

THE ROLE OF INFORMATION IN SAVING DECISIONS

Sarah Tanner

Published by
The Institute for Fiscal Studies
7 Ridgmount Street
London WC1E 7AE
Tel 020 7291 4800
Fax 020 7323 4780
mailbox@ifs.org.uk
www.ifs.org.uk

© Institute for Fiscal Studies, February 2000

ISBN 1-903274-08-7

Published online at <http://www.ifs.org.uk>

The role of information in saving decisions

Sarah Tanner

Institute for Fiscal Studies

February 2000

In December 1999, IFS hosted a seminar on financial planning sponsored by the Nuffield Foundation. The conference was chaired by John Bridgeman, Director General of the Office for Fair Trading. Speakers were Christine Farnish, Director of Consumer Relations at the Financial Services Authority, Professor Luigi Guiso from the Bank of Italy, Professor Richard Disney from the University of Nottingham, Dr Peter Lunt from University College London and Sarah Tanner from IFS. This Briefing Note provides an overview of the issues that were raised at the conference. It represents the view of the author, not of IFS, which has no corporate views, nor the shared view of all seminar speakers. Copies of slides and papers from the seminar can be found on the IFS website at <http://www.ifs.org.uk/research/pensionsandsavings/planning.shtml>. The author acknowledges the support of the Economic and Social Research Council grant number R000237331 'Risk and Household Saving Behaviour' and of the Nuffield Foundation in funding the work on which this paper is based.

Summary

The government is shifting more of the burden for pension provision on to individuals but acknowledges that ‘people are confused and have lost faith in the system’.¹ This provides a compelling case for government intervention to ensure that people make better-informed saving choices. There are also strong economic arguments for intervention. First, there are social benefits to people making better-informed saving choices and, second, in the absence of government intervention, there is a danger that financial service providers will offer only specific information about their products rather than general information about saving. Finally, there is evidence from the US that financial education can increase the level of saving, suggesting that a lack of awareness means people not saving enough.

There are a number of implications for policy. Since planning for retirement is inevitably long-term, the government should provide a stable policy environment and avoid unanticipated reforms to the pension system. It should also make clear the implications of any reforms for retirement incomes. Second, the government can reduce the costs of people becoming better informed by raising levels of financial literacy and by ensuring that information is provided in as clear and simple a way as possible. These are both measures that are currently being undertaken by the new Financial Services Authority. However, the process of financial education is unlikely to be quick or cheap and is likely to require a serious commitment of resources. Finally, in addition to being better informed, people need access to advice that they can trust. In the light of cases of pension mis-selling, there is scope for rethinking the current system of financial advisers.

Introduction

People need to be informed about saving more than ever before. Welfare privatisation, particularly in the area of pensions, makes it crucial that people can make the right saving choices for themselves — and the consequences if they are not able to make the right choices are greater. But there is growing concern that people have low levels of understanding of financial products and little confidence in their ability to make the right saving choices. The government itself has said that ‘people are confused and have lost faith in the system’.²

¹ Department of Social Security, *Partnership in Pensions*, 1998.

² Department of Social Security, *Partnership in Pensions*, 1998.

There are several possible reasons for this. In the first place, saving decisions are inherently uncertain and complex. How much you need to save now for your retirement depends on the level of support you will get from the state when you retire, your employment and earnings during your working life, your family choices, your health and life expectancy, and the rates of return that you will be able to get on your savings. Adding to the uncertainty is the fact that the pension system has been subject to almost constant reform over the past 25 years.

Pensions are not like most other goods and services that people have to buy. It is hard for people to see what they are getting for their money with a pension since the final product is a long way off in the future and its ultimate value depends on uncertain and unknowable rates of return and annuity rates. The Financial Services Authority (FSA) and the Office for Fair Trading (OFT) have also raised the concern that financial service providers make the process more complicated than it need be by excessive use of jargon and by not presenting the costs on a basis that allows consumers to make straightforward cost comparisons. The publicity given to cases of mis-selling of personal pensions and, more recently, endowment policies is likely further to undermine people's confidence in buying financial services.

