Scotland's
Futures Forum

What can we do to prepare for our financial future?

A Discussion Paper

Introduction

On 27 October 2008, Scotland's Futures Forum and Scottish Widows co-hosted a café discussion at the Scottish Parliament to explore how people can best prepare for the financial future particularly given the recent volatility of global financial markets. Chaired in a discussion facilitated by Owen Kelly, Chief Executive of Scottish Financial Enterprise, the café examined emerging issues around the subjects of savings, investments and financial protection. Those attending did so as self-selecting volunteers, and they brought a wide range of backgrounds and experience to the discussion.

The presentations by Scottish Widows clearly revealed the extent to which we are ill-prepared, as a society, to respond to the financial challenges of the near future. The figures, highlighted in the boxes throughout this paper, make for troubling reading.

Based on a very rich discussion from the café, this paper sets out the key issues for the financial industry, governments and individuals to ensure better financial provision and protection in Scotland as identified by the seminar participants.

Forum members unable to attend the café discussion have contributed to this short paper – see sections 'The Forum notes'. The Forum hopes this paper will be helpful to policy makers and the financial industry and prompts wider public policy debate on these critical issues.

Scotland's Futures Forum
November 2008

Key issues / recommendations:

The **financial sector** needs to:

- Re-establish trust with consumers through greater transparency and reducing the complexity of its products
- Tackle profligate and excessively risky lending practices where they exist
- Tackle short-termism and fixation on quarterly results
- Promote more responsible marketing of products
- Increase understanding and/or simplify equity release products
- Consider how best to offer consumers sound generic financial advice

Governments need to:

- Better regulate the financial sector
- Encourage individuals to make greater provision for unforeseen circumstances by doing more to promote a savings culture
- Clarify the role of the state in the future of banking, particularly given the recent recapitalisation of some major UK banks
- Continually review parameters for state support, particularly where they disincentivise individuals from making financial provision for their own future
- Increase funding for consumer education programmes
- Improve financial education amongst young people, particularly amongst schoolchildren
- Consider whether initiatives such as auto-enrolment (in employer pension schemes) detract from a sense of individual responsibility
- Tackle short-termism in the financial sector and wider society
- Promote the benefits of credit unions
- Improve uptake of all benefits, for all groups in society particularly older people and particularly those for critical illness and amongst any minority communities with poor uptake levels

The Forum notes that an interesting dichotomy is presented by the fact that banks need more deposits to help their capital base while the Government – in a recession – wishes to see banks lending as much as they possibly can in order to get the economy rolling.

Individuals need to:

- Take a more active role in ensuring adequate provision for their financial future
- Better understand the risks of cheap and easy credit
- Tackle soaring personal debt levels
- Understand the importance of investing in a wide range of different investment vehicles, so as to spread risk (i.e. not relying wholly on the property market)

Property ownership

Over the last twenty years, more and more individuals have become amateur property developers and the buy-to-let market has skyrocketed. However, many of these people have never experienced falling house prices, let alone the soaring mortgage repayments and negative equity experienced during the last recession.

- 71% of those surveyed said that they saw property as just another investment
- Two thirds of respondents think that property gives a better return than other investments
- House prices have fallen by 11.7% over the first 8 months of 2008, taking £23,000 off the average house price
- 23% of people plan to use their house to fund their retirement instead of a pension plan

Source: Scottish Widows Annual Savings and Investment Report 2008

N.B. THIS DATA REFLECTS THE UK-WIDE EXPERIENCE

Credit

Over the same period, many households have run up high levels of debt and the UK savings ratio (the percentage of disposable income that someone saves) has dropped to its lowest ever recorded level at -0.4%. At the peak of the last recession, the savings ratio was 14%.

