EXECUTIVE SUMMARY

This book draws together expert opinions and recommendations on a number of cutting edge issues presented at the OECD-Bank of Italy Symposium on Financial literacy held in Rome on 9 June 2010. Such issues include the measurement of financial literacy, the evaluation of financial education programmes and the application of findings from behavioural economics, in order to improve financial education provision.

In Chapter 1 Professor Elaine Kempson of University of Bristol, UK summarises the various approaches taken to measuring financial literacy at a national level, and makes recommendations for developing a survey instrument that can be used to compare levels of financial literacy across countries. Such an international measure of financial literacy is essential to identify those countries with particularly successful financial literacy strategies and initiatives, which in turn can lead to benchmarking and cross-country collaboration and synergies.

The chapter is based on a detailed investigation of 19 national and two international surveys of financial literacy conducted within the framework of the INFE. It comprises a checklist of issues to be considered when designing and commissioning a survey of financial literacy or capability, along with an indication of good practice.

There are considerable similarities in the approaches taken to measuring financial literacy at the national level, including the topics covered, the population surveyed and the approach taken to analysis. These similarities make it possible to develop an international measure based on existing good practice questions and survey methods and undertaken on a sample of adults, via interviews conducted in person or over the telephone. It is recommended that the questionnaire covers the full range of topic areas typically included in national surveys (i.e. day to day money management, financial planning, choosing appropriate financial products and financial knowledge and understanding). The resulting data can then be analysed in various ways including the development of a score or segmenting the population according to their responses. These recommendations have been acted on, and the International Network on Financial Education is currently piloting an international survey of financial literacy in 12 countries based on the questionnaire in annex of this chapter.

In the following chapter (Chapter 2), the issue of evaluation is addressed. Professor Annamaria Lusardi of Dartmouth College, USA reminds us that, when it comes to financial education, the question of "what works best" has not yet been clearly answered and should be further explored in the future.

She particularly highlights that the benefits of programme evaluation, the verification of the use of resources, the assessment of the impact of the programme and the effectiveness of the programme can be further improved. For example, resources can be used more effectively and the overall impact of financial education can be increased by using evaluation data to make decisions about which programmes should be improved, which should be continued and whether any should be terminated.

The chapter discusses the challenges faced by evaluators, and explores the benefit of applying a version of the Five-Tier Evaluation Framework modified by O'Connell in 2009. The five tiers within the framework relate to i) the objectives of the programme, ii) inputs, iii) delivery, iv) outcomes and v) impact. The framework offers financial educators a simple guide that can be followed when designing an

evaluation study. It has the advantage of allowing significant flexibility whilst still providing standardisation and comparability. However, there are still potential pitfalls when such a framework is used, for example, the programme needs to have clearly defined objectives in order to apply the framework properly, and even then, the framework assumes a relatively simple programme design whereas in reality programmes often have multiple delivery channels and target audiences. The length of time needed to evaluate a programme in terms of its impact is also a potential problem, regardless of the method used.

The chapter ends with recommendations and conclusions, stressing that:

- Evaluation is important and should be designed alongside the financial education programme
- Employing quasi-experimental methods (ones that mimic scientific experiments in medicine, or agriculture, for example) will give the evaluation added credibility and help to assess causality.
- Employing professional evaluators, using evaluation toolkits/frameworks and subjecting evaluation design and reporting to peer-review can all ensure that evaluations are robust and comparable.

The second part of the book (Chapters 3 and 4) explores the extent to which the design of financial education programmes could benefit from the findings of behavioural economists and economic psychologists.

The standard economics approach to financial education argues that financial consumers will behave in their own best interests if the financial market is perfectly competitive. The fact that they do not always act in this way is blamed on a demand side market failure – consumers do not have all the knowledge and information that they need. According to this analysis, the solution is therefore to provide information and education so that consumers are fully informed and the market can function properly.

In contrast, the psychologists and behavioural economists argue that even with knowledge and information, consumers still act in a way that is not in their own best interest. They do this because they are subject to systematic, psychological influences. Given these psychological factors, financial education needs to address the fact that consumers require tools to help them act in a way that improves their financial wellbeing; just as dieters can benefit from tools to help them overcome a desire to over-eat. Unlike the economists' approach, this type of education does not need to focus specifically on knowledge or information, but on new skills, self-awareness and techniques for self-improvement.

Chapter 3 by Joanne Yoong explains that the assumptions of rationality used by economists when they explore financial behaviour may not be appropriate if actual behaviour contradicts these approximations in systematic (rather than random) ways. The chapter investigates the extent to which behavioural economics might explain some of the problematic financial behaviours that are observed amongst consumers, including low levels of retirement saving and high levels of credit use. It also explores possible ways in which behavioural economics can help policy makers to improve financial education, from take-up to completion.

Attention is then turned to the complementary tools available to policy makers to help consumers overcome psychological constraints. These include supervision and regulation of financial services, and the design of default options. The primary conclusions that can be drawn from this chapter are:

- Consumers could be made aware of their own psychological biases and the methods to combat them through carefully designed diagnostic tools.

