Financial literacy in the UK

Laura Blows explores the average level of financial literacy in the UK, in the first of *Pensions Age*'s year-long special focus on the subject, and how this can affect pensions saving

Summary
- Almost three-quarters of UK adults fall below the 'financial literacy benchmark'.
- This lack of understanding can add to people's financial stress and increase the risk of falling for scams.
- Understanding pensions saving can be even more challenging compared to other financial products, due to its complexity and peoples' struggle to visualise (and therefore understand the need to save for) their future retirement.
- The pensions industry has a role to play in improving the UK's financial understanding.

However you measure it, the UK's knowledge and understanding of financial matters – financial literacy, if you will – is shockingly low.

For instance, almost three-quarters of UK adults fall below the 'financial literacy benchmark' set by Wealthify and CEBR in July 2023.

They quizzed 2,250 Britons on their understanding of 10 frequently discussed financial topics, such as inflation, taxes, pensions, and savings *[see box out]*. To get a good pass rate, respondents needed to achieve a score of at least 6.5 out of 10. However, 73 per cent fell below this benchmark, and just 5 per cent answered all 10 questions correctly.

Young people were found to be most lacking in financial knowledge, with the average 16-18-year-old getting just two questions right.

On a regional basis, the highest number of correct answers was reported amongst respondents in the South-West, where people scored 5.5 on average. At the other end, the lowest average score was in the North-East, where the average was just 4.3 correct responses.

These findings match that of Shepherds Friendly's in June 2023, where just 27 per cent of the 2,000 Brits it surveyed passed its own money literacy test. The quiz also revealed that men in the UK are more financially literate than women, with 31 per cent getting half or more of its questions correct, compared to just 24 per cent of women. Meanwhile, those aged 55+ scored the best on the quiz (scoring 35 per cent) whilst those aged 18-24 scored the lowest (scoring 17 per cent).

Looking internationally at financial literacy levels, the UK still doesn't fare well. According to the *OECD/INFE 2016 Survey of Adult Financial Literacy* competencies, of the 30 countries surveyed, the UK was 15th in the ranking, just above Thailand and Albania; below the average for OECD countries; and well below France, Norway and Austria.

Concerns

Just how concerning is the UK's low levels of financial literacy; why does it matter?

"It's definitely a concern," Legal & General member proposition director, Olasumbo Biobaku-Mason, says. "We know that because financial literacy isn't *[sufficiently]* taught in schools, many people often enter adulthood without understanding the basics, such as the importance of budgeting and saving."

FSCS chair, Marshall Bailey, warns that "individuals often struggle to give sufficient time to their savings and investments, which is a mistake. While many advisers are well-intended and of high quality, there are unscrupulous people who have taken advantage of poorly informed clients and caused a great deal of harm".

Wealth at Work director, Jonathan Watts-Lay, highlights that when individuals do not fully understand their finances and how to address current difficulties and mitigate potential risks, it can result in stress. "In turn, this can lead to lower employee productivity and is a major workplace risk" – one that is being increasingly recognised at work (63 per cent of employers recognised this in Wealth at Work's 2023 research, compared to 58 per cent in its 2022 research).

Pensions understanding

The financial literacy benchmark results also showed that there was a strong link between financial understanding and behaviours, with seven out of 10 respondents with the highest level of financial literacy contributing to a pension.

But what about those not saving into a pension? Could the products' complexity be a barrier?

Pension Insurance Corporation chief people officer, Dara McCann, states that "it is hard to know with certainty whether understanding of pensions is lower than other financial products, but it is certainly the case that pensions are incredibly confusing".

"We don't believe that enough work has been done explaining to workers or retirees exactly what their 'pension' will provide them. Whilst defined benefit schemes provide certainty of income in retirement, defined contribution schemes don't – they're really just pots of cash. Those are two very different things with very different outcomes for policyholders. There is a widespread lack of understanding of these fundamental differences in the pensions field, and that lack of understanding is a serious problem," he adds.

LCP head of financial wellbeing, Heidi Allan, explains that "we can struggle to see the value of things that don't impact us today. This is one of the challenges with future finances such as pensions".

"For many people, the word 'pension' is surrounded by complexity and apprehension as to what that might look like, as well as mystery around when and how that life stage may occur. It's hard for people to engage with something that is deemed complicated and is somewhat taken care of on their behalf with the introduction of auto-enrolment," she adds.

Does this mean that the pensions industry assumes a greater level of financial understanding than their clients necessarily have?

"Our data suggests the answer is regrettably, 'yes'", Isio Rewards and Benefits director, Will Aitken, says.

Isio's June 2023 survey of 7,674 UK private-sector employees asked whether they understood the amount of money their family might receive from their employer's life assurance in the event of their death.

"This was something of an 'acid test' because life assurance is a relatively straightforward benefit – it only pays out on your death and the amount it pays is typically a multiple of your annual salary. This should be a simple benefit to communicate to employees and for them to understand. If you don't understand life assurance, you're likely to struggle to understand a more complex benefit like pensions," Aitken explains.

"An alarming 25 per cent answered that they had 'no understanding at all' in response to this question. Even among the minority of people who claimed to be financially confident, 12 per cent still had 'no understanding at all' about their life assurance benefit," he reveals.

So, perhaps the pensions industry needs to be careful not to overestimate the level of financial understanding when sending out communications to people.

"We know that communications need to have a reading age of nine to be understood by the average reader for a number of reasons (eg dyslexia, neurodiversity, English as a second language)," Biobaku-Mason says.

"Improving people's financial capabilities is a long-term job. Right now, we must assume the lowest common denominator in terms of financial capability"

"There's sometimes a concern that this approach will result in a 'dumbing down' of communications and risk patronising the reader, but we have found when we apply these principles in communication, engagement levels increase. When it comes to pensions, simplicity is key."

