important as being in control of overall finances, and is also less important than Factor 2. Nevertheless, its inclusion is thought-provoking.

1.5.4 Think of money in terms of “pots” put aside for different things (Factor 3 for young workers)

Regression analysis shows that this is a factor unique to the young worker: financial satisfaction is higher for young workers if *they think of money in terms of “pots” put aside for different things*.



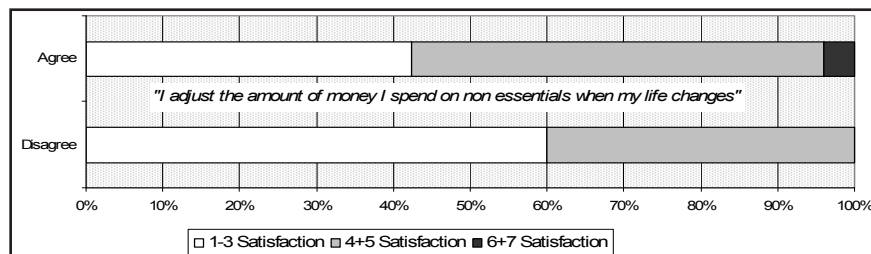
Why is this particularly important for young workers?

Young workers between the ages of 18 and 29 are learning how to manage money. They are entering the world of paying for accommodation, for utilities, for transport, for a myriad of entertainment choices. It appears important for their financial well-being to have a method of dividing these financial demands into categories. This could be viewed as a sub-set of financial control. The difference is that the overall control factor involves living within one's means by monthly monitoring and management. The concept of “pots” indicates an element of planning for the future; an attempt at ensuring that one type of expenditure does not lead to other types of expenditure having to be curtailed.

Living within one's means

1.5.5 Adjust the amount of money spent on non-essentials when life changes (Factor 4 for families)

Overall, this factor is the least important for the family group, but it is still statistically significant. Chart 10 illustrates the impact of the factor on financial satisfaction:

Chart 10: Family – Ability to adjust to change v financial situation

The ability to respond to life changes is a core skill. The more that a person can respond to life events, the more likely he or she is to be able to reduce financial worries and avoid getting into financial difficulty.

1.6 The implications for young workers and families of the FWB Index

In order to understand the implications of the index, it is worth considering the life events that the young worker and the family are trying to manage.

- **Young worker life events:** The survey asked which life event had the most significant financial effect in the previous three years. For 37% of young workers, it was property-related; 23% had bought a property for the first time and 14% had moved house. The second most important life change was getting married or starting living with a partner (15%). The following table is a summary of the items identified by the largest proportion of young workers:

Table 4: Life events for young workers

Life event with greatest financial impact in last 3 years	Experienced it (%)
Bought property for first time	23
Got married or started living with partner	15
Moved house	14
Changed job to work for different employer	14
Finished my education	10
My partner or I started full-time education	8

Fifty percent of respondents had not recovered financially from the life event, although 27% had recovered in six months or less.

- **Life events for families:** For families, the most significant life event is having children. Having children was the event that had the greatest financial impact for 41% of respondents. This was followed by moving house, which had the greatest impact for 23%. This was followed by job-related events – notably, changing employer (8%) and redundancy or job loss (7%):

Table 5: Life events for families

Life event with greatest financial impact in last 3 years	Experienced it (%)
Having first child	27
Moved house	15
Having another child	14
Got married or started living with partner	9
Bought property for the first time	8
Changed job to work for different employer	8
Redundant or lost job	7

Fifty percent of respondents had not recovered financially or returned to normal following the event, although 32% had recovered in 6 months or less.

1.7 Implications of the Index for money management

The importance of keeping track

Control of overall finances: This is key to Financial Well-being. The basic requirement is the importance of keeping track of finances, living within one's means and feeling comfortable with financial matters. These are simple objectives and require simple solutions. In order to achieve control, it may be in the interest of these households to sacrifice some interest income on savings or pay a higher rate on debt. The simplification of product holdings or the selection of products that increase control is a clear objective.

Unsecured debt to household income ratio: It is clear that the higher the debt: income ratio, the lower the Financial Well-being of families. In addition, young workers are the families of the future. Young workers who borrow could be encouraged to repay or encouraged to develop the ability to save. Even at low levels of debt, there is a detrimental effect on FWB and on overall well-being. Reducing and avoiding non-mortgage debt for both young workers and families should be encouraged.

Money in “pots” as a planning tool: Learning these skills as a young worker will increase Financial Well-being. There are implications for the way in which financial services products are delivered.

Ability to adjust non-essential expenditure to life events: This is important for the family. It leads to the conclusion that it is important to have some cushion. A family will have greater FWB if it can adjust earlier to life events, and is assisted with them.

2. Solutions – Financial products offered by banks

Growing demand for many - management tools

The survey asked questions related to new banking products to test the reaction of respondents. At the time, the drivers of Financial Well-being were not known. Three products are described below:

- an Income/Expenditure Management Tool;
- a Savings Tool; and
- a Debt Reduction Tool.

These tools are not radical, and there are some banks/credit card companies that already offer similar features. In the US, there are indications that the appetite for these tools is growing. If these are changes that also occur in the UK, the tools could be in great demand.

2.1 Testing an income/expenditure management tool

The control of overall finances is critical to achieving financial well-being for both families and young workers. Unfortunately, the multiplicity of financial products has made this difficult. Many people have different bank accounts for different purposes, multiple credit and store cards, savings accounts, personal/car loans, student loans and many other financial products.

In the survey, questions were asked about how respondents controlled their day-to-day finances.

It is known that having direct debits and standing orders, set up just after payday so the household knows what is left for the month, is a good strategy. Eighty-six percent of respondents were already doing this. However, it was only 79% in the 18-24 age group (i.e. one young person in five does not).

Young workers were more likely than families to monitor their account regularly “to ensure there is always something left in my account at the end of the month”. Seventy seven percent of young workers were doing this, compared to 67% of families.

The following table gives the breakdown on the frequency of checking bank accounts:

Table 6: Frequency of checking bank account

Frequency of checking bank account	Young Workers (%)	Families (%)
Daily	34	31
Weekly	52	54
Fortnightly	7	7
Monthly	5	8
Less often	1	1

There is little difference in the frequency of checking between young workers and families. Approximately one third of households check accounts daily, and approximately half check weekly.

For families, the percentage checking daily rises in line with the Debt/Income Ratio. Only 19% of families with a DIR below 5% check their account daily, compared with 41% when the ratio is over 40% and 46% when it rises to over 60%.

The following table gives the method used to check the bank account:

Table 7: Method used for checking bank account

Method used for checking bank account	Young Workers (%)	Families (%)
Internet banking	90	86
Statement by post	31	32
Statement at bank/ATM	28	28
Telephone banking	13	11
Text message with balance	4	4

A question was asked about which of the following best described the reason for checking one's bank account balance:

Table 8: Reason for checking bank account

Reason for checking bank account	Young Workers (%)	Families (%)
"It usually influences what I spend"	40	37
"To switch money between accounts before I spend"	20	23
"Out of interest/habit but it rarely influences what I spend"	21	19
"It influences at what point in the month I spend, but not how much I spend"	19	21

There is no statistical difference between the young worker and the family. However, for the family, there is a statistically significant increase in the amount of checking that influences spending when the Debt/Income Ratio rises. When the DIR is under 5%, only 28% check in order to influence expenditure; but this rises to 41% when the ratio exceed 40% and to 54% when the DIR reaches 60%.

What expenditures can be controlled?

