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NOVEMBER 2010

Financial capability and saving: Evidence from the British Household Panel Survey

cfeb consumer financial education body

About the Consumer Financial Education Body

The Consumer Financial Education Body (CFEB) is an independent body, created in April 2010 by the Financial Services Act 2010. We are responsible for helping people understand and manage their money better. We do this by providing impartial information, education and advice through a national financial advice service.

We provide free, impartial advice online and over the phone. We also offer face-to-face appointments in several priority areas across the UK, and from spring 2011, these will be available nationwide. Alongside this, we run strategic programmes that are targeted at helping people through critical stages and events in their lives. To reach people at the right time in the right place, we deliver these programmes in partnership with industry, government, consumer groups, professional bodies, voluntary organisations and the media.

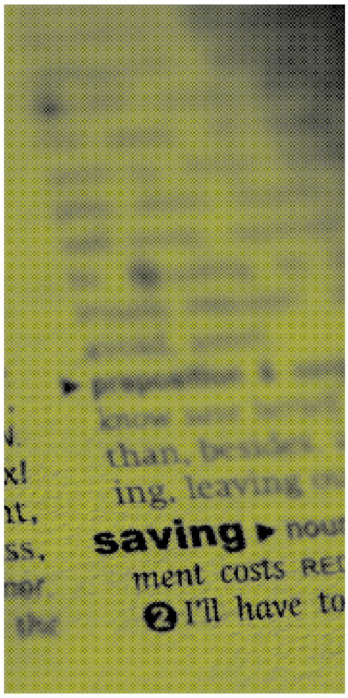
About this publication

The purpose of this document is to summarise the key findings of the research report, *Financial capability and saving: Evidence from the BHPS*, and its bearing on the work we do at CFEB. We commissioned this report to look at savings patterns in Britain and investigate what predicts an individual's probability of starting and continuing to save – that is to build up a saving habit. It focuses on savings that are predominantly for the short term, examining the extent to which people put money aside other than to meet regular bills. The report looks at the relationship between this type of saving and financial capability, income and a wide range of individual characteristics such as age, gender, education level and labour market status.

The analysis is based on the British Household Panel Survey (BHPS). The survey offers a rich longitudinal dataset, and provides a unique opportunity to study the behaviour of individuals over time. The survey collects data on various aspects of people's lives and, for the purposes of this study, analyses how savings behaviour is related to different characteristics and life events over time. It allows a robust analysis of year-on-year changes, and the ability to explore how savings patterns, and non-savings patterns, develop over the longer term.

A range of variables within the BHPS capture an individual's saving behaviour but not all are available at every wave of the survey. This study focuses on the variables that are available at all BHPS waves and covers the period 1991-2006. When data becomes available for 2009, we will consider extending the analysis to look at a broader range of variables and to take account of more recent data.

Definitions



Financial Capability: CFEB's work is focused on five different components of financial capability: making ends meet, keeping track of your finances, planning ahead, choosing financial products, and staying informed about financial matters. Given the data available in the BHPS, the definition of 'financial capability' used in this report corresponds most closely to the 'making ends meet' component. An 'index' of financial capability is used to analyse relationships between saving behaviour and financial capability. This index has been adjusted for monthly household income so a person's financial capability is independent of their income.

Savings: The definition of savings used in this report corresponds most closely with 'rainy day' savings, rather than longer-term savings. Respondents to the BHPS were asked if they '…save any amount of (their) income for example by putting something away now and then in a bank, building society, or Post Office account other than to meet regular bills?'. If so, they were then asked 'About how much on average do you manage to save a month?'. The focus on shorter term savings is simply a function of the questions asked in the BHPS. As an organisation, CFEB is seeking to encourage, where appropriate, all forms of saving – whether saving for a 'rainy day' or of a longer term nature, such as saving for retirement.

Foreword

Most of us would agree that the act of saving is both positive and beneficial. Many advisers recommend setting aside money for a 'rainy day' to act as a buffer against unforeseen events putting strain on our finances. Previous research carried out by the Financial Services Authority (FSA) shows that unforeseen financial setbacks are common.[1] Over a three year period more than a quarter of the population had experienced a large unexpected drop in income. Yet the majority of us (70%) had made no provision. This leaves us more vulnerable to financial shocks.

