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From Financial Education to Financial Capability: Opportunities for Innovation

Sponsored by the Citi Foundation

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Executive Summary

The recent financial crisis has revealed that Americans at all income levels exhibit difficulty in managing their finances and are ill-prepared to weather economic stresses. Across the financial services landscape, the need to chart a new course for financial education has never been more apparent, and consumers themselves have never been more motivated to learn. Consumers urgently need more information and tools to recover financially and steward their financial resources.

A shift in financial education may hold the key. Signs are emerging that financial education is shifting its focus to financial capability, which emphasizes behavior change in addition to knowledge gains. Whereas financial education is a set of provider outputs, financial capability is a set of consumer outcomes. Becoming financially capable is a critical step toward establishing financial security.

Carrying out this new focus will require a variety of tools and approaches. Fortunately, new communication technologies and the insights of behavioral economics are already contributing to innovations in the field.

To learn what strategies might prove effective in improving financial capability, CFSI scanned the financial education literature, interviewed practitioners and stakeholders, and explored a range of new interventions. We found that the most effective interventions strive to be:

- Relevant, addressing participants' specific concerns and financial situations, ideally in a relevant context, to capture their attention and motivate them to change.

- Timely, coinciding with key life events or moments of decision that can provide immediate feedback.

- Actionable, enabling consumers to put newly gained knowledge into action right away in ways that can improve their financial situation.

- Ongoing, developing long-term relationships to provide support, instill a sense of accountability, and track progress.

Financial capability resources can be categorized in two ways: according to the *intensity of the delivery* for the provider (from "low touch" to "high touch") and the *level of commitment* required on the part of consumers (programs that focus on financial communication, instill financial knowledge, or create financial engagement). We examine innovations in financial capability according to both of these characteristics and examine the potential for expanding financial capability tools and programs on a larger scale to reach more people cost-effectively.

The number and variety of innovations is encouraging. Innovations of all types incorporate some of the elements of effectiveness, suggesting that there are many examples on which to build. Because the innovations we explore are all quite young, however, there is a great need for evaluation to help the field determine which are most effective and why, so that elements of effectiveness can be incorporated and combined into future developments.

The good news is that, at this early stage, it is already clear that the focus on financial capability to spur behavioral change is valuable. In addition, technology appears to hold great promise for lowering delivery costs and reaching more people. It is still unknown whether "low-touch" technology solutions will prove as effective as "high-touch," in-person interactions. To create more powerful interventions that can enhance the financial capability of underserved consumers, further collaboration, innovation, and evaluation are essential.

Introduction

The recent financial crisis has made it plain that Americans need more and better skills and tools to be effective stewards of their financial lives. Americans themselves would agree. According to the National Foundation for Credit Counseling's 2009 Consumer Financial Literacy Survey:[1]

- 41% of respondents gave themselves a grade of C, D, or F on their knowledge of personal finance
- 57% did not use a budget to guide their spending
- 32% reported having no discretionary or emergency savings
- 26% admitted not paying all of their bills on time

> ***"As the financial education field evolves, it is important to focus attention on those strategies that not only help consumers increase their knowledge but also help them establish healthy financial behavior."***

Becoming financially capable is a critical step toward establishing financial security, particularly for lower-income, financially underserved consumers. By managing expenses, establishing long-term goals, and effectively navigating the suite of available financial products and services, these consumers put themselves in a better position to weather economic downturns and pursue financial prosperity. As the financial education field evolves, it is important to focus attention on those strategies that not only help consumers increase their knowledge but also help them establish healthy financial behavior.

With crisis comes opportunity. Financial institutions are more aware of the important role they can play in ensuring their customers understand the products and services they are buying and using. Accordingly, they are moving beyond legal disclosure requirements to communicate more frequently and effectively with consumers throughout their relationship. Government is reassessing its role in promoting financial literacy, seeking to understand the components of effective financial education and the challenges in bringing it to fruition. Nonprofits and other community-based organizations increasingly recognize that they can integrate financial tools and information with other programming to help consumers achieve financial stability.

From Financial Education to Financial Capability

The financial education field is relatively young. In 2000, the Fannie Mae Foundation commissioned a study of 90 financial education programs and found that over 70% had been established after 1990.[2] Despite its youth, the field has grown significantly as community organizations, financial institutions, and school systems all work to boost financial literacy. Within the past decade, the federal government has also turned its eye toward financial education, creating the Office of Financial Education (2002), the Financial Literacy and Education Commission (2003), and the President's Advisory Council on Financial Literacy (2008) to identify strategies to help American consumers improve their financial literacy.

The financial education field has been focused primarily on the development and delivery of information about financial products, management, and decision-making. The information is often delivered through seminars, a series of classes, or self-study materials via a variety of channels (books, internet sites, etc.).