Based on qualitative research, a list was presented to respondents of types of expenditure, and they were asked whether they viewed them as ‘essential’ or ‘non-essential’:

Table 9: Non-essential/essential expenditures for young worker

Type of Expenditure (Young worker)	Non-essential (%)	Essential (%)	Don't have view (%)
Eating/drinking out	79	18	3
Day out activities	78	13	9
New clothes for myself	74	24	2
Cosmetics/toiletries	48	46	6
Cable/satellite TV	44	27	39
Memberships	43	14	42
Presents for others	38	61	1
Travel not for work	24	68	8
Mobile phone	21	78	1

“Essential” for women. . . and for men

Table 9 shows that many young workers view the same item differently as to whether it is discretionary or not. For example, 38% of young workers with cable/satellite television regard it as essential. There were also some male/female differences. Women are more likely to regard mobile phones, eating out and buying presents as essential. Men are more likely to have membership/subscription-type expenditures. Men are also more likely to have cable/satellite television and if they do so, are more likely to regard it as essential than are women. New clothes and cosmetics/toiletries were not areas where there was any major difference between male and female respondents.

For families, Table 10 shows that there is a large difference between how respondents view the same type of expenditure. The overall result is very similar to that for young workers – though it is noteworthy that most expenditure on children’s clothes is viewed as essential. Women in this group are no more likely than men to view eating out as essential. There is no longer a male/female distinction on how cable/satellite television is regarded. The family man is less likely to have membership/subscription-type expenditures than the young worker:

Table 10: Non-essential/essential expenditures for families

Type of Expenditure (Family)	Non-essential (%)	Essential (%)	Don't have view (%)
Eating/drinking out	73	14	13
New clothes for myself	66	30	4
Day out activities	65	29	6
Cable/satellite TV	52	33	15
Cosmetics/toiletries	47	44	9
Memberships	40	8	52
Presents for others	39	59	2
Travel not for work	22	64	14
Babysitting	18	10	72
New clothes for my children	8	90	2

Overall, the mix of expenditures and the way that they are regarded between essential and non-essential is very similar between the two groups. The most important point is that people will have different opinions as to whether the same item of expenditure is essential or non-essential.

Respondents were asked what expenditures they would be most likely to cut if they needed to take action. The following chart gives the order in which the respondents consider they would cut:

Table 11: Order of cutting expenditure (all respondents)

Type of expenditure	1st to cut (%)	2nd to cut (%)	3rd to cut (%)	Total (%)
Eating out	21	23	19	63
New clothes for myself	19	23	20	62
Days out	19	16	15	50
Memberships	15	8	7	30
Cable/satellite	9	9	9	27

This table tells us that 63% of respondents had eating/drinking out in the top three budget items they would cut.

Families are significantly more likely to cut eating out as an initial response, and young workers are significantly more likely to cut day out activities.

The overall conclusion is that it would not be difficult to tailor an expenditure management tool so that it helped people focus on the most relevant expenditures.

Some initial ideas to help with control: The following ideas to enhance control were positively received:

Incentives to check your bank account

- Automatically receiving text messages showing your bank balance: This could be pre-set to every week, every two weeks or every month. Thirty-eight percent of respondents considered that they were at least fairly likely to use this feature, with 11% being definite potential users. This was in addition to the 5% that say they already use such a service.
- Automatically receiving a text message when your current account balance reaches a level pre-set by you: This was even better received. Fifty-six percent of respondents were at least fairly likely to use this feature, with 19% being definite potential users. Only 2% indicated that they already had this service. In the 18-24 age group, 68% of respondents were positive, with 25% being definite potential users. However, even in the 35-39 age group, there was a positive response from 47%.
- Loyalty points for checking banking online or at ATM: This was a real hit, with 79% of respondents at least fairly likely to use this feature, and with 48% being definite potential users. This rose to 85% for 18-24 year olds, with 59% being definite potential users. The use of incentives is explored further below.

The response shows that there is demand for more features that encourage and reward control of overall household expenditure.

Testing some specific income/expenditure management tools: Thinking of your money in terms of “pots” put aside for different things has been found to be a significant factor in terms of Financial Well-being for young workers. For families it is also related to FWB.

An expenditure management tool with a number of different features was presented to respondents. The overall concept was well-received, with 46% considering it to be extremely or very useful and only 13% not at all useful. Each feature is discussed below:

- “Tells you whether you are spending more or less than the previous month on the item being tracked”: This feature was liked by 58% of respondents. There was a statistically significant difference between the two groups, as 62% of young workers liked this feature compared to 53% of the families.
- “Allows you to set a target for the month for a certain amount of spending”: This feature was liked by 48% of respondents. There was also a statistically significant difference between the two groups, as 55% of young workers liked this feature compared to 43% of families.
- “Grouping all your expenditures for the month e.g. petrol, supermarket shopping, clothes, etc”: This feature was liked by 43% of respondents. There was much less difference between the two groups, as 46% of young workers liked this feature compared to 41% of families.
- “Gives you information on areas where you are spending more than people like you”: This feature was liked by 37% of respondents.

- “If you are trying to spend less, gives you suggestions on how to do this, e.g. only eating out at weekends, only buying clothes in sales”: This feature was liked by 32% of respondents.
- “*Gives you a reward for meeting your target*”: This feature was liked by 73% of respondents. There was a statistically significant difference between the two groups, as 77% of young workers liked this feature, compared to 70% of families. It was not anticipated it would receive such a positive response.

There appears to be a real appetite among both young workers and families to have a tool that improves budgeting. But what might this tool look like? Three versions were tested on the respondents, and the two that were most liked are considered here:

Version 1 – Income/expenditure management tool

SPENDING PLAN		08:03:00 7 October 2008	
October Plan			
	Total	Spent So Far	What's Left
Over Spent			
Petrol	£50	£65	-£15
Ahead of Plan			
Eat Out	£40	£37	£3
Gifts	£18	£14	£4
Under Spent			
Groceries	£300	£30	£270
Within Plan			
Not Included above	£792	£335	£457
Total Plan			
	£1,200	£481	£719

Version 2 – Income/expenditure management tool

Current Spending Alerts		Plan for the Month of October: £1,200	
Plan by: 07 October: £494		Spent So Far £481	
Alerts: Less or Faster than Planned or In Excess of the Full Month's Plan			
Total Plan £481	Gifts £14	Eat Out £37	Petrol £65
£719 Left to Spend		£4	£3
			-£15

There were no significant differences between the two groups:

Table 12: Clarity of versions of income/expenditure management tool

% Very or Extremely Clear	Total	Family	Young Worker
Version 1	52	56	49
Version 2	41	44	39
Version 1 and/or 2	69	72	66

This shows the importance of different formats – and of offering two types of screen. The outcome is promising given that 46% liked the concept at the beginning of the section of the survey and 69% found the way it was presented clear in at least one of the versions.

Financial rewards/incentives were really popular.

The respondents were asked “which of the following reward schemes would be the most motivating to you?”

Table 13: Most motivating reward schemes

Reward scheme chosen (%)	Total	Family	Young worker
“Monthly financial rewards for controlling my expenditure”	73	71	75
“Annual financial rewards for controlling my expenditure”	11	11	10
“Financial rewards for controlling my expenditure, based on a time period I have set myself”	14	14	14
None of the above	3	4	2

Seventy three percent of respondents thought a monthly financial reward scheme would be the most motivating.

2.2 Testing a savings tool – to help you track your savings

Fifty percent of respondents said they were putting savings away each month. More were doing so at higher incomes, and it varied by Debt:Income Ratio (‘DIR’) so that a lower proportion saved as the DIR increased.

In the survey, respondents were asked how they felt about a number of strategies, including the strategy:

“Save up for specific items so I can buy them outright”.

“I have never tried this but I would consider it.”	c. 20%
“I have tried this but it did not work for me.”	c. 10%
“I already do this.”	c. 70%

This result does not change by income band or age group. The group that was particularly receptive was families with some debt (over 5% DIR). Here, around

A savings tool with different features

25% of them said they had never tried this but would consider it. At very high debt levels, the percentage saying they have tried it, but it did not work, increased by a statistically significant amount.

There is little doubt that a tool to help people save would be good for their money management – and, hence, for financial well-being.