We also know that the ability to stay on top of our finances has a significant impact on our health. The impact of poor financial capability on psychological wellbeing is large and of a similar magnitude to unemployment or divorce.[2] Helping people to manage their money and make ends meet is therefore not only of great benefit to the individual, but also to society more widely.

If protecting against financial shocks is important for the individual, then saving is arguably an important means of doing so. Savings matter; putting money aside, whether in short or long term savings, helps us take control of our lives and build resilience. If CFEB can help people to plan ahead to deal with the expected or unexpected, then not only do we help them to manage their money better, but we also enhance their lives overall.

This report sheds important light on saving habits in Britain and the characteristics and life events that affect an individual's likelihood of saving. The longitudinal nature of this study enables us to identify longer term trends and gain insights into saving behaviour which cannot be captured by cross-sectional analysis that can only offer a snapshot at one point in time. It analyses the different characteristics associated with being a persistent saver or non-saver, and the extent to which people move in and out of savings.

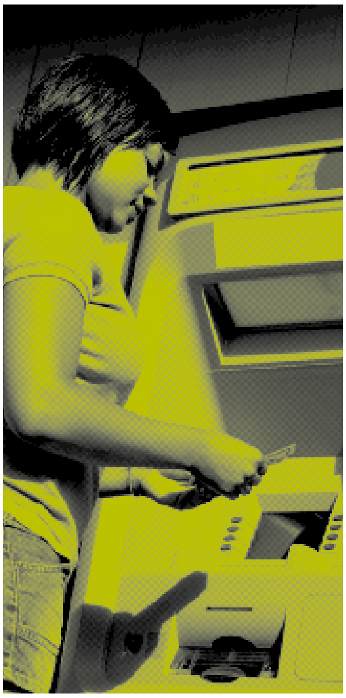
It highlights, in particular, the scale of the challenge we face in helping people to plan ahead and improve resilience to withstand financial shocks. Around 40% of the population show a tendency to be persistent non-savers.

[1] Financial Capability in the UK: Establishing a Baseline, Financial Services Authority (2006)
[2] Taylor et al (2009), Financial capability and wellbeing: Evidence from the BHPS, FSA Occasional Paper Series 34

We need to find ways to engage non-savers and where appropriate help them to start putting money aside for those expected and unexpected events in life. We also need to support those who are irregular savers – again about 40% of the population – so they can see the benefit of developing a regular pattern of savings. And we need to engage those who are saving regularly to ensure they are putting aside enough for their needs.

Encouragingly, this research shows that being financially capable increases the incidence, the persistency and amount of savings. If we can enhance people's ability to manage their money well and stay on top of their finances, we can make a significant contribution to building a savings culture in the UK.

Tony Hobman



Context

Previous research commissioned by CFEB has highlighted the complex relationships between an individual's financial capability, their household income and their saving behaviour.[3] In this new report, Mark Taylor, Institute for Social & Economic Research (University of Essex), investigates these relationships in detail using data from the first sixteen waves of the British Household Panel Survey (BHPS), covering the period 1991–2006.

The main focus of the report is on the drivers of saving behaviour, in terms of whether or not an individual saves from current income, the level of savings (in real terms and as a proportion of income) and the factors associated with continuing to save. In particular, the report models individuals' savings processes – the incidence of saving, the level of saving, and the transition rates into and out of saving – as functions of people's financial capability and a wide range of individual and household characteristics.

The BHPS is unique among British surveys in having annual snapshots on the details of people's lives over a relatively long time period. The report identifies some interesting trends and patterns in saving behaviour over the period of study. In particular, between 1991-2006:

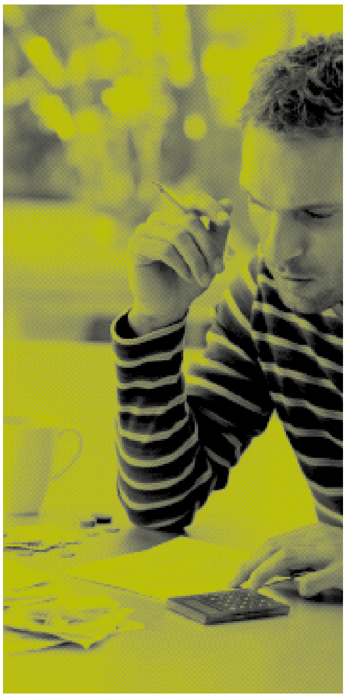
- The number of people putting money aside held up. On average, just under 40% of the population reported saving, by putting some money aside, in any given year. This level remained relatively stable throughout although it did show signs, perhaps not surprisingly, of being inversely related with unemployment (i.e. fewer people reported saving in times of increasing unemployment). Among those who saved, the average proportion of income put aside remained relatively unchanged, at around 6% of gross monthly household income.