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[1] National Foundation for Credit Counseling, "The 2009 Consumer Financial Literacy Survey: Topline Report and Data Sheet," April 2009, http://www.nfcc.org/NewsRoom/FinancialLiteracy/files/2009FinancialLiteracySurvey.pdf.
[2] Lois Vitt, et al., "Personal Finance and the Rush to Competence: Financial Literacy in the U.S.," Institute of Socio-Financial Studies, 2000.

Countless financial education programs and curricula of this kind have been developed and delivered by a wide variety of organizations.

The financial education field is evolving as a result of the economic crisis and its impact on consumers. The most noticeable change so far—and an important one—is a shift in language, from financial education to financial capability. This terminology has been used recently across the globe, most notably in the United Kingdom. The U.S. government has also begun to embrace the phrase. In December 2009, the Department of the Treasury and Department of Education launched the National Financial Capability Challenge, a joint initiative aimed at encouraging financial education in schools. In conjunction, the Treasury Department also worked with the Financial Industry Regulatory Authority (FINRA) to conduct the first National Financial Capability Survey, which measured the financial skills of U.S. adults.

The shift in language is more than semantics. Financial education is a set of provider outputs; financial capability is a set of consumer outcomes. In the report of its survey findings, FINRA notes the distinction, emphasizing that financial capability "encompasses multiple aspects of behavior relating to how individuals manage their resources and how they make financial decisions."[3] No standard definition of financial capability exists, but most definitions tend to include the following elements:[4]

- Being able to cover monthly expenses with income
- Tracking spending
- Planning ahead and saving for the future
- Selecting and managing financial products and services
- Gaining and exercising financial knowledge

"Financial education is a set of provider outputs; financial capability is a set of consumer outcomes."

Behavioral Economics

The growing attention to behavioral economics is also a factor in this shift. Behavioral economics underscores the need to focus on consumers' financial behavior in addition to their financial knowledge. The burgeoning field has demonstrated that people do not make decisions based solely on their rational knowledge but are also influenced by a host of psychosocial factors and inherent tendencies. These factors help determine people's financial decisions, reflecting the often complex feelings people have about their money. Professors Richard Thaler and Cass Sunstein's *Nudge* highlights the biases and tendencies people routinely exhibit when making decisions. Several of these concepts that have the potential to affect financial behavior are summarized below.[5]

- **Optimism and Overconfidence:** People tend to overestimate the likelihood of positive events and, likewise, underestimate the likelihood of negative events. This tendency might explain why some people buy lottery tickets, despite slim odds of winning, rather than saving their money.

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[3] Financial Industry Regulatory Authority Investor Education Foundation, "2009 National Capability Study: Executive Summary," December 2009, http://www.finrafoundation.org/resources/research/p120478.

[4] The elements presented here were selected by comparing definitions of financial capability obtained from the following sources: The United Kingdom Financial Services Authority (http://www.fsa.gov.uk/financial_capability/), The Financial Consumer Agency of Canada (http://www.fcaccfc.gc.ca/eng/publications/SurveyStudy/FinCapability/ FinCapability_01-eng.asp#02b), and FINRA (http://www.finrafoundation.org/resources/research/p120478).

[5] Richard Thaler and Cass Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness*, Yale University Press, 2008.

- **Status Quo Bias:** People tend to stick with their current situation, even when change would benefit them. This bias may keep people from opting out of an automatic overdraft program or increasing their retirement plan contributions.

- **Temptation:** People often choose immediate gratification over a long-term benefit. This tendency can make it difficult to manage a budget and may lead to overspending.

These and other behavioral biases and tendencies can work against financial knowledge, leading people to make decisions they know are not in their best interest. Addressing these behavioral influences, in addition to promoting increased knowledge, is an important step in helping consumers toward financial capability.

Effective Interventions

To learn about effective strategies for improving financial capability, CFSI not only considered the ramifications of behavioral economics but also scanned the financial education literature and landscape, and interviewed dozens of practitioners and stakeholders. We found that the most effective interventions strive to be:

- **Relevant:** Programs that focus their subject matter to address participants' specific concerns and financial situations are better positioned to capture people's attention and motivate them to change. In addition, new programs and tools are more likely to be accepted when they are introduced in a relevant context.

- **Timely:** Timing the delivery of information to coincide with key life events or moments of decision can provide immediate feedback that helps consumers better understand the consequences of their behavior.

- **Actionable:** When programs and tools can be used right away to demonstrate financial capability, they can help consumers establish positive habits and behavior. This approach allows consumers to put newly gained knowledge into action in ways that can improve their financial situation. For example, pairing messages about the benefits of saving with an opportunity to open an account provides an occasion for consumers to take a definitive step toward planning for their financial future.