A savings tool with different features was presented to respondents. It was described as follows: *“A tool to help you build up your savings for a specific item – with a picture of the item to keep you motivated – and a gauge to see how you are doing. Your money would be put into a separate pot from your main bank account – and there would be an occasional reminder that you must check that these are genuine savings i.e. that you are not increasing debt elsewhere to fund this.”*

The overall tool concept was well-received, with 49% considering it to be extremely or very useful and only 13% not at all useful. Each feature is discussed below:

- “See how your savings are building towards the target”: This feature was liked by 62% of respondents. Although not statistically significant, it was liked more by young workers (67%) than by families (56%).
- “Having a ‘rainy day’ pot of around three months’ income that is there for emergencies and builds up after being used”: This feature was liked by 59% of respondents. There was very little variation in the percentages across all categories of respondent.
- “Have a separate saving account within your current account”: This feature was liked by 54% of respondents. There was a statistically significant difference between young workers (60%) and families (48%).
- “Having multiple ‘savings pots’ each building towards different goals”: This feature was liked by 46% of respondents with little variation between categories of respondent.
- “Be rewarded with bonus amounts for saving on target”: There will be a monthly reminder to verify that these are genuine savings i.e. without going overdrawn or increasing overdraft. This feature was liked by 70% of respondents. There was a statistically significant difference between the two groups, as 75% of young workers liked this feature compared to 65% of families.

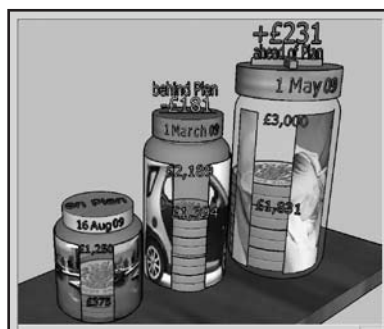
Overall, this tool received extremely high positive responses. What might this tool look like? Three versions were tested on respondents, and the two that were most liked are considered here:

Version 1 – Savings tool

SAVING PLANS

08:03:00 7 October 2008

Saving		Plan		Actual		Month's	Balance		From Plan	Status
for	Priority	Total	Dates	Sept	Oct	Interest	Current	To Go	£	
Baby	Gold	£3,000	01/05/2009	£200	£200	£12.21	£1,831	£1,169	£231	★
Holiday	Silver	£1,250	16/08/2009	£125	£125	£2.19	£375	£875	£0	
Car	Bronze	£2,189	01/03/2009	£187	£200	£6.97	£1,394	£795	-£181	●
Total :		£6,439		£512	£525	£21.36	£3,600	£2,839	£50	

Version 2 – Savings tool

The two versions of the summary page contain much the same information in very different formats. There were no significant differences between the two groups:

Table 14: Clarity of versions of savings tool

% Very or Extremely Clear	Total	Family	Young Worker
Version 1	46	47	44
Version 2	47	50	45
Version 1 and/or 2	70	73	68

Table 14 shows again the importance of differently formatted screens. The outcome is promising given that 49% liked the concept at the beginning of the section of the survey and 70% found the way it was presented clear in at least one of the versions.

2.3 Testing a debt reduction product/service

A debt reduction tool was presented to respondents. It was described as: “Your goal is to reduce your overdraft plus your credit card debt. The bank provides your current overdraft details, and you can add your other debts to it, setting a target reduction. As an incentive you will receive a bonus for achieving your goal.”

Setting a target for debt reduction

The overall concept was well-received, with 57% considering it to be extremely or very useful and only 11% not at all useful. Each feature is discussed below:

- “The ability to see your total non-mortgage debts easily”: This feature was liked by 58% of respondents. There was little variation between young workers and families. However, in this case, there was a significant difference in favour of those with high debt:income ratios for both young workers and families.
- “The ability to set a target for debt reduction”: This feature was liked by 59% of respondents. Not surprisingly, it was liked more by those with a high debt: income ratio.
- “The ability to identify specific reductions in expenditure that can be used to reduce debts or stop them increasing”: This feature was liked by 57% of respondents. There was a greater liking for both categories with high debt: income ratios, which was statistically significant for families.
- “An incentive in the form of a payment from the bank to reward your debt reduction in line with your targets”: This feature was liked by 74% of respondents. There was a statistically significant difference between the two groups, as 78% of young workers liked this feature compared to 70% of families. There were statistically significant differences between the high and low debt: income ratios for both groups.

Overall this tool received extremely high positive responses.

2.4 What are banks already doing to offer financial management products/ services that help customers?

Banks are undertaking positive activity

This report does not attempt to identify every positive activity that is taking place in banks at present. However, what is taking place should be encouraged, especially if the benefit to customers is being measured. The four examples below illustrate that the technology is available and that the costs can be justified. In the area of budgeting and expense management, there are companies (not banks) in the US and UK that are already offering consolidation of all accounts and credit cards through the internet. These companies are small and this may not be the best approach, but they demonstrate that the technology is available and that, for some groups of customers, that it is a commercial proposition:

- **UK Bank A**: In September 2008, this bank launched a mobile phone service that enabled customers to make transfers instantly between savings and current accounts and to receive text messages about their finances. The service allows customers to set up ‘High Balance’ and ‘Low Balance’ alerts to advise them when their current account balances reach, exceed, or fall below certain levels.

The technology is available

There is clearly customer demand for these types of service, and the bank concerned is making a monthly charge for many customers. However, the service being launched is not in itself evidence that the motivation of the bank concerned is to ensure that its products have improved the well-being of its customers.

- **UK Bank B:** In December 2008, this bank launched a money advice service, which offers guidance from trained advisors who are not trying to sell any financial products. The guidance relates to:
 - basic budgets and budgeting skills;
 - prioritising outgoings and expenses;
 - savings plans; and
 - general, impartial views on how financial products work.

This is a response to the need to help customers gain control of their finances. The challenge is the sustainability of the impact for the customer. This was one of the key recommendations made in an earlier CSFI report on why people were getting into too much debt.⁵

- **US Bank C:** This is a major US bank, which has decided that there are commercial benefits in offering a Budget Watch service. The new service allows the customer to set budget goals by key spending categories. The message alert option offers a variety of choices as to the circumstances under which a message is sent. For example, an alert can be sent to remind the customer to pay a credit card or when the balance on an account goes above or below a certain level.
- **US credit card company (not operating in the UK):** In February 2008, this firm launched two new online tools, the Paydown Planner and the Purchase Planner. In February 2009, it launched a Spend Analyzer in order to help customers with their spending behaviour:
 - Spend analyzer: This shows spending broken down by categories, including a pie chart, and monthly bar chart using spending on the card.
 - Paydown planner: Starting with a given monthly payment and varying the spending on the card, the planner will calculate how long it will take to pay off the balance for different levels of spending. Alternatively, for an objective of paying off in a certain period, it will give the monthly payment required and permit you to adjust the monthly spend on the card to achieve the target.
 - Purchase planner: Starting with the purchase price, the tool will work out the approximate monthly payment to pay off the balance. Alternatively, the preferred monthly payment amount and period can be entered and the tool will estimate how much can be spent on a new purchase.

5. Not waving but drowning: overindebtedness by misjudgement. Antony Elliott (Centre for the Study of Financial Innovation, April 2005)

3. Important lessons to learn from behavioural economics

The role of economic psychology

This is not the place to summarise the literature on behavioural economics or economic psychology, especially as the FSA recently published a paper on the subject, which explained why “even if people know and understand the facts, they may still take poor decisions due to lack of self-control and other personality characteristics”.⁶

However, in this section, examples will be given of the potential for “good” design. Economic psychology has already been widely applied by the financial services sector- one use being the role of *inertia behaviour* in enabling banks to profit by creating new savings accounts that have higher rates than “obsolete” accounts. The bank relies on the inertia of the highly profitable customers in the “obsolete” accounts. The modelling of inertia is a key factor in determining the profit to be extracted from each rate change. Another example is selling a low value product with a high profit margin (such as creditor insurance) in combination with a high value product (such as a loan) with a low profit margin.

This report is focused on positive developments that banks can undertake on behalf of their customers. All references to behavioural economics emphasise the potential positive outcome from applying them in the interests of customers. Ideally, banks would encourage people to do what is in their own best interests, measure the results (e.g. by using the FWB index) and amend their systems/processes to keep improving the outcome.