- 74% of those surveyed said that their parents were more likely to save up to buy something rather than relying on credit
- Two fifths of the respondents classified themselves as 'spenders' not 'savers'
- 1 in 7 people spend more than 30% of their monthly income repaying unsecured debt
- Nearly 20% of people say their debt is out of control and causing them difficulties
- 1 in 10 admit to having no idea how much debt we are in
- 44% of 15 – 17 year olds are planning to take out a credit card when they turn 18
- The second most popular financial product is a credit card (64% of people have one)
- The average household debt excluding mortgages is £9,500

Sources: Scottish Widows Annual Savings and Investment Report, 2008; Credit Action, September 2008

Inter-generational transfer

Increasingly parents are gifting or lending large sums to their children, often dipping into their own savings to do so. They are giving their children money to assist them with major purchases such as a house or a car, but also to help with living expenses or pay off debt.

- More than half of the parents surveyed by Scottish Widows had gifted or lent large amounts of money to their children
- On average the parents surveyed had gifted or loaned £12,600 to their children
- 40% said that they didn't think they would be able to top up their savings to replace the money they had provided
- A third also said that this money had been earmarked for their retirement
- Two thirds said that the gifts/loans were unplanned
- Half expect to have to give or lend more in the future

Source: Scottish Widows Annual Savings and Investment Report, 2008

Financial protection

People are living longer and enjoying longer retirements. There is an increased incidence of major illnesses – some brought about by our lifestyles – but an increase in survival rates. Research by Scottish Widows showed that you are three times more likely to contract a critical illness than you are to die before you reach retirement.

According to research by Scottish Widows, almost two thirds of families now depend on two incomes. Increasing numbers of people are self-employed. More parents find themselves responsible not only for their own children but for their ageing parents. Fewer people have the resources in place to cope with any unforeseen change in their financial circumstances.

Research by cancer charity Macmillan showed that 1 in 17 people living with cancer lose their home and 1 in 6 struggles to pay their mortgage or rent. State benefits are limited and the uptake of benefits for critical illness is poor.

In Scotland:

- 67% have life cover of some form
- 22% have critical illness cover
- 17% have income protection

Source: Scottish Widows Protection Report, 2006

Those with household incomes under £20k tend to rely on state benefits for protection and those with savings of over £30k tend to self-insure. However, the 50% of households in between these two categories have the greatest need for financial protection.

Group discussions

Trust

Trust emerged as a key issue for financial institutions. Past misselling scandals and the recent collapses of retail and global investment banks have led to a high degree of mistrust of financial institutions and a subsequent reluctance to invest in their products. The general view was that the financial sector had not succeeded in making its products simple and transparent and that there was a deep-seated suspicion of the 'small print'.

The Forum notes that a return to a more relationship-based approach to banking might be beneficial and help tackle some of the issues raised above.

Property

It was generally thought that this too had fuelled people's preference for investing in the property market. Many people have only ever experienced rising house prices and see investing in property as a 'double one way bet'. Property is something tangible, an asset over which you have more control than many other types of investments.

It was also noted that, culturally, home ownership has been promoted as an aspiration for most people in the UK, beginning perhaps with the drive to encourage people to buy their council houses during the 1980s.

However, it was noted that around 30% of the UK population do not own property and that increased home ownership had helped to create a two-tier society: those with housing assets and those without.

Regulation and responsibility

There was a unanimous view that there had been profligate lending by some banks in the recent past – mortgage multiples that defied common sense, easy credit given to those who were in no position to repay the debt – and that led to calls for tighter regulation of the financial sector. It was also noted that the state faced a difficult challenge in persuading individuals to take greater responsibility for their financial future when they have just watched governments round the world bail out financial institutions to the tune of billions of pounds.

People who have got themselves into difficulty need advice and help from creditors. The first action should not be repossession but finding a way to reorder outstanding debt. Creditors and consumers need to work together.

However, it was also accepted that people had become drunk on cheap credit and that individuals could not wholly absolve themselves of all responsibility.

It was accepted that individuals may need to understand that their life chances may be circumscribed if, in future, it becomes more difficult to access cheap credit.