In recognition of the growing need for people to save for their own retirement, and of the importance of people being able to make informed choices, the government has given the new FSA a statutory objective to 'promote public understanding of the financial system'. But what level, and what kind, of information — both about how much people should save and about the form in which they should save — is the right level? To what extent are people aware of the changes in government welfare provision that are taking place and the implications for their own saving behaviour? What is the best source for information — the government or the financial services industry — and what are the most effective channels for getting information to consumers? What evidence is there on whether people are able to plan for their retirement? Is there any evidence on the impact of information on saving behaviour? These are some of the issues that were addressed at a recent IFS conference and which are considered in this Briefing Note.

Evidence on information and saving

There is growing concern that people lack knowledge, understanding and self-confidence about saving decisions, particularly when it comes to saving for their retirement. In a recent OFT consumer survey, for example, less than one-third of respondents could say what the value of the basic state pension was for a single person per week to within five pounds. This is in spite of the facts that almost everyone will get the basic state pension

when they retire and that the level of the basic state pension is likely to be a key parameter when people are deciding how much they will need to save for retirement themselves. In the OFT survey, 29 per cent of respondents thought that the basic state pension was worth more than its actual level, 27 per cent thought that it was less and 13 per cent said they didn't know. An even smaller proportion of those asked knew the value of the basic state pension for a pensioner couple. The full results are summarised in Table 1.

Table 1. Knowledge of the basic state pension

What is the weekly value of the basic state pension...	Correct answer	Incorrect answers
... for a single person?	32% (to within £5)	29% Greater than actual value 27% Less than actual value 13% Don't know
... for a married couple?	28% (to within £7)	19% Greater than actual value 37% Less than actual value 16% Don't know

Source: Office of Fair Trading, *Report of the Director General's Inquiry into Pensions*, London, 1997.

However, since the state pension will play a less important part in people's retirement incomes in the future, perhaps this result is less significant than it first appears. More crucially, there does appear to be a common perception that the state pension is likely to be worth less in the future than it is now and that people are expected to save more for themselves in private pensions.³

Knowing that you have to save more for your retirement in a private pension is not the same thing as doing it, and one of the things that might be stopping people is that they find the process difficult and confusing. The FSA has been carrying out a number of consumer surveys to assess levels of financial awareness and financial literacy. In one survey, a group of people who had recently bought a financial service were asked questions about how easy they found buying such products. Members of this group are likely to be above average in terms of their financial awareness. But they were more likely to think that buying a financial product is a minefield rather than a straightforward decision, and more likely to agree than disagree that they found it difficult to understand leaflets about financial products. The results are summarised in Tables 2a and 2b. The

³ See J. Banks and S. Tanner, 'Perceptions of saving: an economic analysis of focus group evidence', IFS mimeo, 1999, and K. Rowlingson, C. Whyley and T. Warren, *Wealth in Britain: A Life-Cycle Perspective*, Policy Studies Institute, London, 1999.

majority of people who bought financial products did not find it a straightforward process. It is plausible that there is a group of people who do not show up in the FSA survey because they find buying financial products so complicated that they are put off altogether. In this case, making people better informed could be one way to increase their take-up of financial products.

Table 2a. How straightforward is buying financial products or investments?

It's straightforward buying a financial product or investment ...	10%
	7%
	14%
	15%
	14%
	13%
It's a minefield ...	28%

Table 2b. Do you find it easy to understand leaflets about financial products?

I generally find it easy to understand leaflets about financial products	12%
	13%
	17%
	17%
	11%
	10%
I generally find it difficult to understand leaflets about financial products	20%

Source: BMRB, PIA Consumer Panel Annual Survey, conducted for FSA, May 1997.

There is evidence of a strong positive relationship between an individual's knowledge of financial products — and their general level of education — and the number of different assets they hold (see Box 1 for details of an Italian study). But correlation is no guarantee of causation. It could simply be that people who want to invest in a wider range of assets are more receptive to information that is available and have a greater incentive to acquire information. If so, then providing people with more information would not necessarily have a positive impact on the number of assets they hold or their level of wealth.