In order to focus the analysis, the following significant components of behaviour will be explored to explain how, by using them, banks could improve the money management decisions of their customers:

3.1 Priming

Priming activates memory in order to enhance mental processing. This happens because recent priming of any sort of knowledge makes it more accessible and therefore more influential in decision-making. In their recent book, “*Nudge*”, Thaler and Sunstein⁷ summarise the research that shows that “when people are asked what they intend to do, they become more likely to act in accordance with their answers”. The many examples include the fact that health-related behaviours are changed by

6. Financial Capability: A Behavioural Economics Perspective. Prepared for the Financial Services Authority by David de Meza, Bernd Irlenbusch, Diane Reyniers of the London School of Economics (July 2008)

7. *Nudge: Improving decisions about health, wealth, and happiness*. Richard H. Thaler and Cass R. Sunstein (Yale University Press, 2008)

measuring people's intentions. "If people are asked whether they intend to consume fatty foods in the next week, they consume less fatty foods."⁸

For each tool, the relevance of this approach was assessed:

- Income/expenditure tool: The customer was asked in which area he or she intended to reduce expenditure in the next period.
- Savings tool: Respondents were asked to specify precisely when they are going to start saving and *how much* they will be saving.
- Debt reduction tool: Customers were asked whether they would like to start reducing their debt level.

3.2 Procrastination and complexity

Procrastination is delaying taking an action when prompt action would be better. Offering too many options can induce procrastination. This is a challenging area, but it is clear that reducing the complexity of decisions and reducing the (even minimal) barriers to alternative actions can lead people to improve their financial situation. There are strong arguments for simplification to make it more likely a decision is taken. In addition, priming, commitment devices and incentives can help overcome procrastination:

- Income/expenditure management tool: It is important to keep any tool as simple as possible in order to avoid procrastination. Asking the customer which expenditure items to target, and providing a simple monitoring mechanism, should be useful.
- Savings tool: The best time to start saving for something is as early as possible. The idea of a savings account within the current account was liked. The key point is to reduce barriers to starting saving. A monthly review of finances could include a question about whether there are any large items that the customer would like to save for. A few easy steps could create a new savings "pot", and a regular amount could then put into that pot.
- Debt reduction tool: Making it easy to reduce debt is the key. Once the decision has been taken, products and processes should be designed such that the customer can make regular payments, particularly to reduce credit card and overdraft debts. For example, immediately a decision is taken to reduce an expenditure item, the customer should be able to allocate a regular amount from the current account to repay the debt.

8. Jonathan Levav and Gavan J. Fitzsimons "When Questions Change Behavior". Psychological Science 17 (2006)

There is a need for a sense of control

3.3 Optimism/underestimating in budgeting

Households will persistently underestimate their expenditures for next month; even when budget estimates are based on their previous period's expenditure.⁹ Financial well-being can be improved with a greater sense of control, but this needs to be genuine control:

- Expenditure management tool: If it has been established that the customer has a genuine desire to control expenditure, then there is real potential to provide assistance. A system could be designed to provide questions regarding the conservatism of the budget. A buffer could be added automatically by the system. This would be a positive form of default mechanism to be overridden at the customer's discretion.
- Savings tool/debt reduction tool: Both of these could have features that encourage a realistic target, so that the customer does not become demoralised. If the target is proving hard to achieve, it may be because it is unrealistic and should be reduced.

3.4 Commitment devices

It is helpful to eliminate the option of not taking a decision. Asking people to pre-commit is useful because we tend to procrastinate, in spite of being aware that prompt action would be better. Most people are aware of their will-power weaknesses, and look for commitment devices that bind them to the 'right' course of action.¹⁰ Commitment involves choice of a future state that requires some action and imposes some cost of not acting.¹¹ People may impose on themselves penalties for failing to act according to their long-term goals¹² (e.g. paying a cancellation fee for missing a savings or debt reduction target). Even by simply translating an intention into a specific plan, the probability of an action will significantly increase.

Products could be designed that give the customer the opportunity to determine a course of action, such as to increase saving, reduce expenditure, etc. "Commitment relies on several automatic psychological processes. The most general process, which plays a role in all commitment devices, is the non-linear (hyperbolic) discounting of the future; people tend to overvalue the present and undervalue the future consequences, including costs and

9. Gulden Ulkumen, Manoj Thomas and Vicki G. Morwitz, "Will I spend more in 12 months or a year? The effect of ease of estimation and confidence on budget estimates", *Journal of Consumer Research* 35, 245-256 (2008)

10. Dan Ariely and Klaus Wertenbroch "Procrastination, deadlines, and performance: Self-control by precommitment," *Psychological Science*, 13, 219-224 (2002)

11. I. Vlaev and P. Dolan, "From changing cognitions to changing the context: A dual-route framework for behaviour change". Mimeo, Imperial College, London (2009)

12. Yaacov Trope and Ayelet Fishbach, "Counteractive self-control in overcoming temptation". *Journal of Personality and Social Psychology*, 79, 493-506 (2000)

benefits”.¹³ A recent study suggests that individuals identified as having hyperbolic preferences also desire commitment devices:

- Income/expenditure management tool: The customer could be encouraged to commit by writing a note of how a reduction in expenditure would be achieved. A month later, the tool would show how expenditure had differed from plan and may give some feedback. Even negative feedback could act as an incentive for improvement.
- Savings tool: When it has been established that saving is a customer objective, this could encourage customers to commit to a regular amount.
- Debt reduction tool: The same effect is likely to be achieved by establishing a commitment to a certain amount of debt reduction. In addition, there would be further impact if customers were to specify when, where and how to perform goal-directed behaviours (e.g. during the week I will not eat out and instead use the money to repay my credit card).

3.5 Accountability

There are signs that respondents feel that to be held accountable in some way would be of benefit:

- Income/expenditure management tool: Just knowing that you will be asked what has caused a difference from your targeted outcome will cause a change in behaviour.
- Savings tool: Similarly, knowing that you will be shown progress with saving towards your goals will alter behaviour.
- Debt reduction tool: The debt tool could ask questions about how to achieve a debt reduction goal if this is not happening.

3.6 Enabling comparison with others (social influence)

One of the topics considered in the survey was the importance of “keeping up with the Joneses”. We are influenced by the behaviour of others, and this effect can be used in a positive way to alter behaviour. This has already been demonstrated in

13. Shane Frederick, George Loewenstein and Ted O'Donoghue, “Time discounting and time preferences: A critical review”. *Journal of Economic Literature* 40, 351-401 (2002)

relation to energy wastage, where descriptive messages comparing the customer's bill with average energy usage in the neighbourhood, produced energy savings:¹⁴

- Income/expenditure management tool: Thirty seven percent of respondents said they would like information on how much they spend, compared with others like themselves. This information needs to be presented carefully in order to alter behaviour positively. For example, it is not good enough to simply point out that somebody is below average on their "eating out" budget; this is likely to just encourage them to eat out more

3.7 Mental accounting

The need for "mental budgets"

Twenty years of research shows that people conceive of their finances using "mental budgets": different income sources (regular, bonus, windfall, future earnings, etc.) are treated differently, and spending is constrained by arrangement of wealth into accounts (e.g. current, savings, capital, buffer, etc). Also, people are very reluctant to move money between such accounts. They can generate complex rules by which to manage these accounts, but in doing so, frequently lose track of the overall situation:

- Income/expenditure management tool: Generally, this is a good way of achieving control. However, inconsistent activity needs to be highlighted. Over-spending on a luxury that is not genuinely being offset by an under-spend in another area can be flagged.
- Savings tool: It is important to make it easy for a customer to identify whether genuine saving is occurring, i.e. that a new savings pot is not increasing either at the expense of another area of saving or as a result of debt rising.
- Debt reduction tool: Similarly, if a customer is trying to reduce debt, it is important to monitor that debt is not rising elsewhere.