- But the majority of the population were still not saving. This is consistent with the FSA's financial capability baseline survey[4] which found that 70% of people had made no personal provision to cover an unexpected drop in income.

- And the age profile of savers changed. There was a worrying trend among young savers (aged 16-25) whose level of saving fell steadily throughout the period investigated. In 1991 they were among the most likely to save, with 45% reported saving, but in 2006 were among the least likely to save (36% reported saving)[5]. The proportion of people saving in the age group 55-64, however, increased steadily over the period. This trend coincided with a period of significant change within the pensions landscape.

[3] Taylor (2009), The impact of life events on financial capability: evidence from the BHPS, FSA Consumer Research Paper 79
[4] Atkinson et al (2006), Levels of Financial Capability in the UK: Results of a baseline survey, FSA
[5] Recent surveys indicate that the savings rate among young people may be on the rise again. This might suggest that young people are more immediately influenced by the prevailing economic climate, and that young people's saving behaviour is counter cyclical to a greater extent than other age groups.

Key findings



We have drawn out below the key findings that shed important light on the complex inter-relationships between people's saving behaviour and a wide range of individual and household characteristics. In particular, these findings further our understanding of people's propensity to put money aside, the amount they save and their persistency in saving, bearing in mind their ability to understand and manage their money.

Financial capability influences saving behaviour positively

Increasing financial capability has a positive effect on saving behaviour and this is especially pronounced at the lower end of the financial capability spectrum. In short, a more financially capable person is more likely to start, and less likely to stop saving compared to an otherwise similar individual with low financial capability. They are therefore likely to be a more persistent saver.

In particular:

- A person with average financial capability is nearly 20% more likely to be saving than an otherwise similar individual with low financial capability. This is broadly equivalent in size to increasing a person's household income by £1,000 per month.

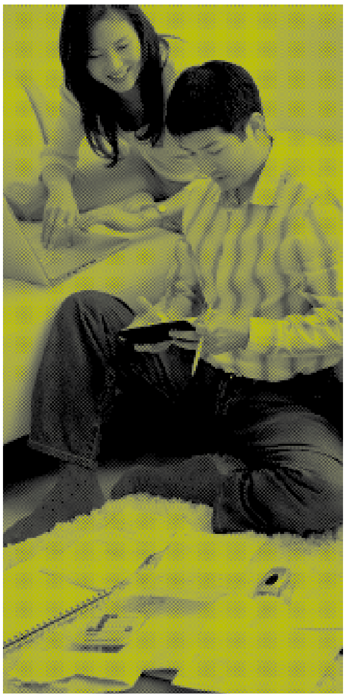
- Moving an individual up the financial capability distribution from relatively low to relatively high financial capability increases their chances of starting to save. The size of this effect is comparable to educating a person with no qualifications to GCSE level, increasing their household income by £1,000 per month, or giving an unemployed person a full-time job.

- Furthermore, a more financially capable person is less likely to stop saving. The size of this effect is also similar to moving a person from unemployment into full-time work.

- Having high financial capability is associated with saving a higher proportion of your income. Someone with relatively high financial capability is estimated to put more aside more than an otherwise similar person with low financial capability[6].

These results imply that improving financial capability would have a significant impact on people's saving behaviour and on the savings industry. At CFEB we want to make managing money well the 'norm' and to encourage people to plan

[6] Multivariate models used in this study indicate that people with higher financial capability put aside about £13 more per month than otherwise similar individuals with low financial capability.



ahead and set money aside to meet both short term goals and long term needs. Our recent research report, *'Transforming Financial Behaviour: developing interventions that build financial capability'*[7], shows how we can use learning from psychology and sociology alongside more traditional policy interventions to foster change in financial behaviour. We are drawing on this research as we look to build on the strengths of our current products and programmes and seek to find new and innovative ways of transforming saving behaviour.