Mantle Services (sister company of Dalriada Trustees) DB fintech development, Graeme Riddoch, gives the following example: "I recently reviewed an online McCloud comparison calculator. I couldn't understand it and I've been in DB pensions all my career. It used terms like nominal value, which most people wouldn't have a clue about.

"I think that improving people's financial capabilities is a long-term job. Right now, we must assume the lowest common denominator in terms of financial capability and build from there. It can be done if you start with that objective."

Improving financial knowledge is a matter of increasing urgency, as the pensions sector goes through its transformation from a paternalistic DB style to one of individual responsibility with DC saving – plus there is more change ahead.

For instance, the government's recent 'pot for life' proposals set out to increase the choice for employees in selecting their own pension provider. "This only adds further complexity to a system that has been successful on the basis of inertia, and one which already allows many choices for those who want it", Royal London director of policy and communications, Jamie Jenkins, warns.

Commenting at the time of the government's pot for life announcement, Pinsent Masons pensions partner, Simon Laight, said: "Buying a pension is fundamentally different from shopping around for petrol. Not everyone is knowledgeable on pensions and consumers need protection as they might mis-buy. We need to guard against the pension mis-selling scandals of the past."

Making a difference

A study by the Money Advice Service, published in 2016, suggested that people across the UK could be better off by around £108 billion over the next 30 years if they were better able to manage their money.

In 2022, the CBI suggested that the government and business could improve the UK's financial literacy by developing a collaborative national strategy for financial literacy that works with industry and other private-sector partners, introducing financial management and financial literacy in the UK from primary school age, and providing practical learning tools for children and parents.

The pensions industry would have its part to play in helping improve financial literacy.

As McCann says, "changing the way we talk about pensions and increasing financial literacy about pensions is critical. We need a huge effort to lift financial literacy, starting at school and higher education, through to the workplace".

Jenkins notes that there is a lot of great work within schools to help younger people come to terms with managing money on a day-to-day basis, "but there is a wider issue in the understanding of longer-term financial considerations, such as pensions planning and protecting against unforeseen events".

Moving onto the workplace, Octopus Money CEO, Ruth Handcock, states that "simply providing webinars, education, or different pension statements pre-supposes that an average person will then be able to understand pensions well enough to be able to interpret information in the context of their personal situation".

"Basically," she explains, "we're leaving it to individuals to piece the jigsaw together and understand what all of this information means for their financial future. For most people this simply isn't something they're used to doing. Instead, they need help."

Handcock adds that the pensions industry can't be expected to solve all of these problems on its own.

"Instead, we'd like to see employers and workplace pension schemes consistently providing access to personalised, holistic help alongside their schemes to help members make the right decisions for their future," she states.

"It's only by proactively helping customers that we can help the UK avoid the pensions crisis that it is currently hurtling toward."

Written by Laura Blows

Financial Literacy Benchmark quiz

1. In the UK, in which month does a new tax year begin? This is also referred to as a fiscal year.
a. January
b. February
c. March
d. April
e. May
f. June
g. July
h. August
i. September
j. October
k. November
l. December
m. Don't know

2. Imagine you earn £60,000 per year. In this case your marginal income tax rate would be 40%. In this situation, how much of your income is lost to tax each year?
a. Less than 40%
b. Exactly 40%
c. More than 40%
d. Need more information
e. Don't know

3. Suppose you have £100 in a savings account earning 2% interest per year. After five years without making any deposits or withdrawals, how much would you have in the account?
a. More than £110
b. Exactly £110
c. Less than £110
d. Need more information
e. Don't know

4. Suppose you are offered an interest rate on a savings account of 5% but can choose how frequently interest is paid into the account. Any interest paid into this account would also receive interest (compound interest). Assuming you don't make any deposits or withdrawals, which of the following would leave you with the largest value in the account after two years?
a. Interest paid annually
b. Interest paid every six months
c. Interest paid quarterly / every three months
d. Interest paid monthly
e. It would not make a difference
f. Need more information
g. Don't know

5. Imagine that the interest rate on your savings account is 2% per year and inflation is 4% per year. After two years, would the money in the account buy more, exactly the same, or less than it does today?
a. More
b. Same
c. Less
d. Need more information
e. Don't know

6. Imagine you are buying apples. Which of the following represents the best deal in terms of price per apple?
a. Six apples for £5
b. Twelve apples for £9
c. One apple for £1
d. Two apples for £3
e. Need more information
f. Don't know

7. Suppose inflation in April was 5% and that inflation in May was 4%. How did prices change between April and May?
a. Prices were higher in April than May
b. Prices were lower in April than May
c. Prices were the same in April and May
d. Need more information
e. Don't know

8. Imagine you have a variable rate mortgage. Which of the following will lead to the amount you pay each month changing?
a. The amount of money you earned that month
b. Changes in the Bank of England's interest rate / base rate
c. Fluctuations in the value of your property that month
d. The amount you need to spend on other goods and services that month
e. Need more information
f. Don't know

9. If your investment increased in value by 8% in 2021 and a further 8% in 2022, by how much would its value increase in 2023?
a. More than 8%
b. Exactly 8%
c. Less than 8%
d. Cannot be certain
e. Need more information
f. Don't know

10.Which of the following will NOT affect your credit score?
a. Being registered to vote
b. Missing a payment on an existing debt
c. Checking your existing credit score
d. Making regular payments by direct debit
e. Need more information
f. Don't know

Answers: 1.D, 2.A, 3.A, 4.D, 5.C, 6.B, 7.D, 8.B, 9.D, 10.C

(Source: Wealthify)