"Small incentives offered at the right time can have a substantial effect"

3.8 Incentives

The widespread use of loyalty schemes of various kinds is testament to their success. Thaler & Sunstein⁷ discuss the importance of salience. Work has already been done in this area in respect of financial incentives. One measure that has been found to change behaviour is a measure of value in terms of how many hours of work the saving or expenditure represents. It has been used in a course to teach parents how to

14. P. Wesley Schultz, Jessica M. Nolan, Robert B. Cialdini, Noah J. Goldstein and Vidas Griskevicius. "The Constructive, Destructive, and Reconstructive Power of Social Norms". Psychological Science 18, 429-434 (2007)

teach their children about money.¹⁵ In this context, it has been described as something that “switches a light on” for these parents. Small incentives offered at the right time can have a substantial effect on behaviour:¹⁶

- Income/expenditure management tool: Respondents were very receptive to the idea of incentives to manage expenditures. These were expressed in terms of financial incentives, without giving any indication of size. It is likely that modest incentives – even in the form of “loyalty points” or a reduction in the bank’s fees – could generate changes in behaviour.
- Savings tool/debt reduction tool: It would be very straightforward to offer modest incentives in this area. It is likely that even very small incentives would have an effect on behaviour. This is particularly straightforward when account fees are being charged as the opportunity to rebate or reduce these fees based on the use of these tools gives the bank scope to provide the incentive and inform customers periodically of the reward they are getting.

These ideas are summarised in the following two charts:

Income/expenditure management tool	
Feature of Tool	Behavioural Change to be Encouraged
1. Ask Questions: “Do you want to cut any expenditure in next 3 months?” “Which of your expenditures do you want to cut?” “What target do you have?”	“Priming” is more likely to lead to action.
2. Simple identification of target expenditures.	“Procrastination” reduced with more likely action.
3. Revisit/query the prudence of the target.	“Optimism/underestimating” is reduced.
4. Default mechanism to add contingency (e.g. a percentage added onto groceries or clothing).	“Optimism/underestimating” is reduced.
5. Default mechanism to lead to action to reduce expenditure. Feedback provided the following month.	“Commitment device” to make action more likely to be in line with target.
6. Customer writes a freeform note of how expenditure reduction will be achieved.	“Commitment device” to make action more likely to be in line with target.
7. Request to identify reasons for target not being achieved.	“Accountability” improves the likelihood of change.
8. Comparison with how much other households are spending on certain items e.g. groceries, eating-out, etc.	“Social influence” can be effective, but would have to be combined with a non-financial incentive to ensure spending does not rise towards the average.

15. Quidz in: raising financially confident kids. A course for parents developed by the charity, Care for the Family. Mel Griggs developed the “Money Equivalent Labour” measure used on the course to express value in terms of the number of hours’ work that is needed to pay for an item. (2007)

16. Esther Duflo, Michael Kremer and Jonathan Robinson. “Nudging farmers to use fertilizer: Evidence from Kenya” (2009)

9. Highlight areas of inconsistency such as known over-spending on a luxury that is not off-set elsewhere.	"Mental accounting" is a good activity, but can be subject to abuse.
10. "Loyalty points", fee reductions or small financial incentives have salience (i.e. can be measured in working hour equivalent).	"Incentives" can encourage good outcomes, even when modest, especially when the performance measure strikes a chord.

Savings Tool Features	Debt Reduction Tool Features	Behavioural Change to be encouraged
1. Ask Questions: "Do you want to save for anything specific?" "When will you start?" "Do you want to save for a contingency fund e.g. 3 months' income?"	1. Ask Questions: "Do you want to reduce your debt level?" "Do you need to spend less?"	"Priming" is more likely to lead to action.
2. Straightforward to establish a new savings "pot", potentially with a target and a goal. This could be a pot within the current account or a separate linked account.	2. Straightforward to establish a debt reduction plan, potentially with a target and a goal.	"Procrastination" reduced with more likely action.
3. Make target realistic, making point that better to be realistic. Enable resetting of target at the same time giving a positive view of progress made.	3. Make target realistic, making point that better to be realistic. Enable resetting of target at the same time giving a positive view of progress made.	"Optimism/underestimating" is reduced.
4. Agreement to a regular amount of saving for a goal.	4. Agreement to a regular amount of debt reduction for a goal.	"Commitment device" to make action more likely to be in line with target.
5. Review of progress towards savings goal.	5. Review of progress towards debt reduction goal.	"Accountability" does improve the likelihood of change.
6. Identify "fictional" saving "pot" increases. For example, increases at expense of other savings or while debt is also rising.	6. Identify "fictional" debt reductions. For example, reduction in one debt account when another is increasing e.g. overdraft reducing, but credit card increasing.	"Mental accounting" is a good activity, but can be subject to abuse.
7. "Loyalty points", fee reductions or small financial incentives. Use salient measure of benefit.	7. "Loyalty points", fee reductions or small financial incentives. Use salient measure of cost savings.	"Incentives" can encourage good outcomes, even when modest, especially when the performance measure strikes a chord.

3.9 Further research

If banking services are viewed in the same way as pharmaceutical drugs, they should be designed to be good (or at least not harmful) for the user. The further research advocated by the charity, FairBanking, should be based on the same principle. The costs of undertaking this research is not significant when considered in the context of the enormous cost of bank bail-outs and the costs of the personal misery caused to those who find themselves under financial pressure.

We recommend research into the three areas of Financial Well-being, Money Management Behaviour and Banking Products:

- Financial Well-being: The two indices developed here could be applied to approximately 20% of the UK adult population. However, several key groups are not covered – students, 40 to 65 year old workers, the elderly, those on the lowest incomes and ethnic groups. The work involved in expanding the indices for these groups would not be as great as that undertaken to date. A full set of indices would provide a useful benchmark by which to gauge the success of developing financial products to improve financial management skills.
- Money management behaviour: This report highlights insights from behavioural economics that may be valuable in assisting bank customers to achieve their financial objectives. With an understanding of Financial Well-being it should be possible to incorporate them into banking tools. Testing the tools with those groups that have found themselves least able to manage their money would be a good starting point. Another group on which to focus would be those going through major life events, e.g. moving house or having children. The objective would be to minimise the reduction of FWB as a result of a life event.
- Banking product research: A car manufacturer looking to improve the safety of its cars will do extensive research. There is competition because the overall score for the safety of different cars is assessed and publicised. As a result, there has been a gradual improvement in safety. A similar approach can be developed in financial services that will improve the Financial Well-being of bank customers.

Learning from Dee Hock

A useful lesson can be taken from the inventor of the credit card, Dee Hock. In 1968, he believed consumers wanted “a device that would allow them to exchange value 24 hours a day, seven days a week and anywhere in the world – providing they did not have to deal with local law, currency convergence, all the things that go on in the backrooms of financial institutions”. The idea was global electronic money. However, Hock has no credit cards. When interviewed in 2004¹⁷, he vowed that “never again would I ever be in

17. Give me some credit. The Observer (18 April, 2004) interview conducted by Tim Adams with Dee Hock.

Improve the dashboard as well as the airbags

more debt than I had cash in the bank. And I never have been”. The credit card resulted from a money transmission invention. The credit card features – of ever increasing limits, late payment penalties and high interest rates, together with a culture of balance transfer – are not intended to improve customer financial well-being, but to increase profitability. Indeed, the credit card as we know it is the equivalent of making a much faster car widely available without providing the customer with better brakes.

In contrast, the Expense Management Tool, the Savings Tool and the Debt Reduction Tool can become an improved “dashboard” – as well as the “seat belts” and “airbags” of the banking industry.

4. Trust and financial capability

4.1 Trust in banks

For banks, building societies and credit card companies to help customers, it is important that there is a high level of trust. The Financial Services Research Forum at Nottingham University produces its Trust Index on an annual basis.¹⁸ Consumers’ trust in a financial services institution is broken down into two components:

- low-level, based around notions of reliability and dependability; and
- high-level, based around notions of being concerned about the best interests of the customer.

It is the latter kind of trust that is important for customers to trust banks, building societies and/or credit card companies with providing the types of money management tool that will help them achieve greater FWB.