Saving behaviour is correlated to income, but savers in low income households put aside the highest proportion of income

As could be expected, the probability of saving is positively linked to household income. Only 20% of adults in the lowest income group were, on average, found to put money aside from current income, compared with around 60% in the highest income group. However, the analysis indicates that this relationship weakened over time as the propensity to save fell among those in the higher income quintiles.

The research also found that, among people who save, it is those with the lowest incomes who saved the highest proportion, at around 10% of monthly household income[8]. This was consistently the case (and it indeed strengthened) throughout the period of study.

Furthermore, the analysis also suggests that a relatively high proportion of low income savers are found among those exhibiting the highest level of financial capability – which may help explain, at least in part, why they put aside the highest proportion of income. It might also point to some complacency on the part of savers from higher income groups – who were typically saving the smallest proportion of income (around 5%) – but further research would be necessary to investigate this more closely.

Saving behaviour is significantly associated with a range of other individual and household characteristics

The research examines relationships between saving behaviour and a range of other individual and household characteristics. Over the period of study, it found that:

- People with the highest incidence of saving tend to be aged between 25 and 54, married or single (not married before), with non-dependent

[7] www.cfeb.org.uk/pdfs/Trans_fin_behav_reportJuly2010.pdf
[8] The lowest income quintile saved on average 10% of gross household income over the period (conditional on saving) compared with 5% for the highest income quintile. The monthly income cut-offs for the quintile groups are as follows; lowest quintile £0-£1,117, 2nd quintile £1,117-£1,949, 3rd quintile £1,949-£2,821, 4th quintile £2,821-£3,971, highest quintile £3,971 and above.

children and a relatively high household income. In contrast, people with the lowest incidence of saving are on average older, widowed or divorced, lone parents or living in local authority housing.

- Employment status, both of the individual and of other household members, significantly impacts the likelihood of, and persistence in, saving. In particular, being unemployed reduces the probability of saving by 73% compared to those in full time employment.

- Educational attainment also impacts savings positively. The report highlights large differences in savings behaviour between people with qualifications and those without qualifications (even when controlling for mediating factors, such as income). For example, men with GCSEs or the equivalent are about twice as likely to save relative to those with no qualifications, holding all else equal.

- On average, men are more likely to be saving than women, and to save more both in terms of amount saved and in terms of proportion of income they save.

Positive saving behaviour 'sticks' – as does non-saving

The research looks explicitly at the dynamics of saving behaviour and examines how transition rates into and out of saving vary with a range of household and individual characteristics. The analysis found that:

- There are fairly substantial transitions in and out of savings on an individual level. The first few years of saving seem to be a particularly vulnerable period. We found that 25% of people saving in one year had stopped after three years (see Figure 1 below). Following that initial drop off, the transition rate out of savings starts to flatten and around 50% of savers were still saving fifteen years later.

- Persistence in non-saving, however, was higher than in saving. We found that 65% of non savers were still not saving fifteen years later (Figure 2).

- Those with higher financial capability are less likely to stop saving than those with low financial capability.

This suggests that around 40% of the sample showed a tendency to be a persistent non-saver throughout the period of study, whereas a much lower proportion (20%) showed a tendency to be a persistent saver.

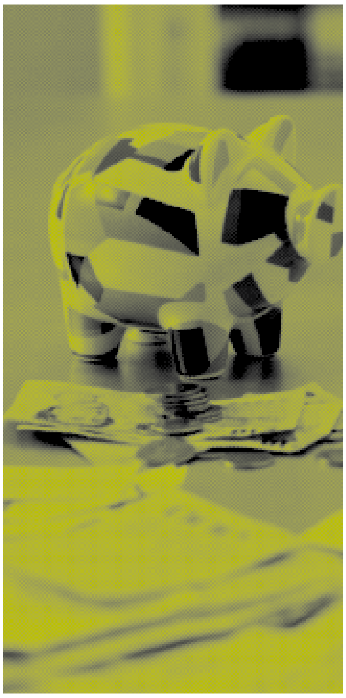
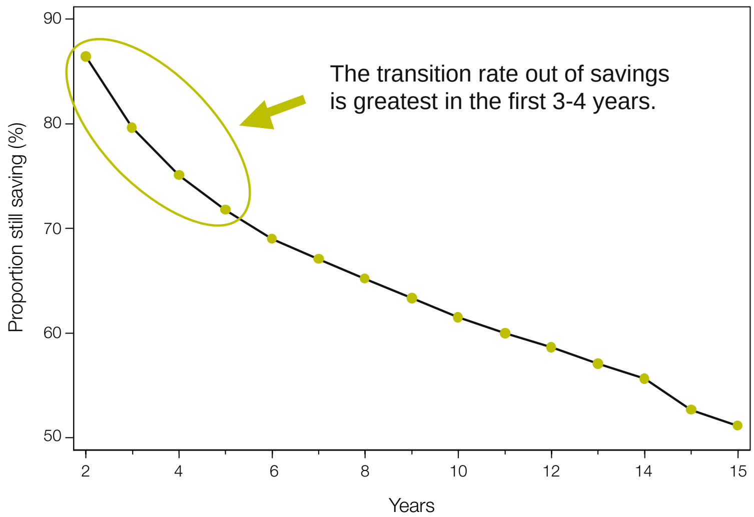


