



Advancing financial access for the world's poor

Financial Capability – What works

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Promoting Financial Capability and Consumer Protection

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Financial Capability: One of the 3 Pillars of Responsible Finance

The Pillars	Who	How	Examples
Responsible Providers (RP)	Financial institutions / providers	Good business practices and standards in consumer & SME lending: Transparency in terms and pricing, disclosure, ethical behavior.	Voluntary codes of conduct; customer evaluation tools; transparent information on products
Consumer Protection (CP)	Government	Drafting laws and regulations, creating policies to align incentives in financial markets and protect consumers' interests	Consumer protection regulations for microfinance and banking
Financial Capability (FC)	<u>Consumers</u> (individuals, micro-entrepreneurs, SMEs)	Develop and practice skills that promote good personal financial management and decisions	Financial Extension Workers (FEW) in Uganda & school-based curriculum

Financial Capability – What is it?

- Financial Capability: The combination of knowledge, understanding, skills, attitudes and especially behaviours which consumers need to demonstrate in order to make sound personal finance decisions, given their economic and social circumstances.
- Focus is on changing behavior
- Providing information is only one part of financial capability
- Financial capability empowers the consumer so they can achieve a desired outcome (examples – reducing risk, increasing wealth or savings, selecting better financial products, avoiding frauds)

Why information isn't enough – insights from behavioral economics

- 1. Time bias – wanting it now – leads to overuse of credit and under-saving**
 - **Consumers will pay higher prices and spend more using credit cards than cash**
 - **Voluntary savings for retirement are generally inadequate**
- 2. Avoidance and procrastination**
 - **Faced with an important issue, such as saving for old age, people avoid making a decision**
 - **Rather than making an active choice, people settle for the default option**

Why information isn't enough – insights from behavioral economics

3. Limits on processing information

- Too many choices / too much information can reduce active decision-making
- The context the information is presented in matters
- Financial concepts, like interest rates, are not easily understood
- Hard to compare products reduce efforts to weigh pros and cons

Evidence of impact – a mixed bag

- First issue – lack of rigorous empirical evidence in developed and especially developing countries
 - Selection bias - who participates in financial training is not random
 - Self-assessments of value of training are common ways to evaluate but are not reliable
- Comprehensive studies of financial education and financial literacy initiatives have provided mixed results on effectiveness
 - Example: FSA Consumer Research (#68, 2008)

Evidence of impact – some promising results

- A survey of U.S. households showed that participation in 401(k) pension plans increased by 12 percentage points for employees who had been offered workplace financial education. (Bernheim)
- U. S. consumers with low initial credit scores who received credit counseling reduced revolving debt by 12% more than non-counseled borrowers. They also reduced their number of accounts, total debt and bank card utilization. (Elliehausen)
- Low-income households in the United States who received mortgage counseling faced less than half the default hazard of households who were not counseled. The counseled households also increased their financial sophistication and were more able to evaluate optimal behavior with respect to defaulting on a loan or refinancing. (Hartarska)

What works – some promising approaches to financial capability

Teachable moments

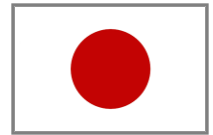
- Ready to learn
- Have opportunity to use information
- Examples –
 - Debt counselors
 - Information at work on pension plans
 - Child savings account in the U.K.
- What happens when the provider is the source of information at the teachable moment?
Problem if only source, not just one source

Policy prescriptions and bounded choice -

- Changing the default option
- Setting penalties and creating incentives – credit bureau for over-indebtedness and access to credit
- Creating standard products or information formats to facilitate comparisons

Sustaining the message and adapting it to the audience

- Not a one-time effort
- Multiple delivery channels required
 - Cell phones
 - Video games
 - Trusted intermediaries
- Social marketing tools useful – learn from public health



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