The 2009 index shows that following a dip in overall trust in 2008, it is back at its previous levels for banks and building societies. For high-level trust, it is back at the level of 2005, but somewhat lower than 2006 and 2007. Although high-level trust in building societies is higher than in banks, there is not a large difference. The evidence is that overall trust in banks has recovered from the shock of the Northern Rock collapse:

18. Measuring trust in financial services: the trust index. Christine Ennew and Harjit Sekhon (Consumer Policy Review: Vol. 17, no. 2 (2007) and The Financial Services Trust Index 2009. Christine Ennew, Nottingham University Business School (May 2009)

Chart 16: Trust Index – overall trust

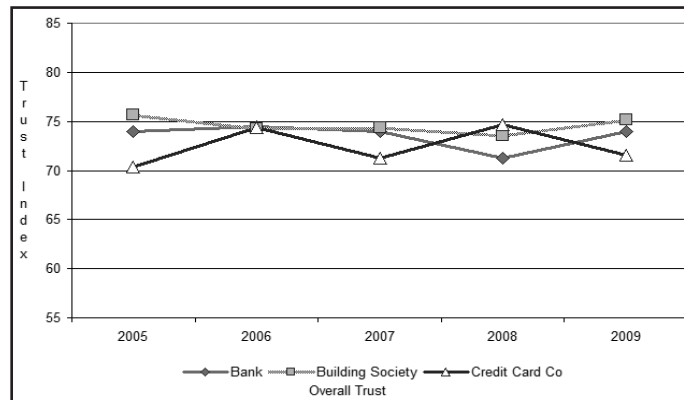
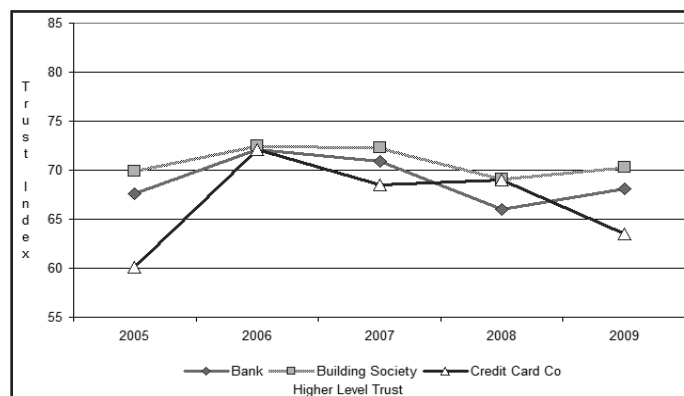


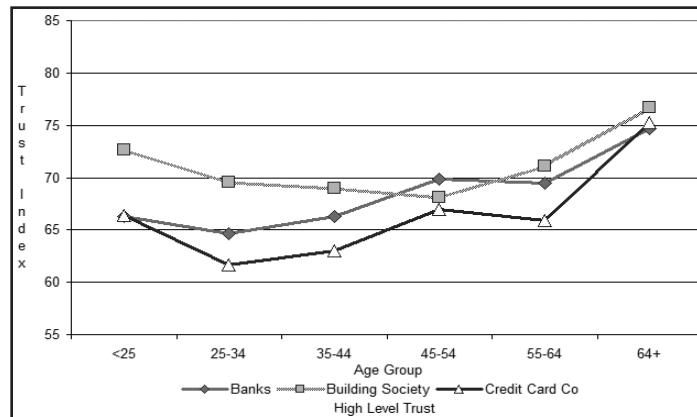
Chart 17: Trust Index – high level trust



High-level trust in banks is similar to that of supermarkets, mobile phone operators and employers.

The following charts show that the under-25 age group, which includes young workers, is more trusting that banks and building societies are acting in their interests than those aged 25 to 44. This is important as it indicates that attempts to help the young worker population may be more likely to succeed. This may partially explain why young workers are even more positive than families towards the new products being proposed:

Chart 18: High Level Trust by age group

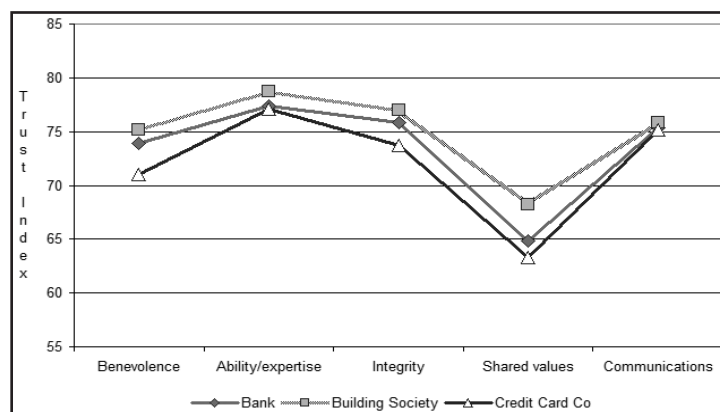


4.2 Is there enough trust in banks and building societies?

Although trust may have been restored in banks, there are key elements of trust that are too low. The chart below shows the different influences of trust. The two of these that are lowest are probably the most important for customers to believe that the tools in this report are being provided to assist them. The two influences are:

- benevolence – the extent to which a financial institution is concerned about customers' interests from a customer perspective; and
- shared values – the extent to which consumers believe an FSI has values similar to their own.

Chart 19: Influences on trust



It will take time to increase trust

In conclusion, despite all recent negative press with regard to banks, they remain institutions that are relatively highly trusted (comparable to supermarkets, mobile phone operators and employers). If services were offered with the genuine intention of assisting customers, this would help financial institutions gain more trust. Of the two groups in this research, young workers are more likely to be trusting – and this represents a good opportunity if banks and building societies are prepared to act in customers’ interests. In the important areas of benevolence and shared values, it will take time to increase trust. However, there are many customers who would respond well to the types of service proposed.

4.3 Financial capability

Concerns about financial capability in the UK have been documented by the FSA.¹⁹ It is identified as a particular concern because people are expected to take care of their own financial affairs. The Thoresen Review identified the need for Money Guidance and progress is being made through setting up pilots for this service.²⁰

The implications of this research for Financial Capability could be the subject of a separate report. It adds to the evidence that a person’s choices in terms of financial management will significantly alter Financial Well-being. A recent report from the University of Manchester²¹ on the financial education of 16-19 year olds shows that taking the Certificate in Financial Studies:

The key to a greater FWB

- changed the way students valued money and their spending/saving habits;
- changed students from not keeping track of money to keeping track of money;
- for some, changed from not planning ahead to planning ahead;
- gave greater confidence with regard to personal financial management;
- caused a statistically significant increase in the number of products owned; and
- caused a decrease in the proportion of students who owned one or more credit cards.

If these changes in financial capability are sustained, they are likely to lead to greater FWB. A key is that products offered by banks should be designed to assist people to achieve these objectives. The need for education is greater when products are not designed in such a way as to increase the probability that FWB will increase as a result of using them.

19. Financial Capability in the UK: establishing a baseline, Financial Services Authority (2006)

20. Thoresen Review of generic financial advice: final report (HM Treasury, March 2008)

21. Becoming Financially Capable: A report into the impact of financial education for 16-19 year olds (University of Manchester School of Education, January 2009)

Appendix 1

Demographic Tables (Number of respondents) (Total: 654, Young Workers: 334, Families: 320)

Table 1 – Age Groups

Age	18-24	25-29	30-34	35-39
Total	104	293	118	139
Young Workers	104	230	0	0
Families	0	63	118	139

Table 2 – Gross Annual Household Income

Gross Income	£15k-£25k	£25k-£35k	£35k-£45k	£45k-£60k
Total	123	194	133	204
Young Workers	72	92	71	99
Families	51	102	62	105

Table 3 – Ratio of Unsecured Debt to Gross Annual Household Income or Debt/Income Ratio ('DIR')

DIR	<5%*	5-14%	15-39%	40-59%	>60%
Total	134	134	183	98	105
Young Workers	46	59	98	61	57
Families	88	75	85	37	48

*including respondents with no unsecured debt (34 in total).