- Behavioural economics can be used to fine-tune a number of existing services and provisions to help to improve the efficacy of financial education. For example, it can be incorporated within the design of administrative processes, marketing materials, educational materials and delivery mechanisms to improve take-up of education and relevant products, increase behaviour change following education and incentivise commitment and sustained behaviour.

- Financial education is only one of the relevant approaches that can be taken to help people avoid the consequences of unwanted psychological traits, and should be used alongside other policy tools such as regulation and product design. All of these tools can incorporate lessons from behavioural economics.

Chapter 4 by Vera Rita de Mello Ferreira asks whether economic psychology and behavioural economic can help to improve financial education. It starts by noting that the provision of knowledge and information in itself is not sufficient; the information must be incorporated into daily life. It then goes on to describe an innovative solution developed for Brazilian school children. The approach combines information and recommendations about personal financial issues with information about the way in which psychological factors may both help and hinder behaviour. This psychological guidance is intended to raise the pupil's awareness of their own traits and trigger discussions about the typical psychological factors that influence financial decision making.

The approach described also includes a simple diagnostic tool, as recommended in the previous chapter. This tool takes the form of a quick quiz that helps pupils to identify their own consumption type.

Some important conclusions can be drawn from this chapter:

- Behavioural economics and economic psychology can help to explain the shortcomings of traditional approaches to financial education, but more importantly, they can be employed in the design of more effective programmes

- Product design and product delivery can also be improved by applying the lessons of behavioural economics.

- Behavioural economics assumes that people will respond to certain situations or incentives in predictable ways. It is important that policies that draw on the lessons from behavioural economics do not disadvantage individuals or groups of people who do not behave in the ways predicted.

- Behavioural economics has not provided us with a clear understanding of the link between knowledge and behaviour, but it does help to explain why knowledge in itself may not be enough to *change* behaviour.

- Mechanisms that draw on behavioural economics to change behaviour are not universally welcomed. In some countries policy makers prefer to encourage responsible financial behaviours through highly personalised approaches rather than approaches that provide just one solution to everyone.

The final part of this book focuses on the role of financial education in supporting consumer decision making in a particular sector: defined contribution (DC) pension schemes. The shift to DC pensions has implied a transfer of financial and management risks onto individuals, requiring them to be knowledgeable about financial matters. However, evidence suggests that even basic numeracy is poor amongst a sizeable proportion of working adults and pension issues actually involve particularly complex concepts (including

inflation, investment and longevity risks, taxation) which most individuals are very unlikely to be familiar with. Furthermore there is evidence to suggest that many people do not plan for retirement and do not understand the pensions they hold.

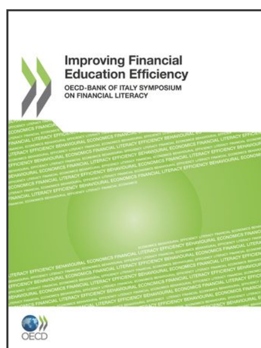
Chapter 5, written by Professor Anna Maria Lusardi, and Chapter 6, written by Ambrogio Rinaldi (Pension Funds Supervision Commission) consider the impact of the shift to DC pensions and evidence indicating the need for financial education, information and guidance; they also assess and highlight various policy options to address these issues based on available research (Chapter 5) and on the case of the Italian supplementary pension system (Chapter 6). Chapter 5 notes that the use of default options can substantially increase the take-up of pensions, but such options do not in themselves make people more financially literate, and may even put some people at a disadvantage. It is therefore argued that financial education should be seen as a complement to automatic pension enrolment in workplaces, since a degree of individualisation is necessary to ensure a well-rounded financial plan that takes into account existing credit commitments as well as wealth accumulation and it is more likely that this will be achieved if consumers are well informed.

We can conclude from this chapter that as long as retirement planning and pension decisions are left to individuals to organise, there will be an urgent and unabated need to provide high quality financial education that enables individuals to assess their own circumstances, make informed financial choices and identify the retirement plan that is right for them. The alternative approach of nudging people to choose the right option through default mechanisms will not provide the perfect solution, since it leaves them no wiser, and is not tailored to individual circumstances. Continuing financial education will also be vital as the system evolves.

In the final chapter Ambrogio Rinaldi focuses on the case of the supplementary pensions landscape in Italy in the last 20 years. The main transition started in 1995 with a shift from Defined Benefit to DC pensions. Subsequently, the decision was taken to move to nationwide auto-enrolment, and it is the introduction of this initiative that is the primary focus of the paper.

The auto-enrolment initiative was not as successful as anticipated, although its role does appear to be increasing markedly through time. In 2009 it accounted for 38% of new adhesions to private pensions, from just 5% in 2007.

The key conclusion from this final chapter is that auto-enrolment needs to be appropriately implemented and supported by adequate financial education initiatives. In theory it can harness people's natural psychological tendencies for their own benefit, but in practice, there are many hurdles to overcome, including the need for a consistent, comprehensive strategy that exploits the complementarities of each instrument in use.



From:

Improving Financial Education Efficiency

OECD-Bank of Italy Symposium on Financial Literacy

Access the complete publication at:

https://doi.org/10.1787/9789264108219-en

Please cite this chapter as:

OECD (2011), “Executive Summary”, in *Improving Financial Education Efficiency: OECD-Bank of Italy Symposium on Financial Literacy*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264108219-3-en

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