The Forum notes that the number of individual insolvencies in Scotland has increased significantly since 1st April 2008 when the Bankruptcy and Diligence etc (Scotland) Act 2007 introduced a new route into bankruptcy for people who have low income and low assets (LILA). A review of the first four months of LILA has indicated that LILA is effective in allowing debtors who could not previously make themselves bankrupt access debt relief.

Education

Another issue which surfaced throughout the group discussion was education, and in particular the need to educate young people to a reasonable level of financial competence before they reach adulthood. One of the younger attendees revealed that they had had no formal education in personal finance before leaving school.

It was thought that young people should have at least a rudimentary understanding of macroeconomic cycles as well as their impacts on personal finances. It was also suggested that some young people needed to have more reasonable expectations of their own financial independence.

There was also a call for greater investment in consumer education.

Role of the media

The media was regarded as having a critical role in promoting a 'have it now' society and a number of attendees noted with distaste how casually many credit deals are marketed to the general public.

Given our reliance on the media to explain the workings of financial markets, concern was also voiced about the lack of journalists in the mainstream media with a strong working knowledge of complex financial systems.

Financial advice

It was observed that many people rely on friends and family for financial advice and that this may be attributable to a real or perceived lack of sound generic financial advice. That said, it was also agreed that there was most likely an unwillingness to pay upfront for impartial financial advice.

Some individuals highlighted the potential contradiction in telling young people not to get into debt when, on the other hand, they are actively encouraged to take out loans to the tune of thousands of pounds in order to gain a university education.

Role of the state

Many of the participants agreed that there was a need for governments continually to review the thresholds for state support to tackle any perverse incentives that result in individuals deciding not to make their own provision for unforeseen circumstances.

There is also a need to improve the uptake of benefits, particularly those for critical illness, and to tackle any poor uptake amongst minority communities.

Given the recent recapitalisation of some of the UK's major banks, it was considered important for governments to make clear the longer term role of the state in the banking sector and the interplay between the three new types of bank: fully nationalised, part-nationalised and privately-owned.

Culture of optimism

There has always been a sense that you could expect to 'do better than your parents' and many participants wondered aloud whether this culture of perpetual optimism had contributed to the upward spiralling of debt levels in the developed world.

Credit unions

There was a brief discussion about whether there could be a more significant role for credit unions in future, which often spring up in deprived areas 'where the banks won't go'.

The Forum notes that credit unions work for many people, including those who do not see themselves using a full-scale commercial bank. They may be more numerous in certain socio-economic neighbourhoods, but can exist anywhere. Credit unions provide a very important option and should be seen as part of a continuum of services that can be on offer.

To note

The Forum is aware that there are a number of initiatives and pieces of legislation that go some way to addressing or partially addressing some of the concerns raised by the participants during the group discussion.

For instance, HM Treasury and the FSA are due to pilot a generic financial advice service in the North East and North West of England in early 2009, after which the UK government will make decision on national roll out. However, there has been limited debate about this and the implications for Scotland.

The Forum is also conscious of the extensive work of the Financial Inclusion Taskforce over the last three years in gathering data on credit and financial advice around the UK, including in Scotland.

Also, the FSA National Financial Capability Strategy is looking at the issue of consumer education and the Scottish Government has been looking at the effectiveness of financial education in Scottish Schools.

Acknowledgements

The Futures Forum is grateful to both Richard Jones, Director of Protection at Scottish Widows and to Gordon Greig, Head of Savings and Investment at Scottish Widows for their presentations to the Forum.

Thanks are also due to Owen Kelly, Chief Executive of Scottish Financial Enterprise, for chairing the discussion.

The Forum is very grateful to the 30 people who took part in the café discussion.

This paper was prepared by Lisa Mackenzie, Scotland's Futures Forum.

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The Forum is grateful for the financial support given to support this project from the organisations listed. However, the contents of this or any other Scotland's Futures Forum publication, do not necessarily reflect their views.

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