Table 4 – Gender

Gender	Female	Male
Total	377	277
Young Workers	193	141
Families	184	136

Table 5 – Marital Status

Marital Status	Single	Co-habiting/Married	Separated/Divorced/Widowed
Total	127	522	5
Young Workers	127	207	0
Families	0	315	5

Table 6 – Children at home (age of child/children)*

Age of child	<5	5-16	16<
Families	208	171	14

*some respondents have more than one child.

Table 7 – Number of children in household

No. of children	1	2	3	4 or more
Families	127	147	38	8

Table 8 – Social Grade

Social Grade	A	B	C1	C2	D	E
Total	32	170	285	114	45	8
Young Worker	8	94	174	34	19	5
Families	24	76	111	80	26	3

All cells used in the analysis contained a sufficient number of respondents to carry out statistical tests. The only quotas set for the sampling were to ensure at least 300 respondents in each of the young worker and family groups. In addition, a quota of 40% male was set, with 42% being achieved.

Appendix 2

Fair Banking: exploring key drivers of, and relationships with, financial satisfaction

Charles Adriaenssens
Damian Frankcom

This is a summary; a complete report is available through the FairBanking website.

Respondents were asked to assess their current life 'situation' using a scale ranging from 0 to 10, where 10 represents the best possible life and 0 the worst possible life. Correlation revealed a strong relationship between life 'situation' and financial satisfaction (correlation of $r = 0.6$).

Correlations was assessed using the following criteria:

$r < 0.3$	Weak
$r = 0.3 - 0.59$	Moderate
$r = 0.6 - 0.79$	Strong
$r \geq 0.8$	Very Strong

Correlation also revealed a moderate relationship between financial satisfaction and overall quality of life ($r = 0.44$) and a strong relationship between financial well being and financial satisfaction ($r = 0.6$). Perfect correlation is 1, so these data signify a relationship between financial satisfaction and each of life 'situation', overall quality of life and financial wellbeing.

Understanding the relationship between income and financial satisfaction

Invariably, income has an influence on financial satisfaction: in fact, 37% of respondents who did not rate their financial well being as excellent claimed a perceived insufficiency of income was preventing them from giving a better rating on this measure. However, when exploring the relationship between financial satisfaction and income through analysis, it is clear that financial satisfaction did not automatically increase with income levels:

Table 1 – Financial satisfaction and personal income

Personal Income	M1c And how satisfied would you say you are with your overall financial circumstances?						
	Extremely satisfi (small base)	Very sat- isfied	Fairly sat- isfied	Neither satisfied nor dis- satisfied	Fairly dis- satisfied	Very dis- satisfied	Extremely dis-satisfied
	3	28	221	115	186	67	34
£17,500	0%	4%	3%	5%	9%	6%	15%
£22,500	0%	21%	10%	15%	13%	16%	12%
£27,500	0%	4%	19%	30%	23%	22%	21%
£32,500	0%	7%	7%	10%	10%	6%	9%
£37,500	0%	11%	7%	3%	8%	4%	9%
£42,500	33.3%	18%	17%	9%	11%	18%	6%
£47,500	0%	4%	16%	12%	14%	16%	15%
£52,500	33.3%	7%	14%	9%	7%	10%	15%
£57,500	33.3%	25%	7%	7%	5%	0%	0%

In the above table, green cells show a higher than average percentage and red cells show a lower than average percentage. Further analysis through correlation shows that the relationship between financial satisfaction and personal income (correlation of $r = -0.162$) is weak. In other words, while a relationship between the two variables exists, income by itself does not have a strong relationship with financial satisfaction. In fact, financial satisfaction needs to be understood within the context of lifestyle, wider aspirations and disposable household income. And, as an amalgamation of these influences, a key variable that needs to be taken into account is the level of household debt.

Household debt on its own has some correlation with financial satisfaction ($r = 0.3$). However, if we use the ratio of debt to income, we establish a moderate relationship ($r = 0.336$). This implies the higher the ratio of debt to income, the lower the financial satisfaction.

Table 2 – Correlation of financial satisfaction, household debt, personal income & debt to income

Correlations					
		Financial Satisfaction	Household Debt	Personal Income	Debt to Income
Financial Satisfaction	Pearson Correlation	1	0.306	-0.162	0.336
Personal Income	Pearson Correlation	-0.162	0.156	1	-0.157

What it also means is that while respondents are likely to say they want an increase in income, having one may not translate into an increase in financial satisfaction if their debt level is relatively high.

Attitude to financial matters

In the research, respondents gave scores for a battery of statements about their attitudes to financial matters. Factor analysis (which groups individual attitude statements into key themes) was conducted on responses in order to reveal overarching attitudes.

Variables that had a low correlation with all other variables were removed. A four-factor solution accounted for 61% of the overall variance in respondents' attitude. Lists of these four factors, together with the statements that comprise them, are shown in Table 3.

Table 3 – Factor analysis output

1. Being in control (overall finances)	2. Comfort with being in debt	3. External pressures affecting borrowing	4. Ability to influence situation
I feel I am on top of my monthly outgoings (0.788)	Borrowing makes me feel uncomfortable (-0.783)	I find it difficult to resist pressure to "keep up with the Joneses" (0.778)	I think it is easy to get into debt because banks and shops make it too easy to get credit (0.874)
I know the detail of my financial situation at all times of the month (0.787)	I am comfortable with borrowing for something that I consider to be essential (0.769)	In order to keep in touch with friends, I spend money that I would rather not spend on going out (0.727)	I adjust the amount of money I spend on non-essentials when my life changes (0.556)
I feel comfortable dealing with financial matters (0.786)		I always use credit for non-essential items (0.590)	
I only spend within my means (0.572)			

The scores in brackets above relate to the factor loading or contribution of each attribute, which shows the direction of relationship and the relative strength for each factor. A positive score means that agreeing with the statement will have a positive influence on the factor:

- **Factor 1 - Being in control:** The most important factor is 'being in control'. This factor is broadly about being in full control of overall and monthly finances, and adjusting spending habits accordingly. Three equally significant statements make up this factor: "Feeling on top of my monthly outgoings"; "I know the detail of my financial situation at all times of the month", and "I feel comfortable dealing with financial matters". The statement "I only spend within my means" is a fourth contributor.
- **Factor 2 - Comfort with being in debt:** Comfort with being in debt is derived from the comfort people feel with being in debt and with borrowing money. The statement "Borrowing makes me feel uncomfortable" has a negative influence on this factor, while the statement "I am comfortable with borrowing for something that I consider to be essential" has a positive influence.

- Factor 3 - External pressures affecting borrowing: This factor is concerned with the external pressure people feel on their spending habits and a willingness to dip into credit for 'non-essential' expenses. Its most important components are the statements "I find it difficult to resist pressure to 'Keep up with the Joneses'" and "In order to keep up with friends, I spend money that I would rather not spend on going out". There is also a third statement that had a lower factor loading: "I always use credit for non-essential items".
- Factor 4 - Ability to influence situation: Finally, the ability to influence my financial situation factor is concerned with the extent to which individuals perceive they are able to control their debt. The factor is made up of two statements: the dominant component is "I think it is easy to get into debt because the banks and shops make it too easy to get credit". But there is also a secondary component: "I adjust the amount of money I spend on non-essentials when my life changes".

Cronbach's Alpha was calculated for each factor to determine its reliability as an independent variable in a regression analysis. While the first three factors reported a strong Cronbach's Alpha, the fourth factor had a very low score (0.28) suggesting that it would not be appropriate to include this factor in the regression analysis.

Regression analysis – summary of co-efficients

Three separate regression analyses were conducted; one for each of the sub-groups of interest:

- total sample;
- families; and
- young workers.

Regression enables us to understand the relative impact that a number of (independent) variables have on one dependent variable, in this case financial satisfaction. One of the key outputs is a co-efficient that describes how important that variable is in influencing financial satisfaction. The inputs (independent variables) to each regression model we produced were the variables from research that it was felt were likely to impact on financial satisfaction – factors 1-3 from the factor analysis, and all other attitudinal statements that were not included in one of the factors. The resulting regression co-efficients for each independent variable are shown in Table 4.