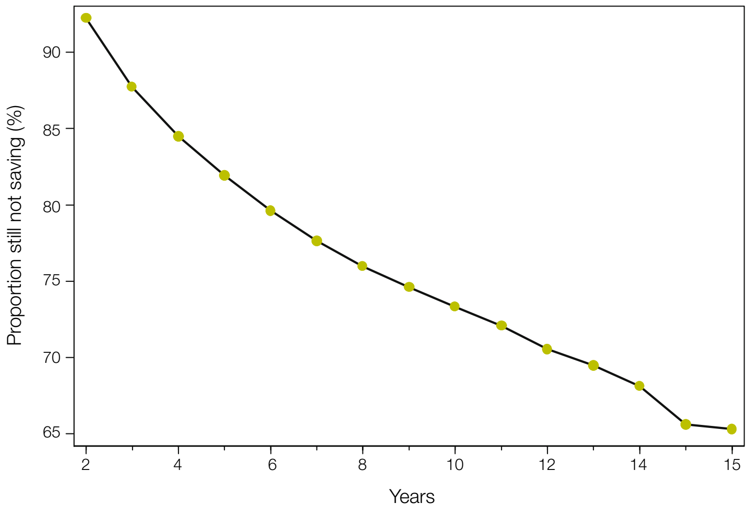
Figure 1: Persistence in saving: 1991-2006



Source BHPS 1991-2006

Figure 1 presents the 'survivor rate' among people who were saving in 1991. It reads, for example, that of all savers in 1991 just over 70% were still saving four years on, whereas just over 50% were still saving 15 years on.

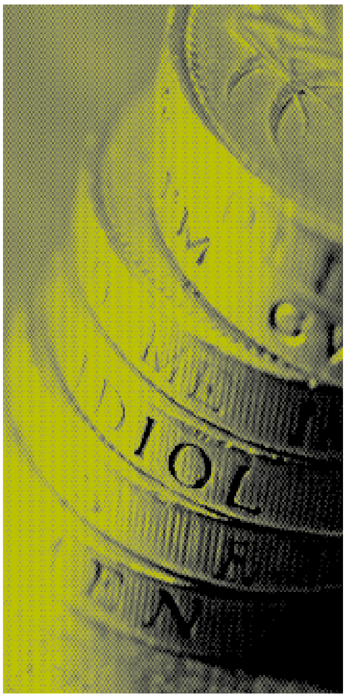
Figure 2: Persistence in non-saving: 1991-2006



Source BHPS 1991-2006

Figure 2 presents the 'survivor rate' among people who were not saving in 1991. It reads, for example, that of all non-savers in 1991 over 80% were still not saving four years on, whereas just over 65% were still not saving 15 years on.

Conclusion



This research has shed important light on the complex relationships between saving behaviour, household income and financial capability. It has identified characteristics of individuals and the households in which they live that are most associated with different saving patterns; and these findings will help CFEB determine where it needs to focus its work.

Significantly, this study has established that financial capability has a large impact on people's saving behaviour, over and above that of their household income and independent of their individual and household characteristics. It suggests that improving people's financial management skills will have substantial impacts on their propensity to save, transition rates into and out of saving, and on the amount and proportion of income saved per month.

Linking these findings with previous research which establishes strong associations between financial capability and psychological health suggest that initiatives successful in improving financial capability would not only be beneficial to the individual and the savings industry, but to society as a whole.

An independent body helping consumers understand financial matters and manage their finances better

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