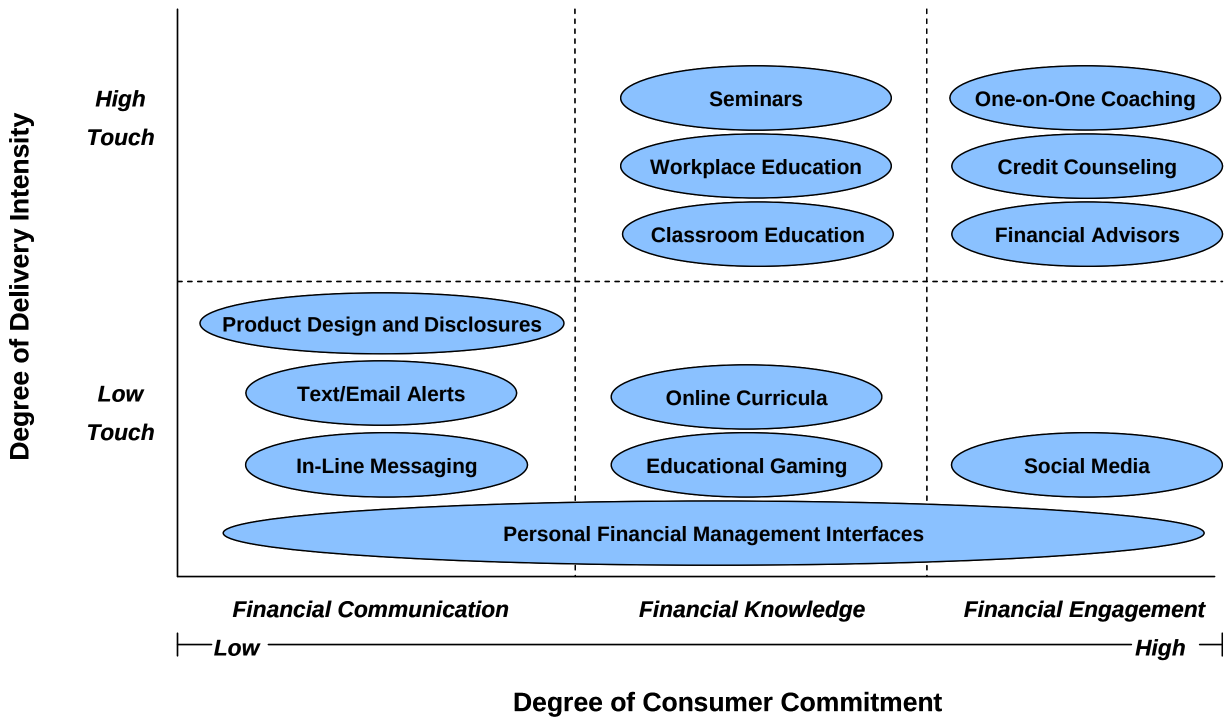
- **Ongoing:** Programs that develop long-term relationships offer essential ongoing support as consumers change their behavior. In particular, periodic progress assessments and tracking capabilities help consumers establish positive habits and internalize the long-term impact of their decisions. For example, goal-based savings products can help consumers achieve their targets by encouraging them to develop long-term plans and providing tools to track their progress. Pairing these interventions with peer support and evaluation provides additional incentive for consumers to live up to their commitments.

Finally, we examined another important development in the shift to financial capability—the increasing availability and sophistication of communication technology. Technology makes it possible to reach more people cost-effectively. From cell phones to websites, there are more ways than ever to communicate with consumers in real time about their finances. In addition, there are new tools to aggregate financial data from disparate sources and analyze it in multiple ways. These tools can help with budgeting, cash-flow management, shopping for the right product, and planning for the future. Finally, social networking tools can be used to provide peer support around financial issues, motivating consumers to achieve their goals.

The developments described here have opened the door for innovation in the financial capability field. This paper focuses on some of the most promising new programs to date. While some early lessons have been learned, opportunities abound for further innovations that build on the most effective strategies, as evaluation methods and practices evolve to identify them.

A Framework for Financial Capability Innovation

While financial education programs have aimed to help consumers improve their financial knowledge, the concept of financial capability extends beyond what a person knows to what the person does. This shift requires a broader range of tools and programs that help consumers change their behavior in financially beneficial ways. Potential means of intervention extend beyond the classroom to provide support at various points throughout a consumer's financial life. The chart below shows several existing tools and programs that can be brought to bear to improve consumers' financial capability.[6]



The chart above categorizes financial capability resources by two characteristics that illustrate how they are offered by providers and received by consumers. The first, on the horizontal axis, is the degree of consumer commitment the resource requires, and the second, on the vertical axis, is the degree of intensity with which the resource is delivered.

[6] Our focus was on those resources that catered to the adult segment of the population.

Go to http://cfsinnovation.com/node/440485 for the paper in its entirety.

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