Table 4 – Regression Coefficients: Summary

	Total	Families	Young Workers
Being in control (factor 1)	0.467	0.481	0.435
Comfort with being in debt (factor 2)			
External pressures affecting borrowing (factor 3)			

"I adjust the amount of money I spend on non-essentials when my life changes"	-0.117	-0.144	
"I think it is easy to get into debt because banks and shops make it too easy to get credit"			
Personal Income			0.202
Debit to Income ratio	-0.229	-0.226	
"Its better to live your life and enjoy it, rather than worry about money"	0.138	0.177	0.165
"Its Important to save up for things I/we want"			
"I think of my money in terms of "pots" put aside for different things"	0.079		0.196
" I find it difficult to resist buying things/paying for activities for my children"	N/A		N/A

In the above table, only the regression co-efficients having a statistically significant impact on financial satisfaction are shown. The higher the coefficient, the greater the variable impacts on financial satisfaction. Colinearity statistics were calculated to assess any potential violations of the assumptions inherent in the regression, and both the VIF and Tolerance statistics for models were within acceptable levels for all variables. This validated the model. A number of different coding methods were used to test the impact of personal income. Data for this variable was collected using a categorical scale, and three different categorisations were used to test its significance:

- coding of mid points to form a quasi continuous scale;
- using dummy variable for high and low income; and
- using dummy variables for low, medium and high Income bands.

In each case, personal income did not have statistically significant influence on financial satisfaction for the total sample or for families; for these lifestages, the ratio of income to debt was more important.

Regression analysis – total sample

Across the total sample, being in control was the most important influence on financial satisfaction, and the ratio of debt to income was the second most important. The statement, 'better to live your life and enjoy it' was also a strong contributor, while other variables that were less strong (but still statistically significant) were adjusting the amount of money spent on non-essentials when life changes and using different pots as a strategy for managing money.

A number of the variables included in the regression model did not have a significant influence on financial satisfaction: the factors of comfort with being in debt and whether or not external pressures affect borrowing, as well as the attributes 'its easy to get into debt because banks and building societies make it too easy to get credit' and the importance of saving to reach your goals.

Regression Analysis – Families

We then ran a regression model for those who had children using the same variables as the total sample, but with inclusion of the statement “I find it difficult to resist buying things/paying for activities for my children”.

As in the overall model, the most important factor overall was being in control, and the second most important driver was the debt to income ratio. Adjusting the amount of money spent on non-essentials and the statement that it's better to live your life and enjoy it, meanwhile, were stronger drivers among families than in the total sample. This reflects the change in lifestage, where people adjust their outlook because of their family responsibilities.

The statement that was added for this group only, “I find it difficult to resist buying things/paying for activities for my children”, was not found not to be a significant driver of financial satisfaction.

Regression Analysis – young workers

Finally, the regression was repeated amongst young workers. As with both other models, the most important driver of satisfaction is being in control. The second most important driver of financial satisfaction for this lifestage was personal income; “I think of my money in terms of ‘pots’ put aside for different things.” and ‘better to live life than enjoy it, rather than worry about money’ were also significant drivers. Interestingly, the debt to income ratio was not a statistically significant driver of financial satisfaction for this lifestage.

Appendix 3

The relationship between the unsecured debt income ratio and various answers in the survey

1. Attitudinal Statement and DIR

The charts below show that for many attitudinal statements included in the survey there is a statistically significant difference in the response according to the level of the DIR.

As the DIR rises, households are:

- more likely to use credit for essentials (although after becoming more likely for both groups at a level of DIR in the 14 to 39%, the likelihood reduces, maybe in recognition that the debt level is getting too high);
- more likely to borrow for non-essential items;
- more likely to feel anxious about the state of their finances (this is particularly strong for the family group compared with young workers);
- more likely to spend money that they would rather not spend going out in order to keep in touch with friends (young workers only); and
- more likely not to be able resist spending money on their children (families only).

Chart 1: Agree more with statements when DIR is high – Young Worker Group

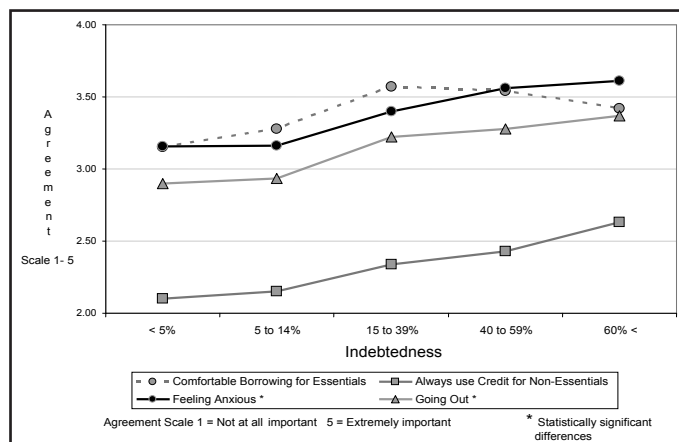
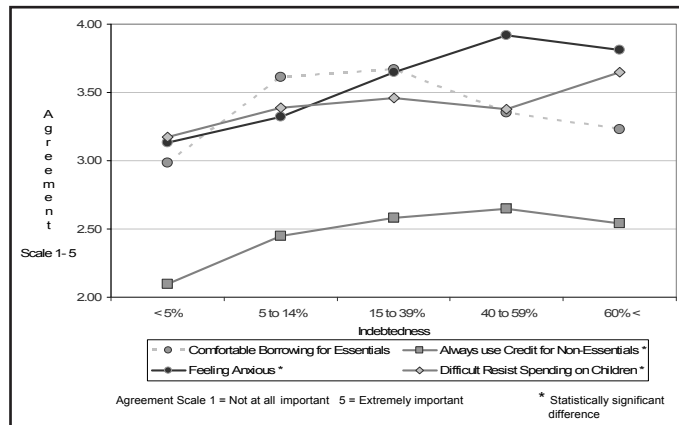


Chart 2: Agree more with statements when DIR is high – Family Group



The higher the DIR, the data shows that the respondent is:

- less likely to admit that borrowing makes them feel uncomfortable;
- less likely to think it is important to save up for things;
- less likely to dip into savings when money is tight; and
- less likely to think of money in terms of 'pots' for different purposes.

2. Actions to improve Financial Well-being and DIR

The survey asked about the importance of actions for households in achieving financial well-being. For many questions, the importance of the action is different according to the level of DIR. As the DIR increases, in order to improve financial well-being, households consider that it is more important:

- to reduce regular outgoings;
- to pay off any loans in full;
- to pay off outstanding balance on credit cards/store cards;
- to know debts are reducing each month;
- to have the equivalent of 3 months' salary to fall back on (families only); and
- have a plan for the next 6 months' income and expenditure (families only).

A 10% increase in income is viewed as an important factor in improving Financial Well-being regardless of debt level.



Antony Elliott FCIB spent over 10 years as Group Risk Director of Abbey National plc having worked for a number of UK and international banks previously. He had overall responsibility for the control of consumer credit risk throughout this period. For many years he contributed to or was chairman of committees providing industry input to the supervision of banks, particularly at the British Bankers' Association and the Institute of International Finance. He was particularly active in contributing to the industry responses to the revised Basel Accord.

After he left in 2003, he researched and produced a report on why people get into too much debt. Entitled, 'Not waving but drowning: over-indebtedness by misjudgement', it was published by the Centre for the Study of Financial Innovation in 2005 and was widely discussed at the time.

This report led to the development of a new banking product. He has patent pending and developed a prototype of the product, Capacity Card, which has many money management features.

He now divides his time between working for a large hedge fund and pursuing the vision of a banking system that helps people manage their money. He has founded the charity, FairBanking, which has commissioned the research into the link between a person's money management and their level of contentment or well-being. The research has been developed to consider the implications for banking products and services.

Antony has a BSc in Banking and International Finance from City University and an MSc in Operational Research from Imperial College, London.

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