Box 1. Information and household portfolios: evidence from Italy

A paper by Luigi Guiso and Tullio Jappelli ('Household portfolios in Italy', Bank of Italy mimeo, 1999) looks at the relationship between information and portfolio allocation among Italian households. As in most OECD countries, households in Italy hold less diversified portfolios than standard economic theory predicts. Most households hold only a few assets and, in particular, are unlikely to invest in stocks and shares. One possibility is that entry into the market for a particular asset is costly — but this does not explain why even the rich do not hold well-diversified portfolios. A second possibility is that households do not buy certain financial

instruments because they lack information. A survey by the Bank of Italy of around 8,000 households in 1995 asked respondents whether they knew about the existence of different assets (bank and building society accounts, government bonds, stocks and shares, etc.). On average, households knew about one-half of all the financial assets in the available menu. About one-third of the sample did not know of the existence of equities.

The level of financial information is fairly constant across households of all ages, but falls slightly around retirement, reflecting either a genuine decline in knowledge after a certain age or a cohort effect, i.e. older generations were never aware of as many assets. Perhaps surprisingly, there is not a strong relationship between total wealth and knowledge of financial assets, but there is a strong positive relationship between knowledge of assets and education (controlling for income and wealth).

Whether or not households own different assets, and in particular whether they hold stocks and shares, is strongly correlated with the level of financial information. Among households that do own stocks and shares, however, the proportion of their total wealth held in this form is not related to financial information. This suggests that information acts as a barrier to entry but that once people start investing in particular assets, financial information plays no role in shaping the portfolio.

Recent studies from the US offer more convincing evidence that providing financial education has a significant effect on saving behaviour. One study looked at the effects of financial education in schools.⁴ Mandatory financial education programmes were introduced in several US states between 1957 and 1985 — the majority during the 1970s. In 1995, information on 2,000 individuals was collected, including the state in which they were educated, their current rate of saving, their total wealth and demographic control variables. The study looked at whether growing up in a state with a financial education mandate had any effect on people's later saving behaviour. In fact, people who entered high school five years after the imposition of a financial education mandate (i.e. allowing for a possible delay in effective implementation) had saving rates that were on average 1.5 percentage points higher than those who were educated in states with no mandate.⁵ This result controls for demographic characteristics as well as any underlying differences in saving rates across states. One possibility is that people who have received financial education might simply be better at *reporting* their rate of saving. Since the survey asked for self-reported rates of saving, this cannot be ruled out completely, but the questionnaire did specify the same definition of the rate of saving for all respondents (unspent take-

⁴ B. Bernheim, D. Garrett and D. Maki, 'Education and saving: the long term effects of high school financial curriculum mandates', Stanford University, Working Paper no. 97-012, 1997.

⁵ The median self-reported saving rate is 10 per cent.

home pay plus voluntary pension contributions). This makes it more likely that the difference in self-reported saving rates reflects a genuine difference in behaviour that is attributable to the financial education mandate.

A second set of studies has looked at the impact of workplace financial education on participation in — and contributions to — private pension plans and other saving.⁶ Many firms in the US offer their employees some help with retirement planning — from providing a summary plan description to organising regular seminars. Information from a survey of 2,000 firms collected in 1993 and 1994 was used to look at the impact of different forms of workplace education on employees' voluntary participation in — and contributions to — 401(K) plans (similar to group personal pensions in the UK). If firms respond to pressure from their employees to provide financial education then an observed relationship between workplace education and higher saving could simply be picking up an underlying predisposition to save among employees rather than an effect of education on saving. In fact, the evidence suggests that workplace education in the US tends to be a response by employers to low levels of participation in pension schemes. Under non-discrimination provisions, the pension contributions of 'highly-compensated employees' (typically managers) are constrained by those of 'non-highly compensated employees', providing an incentive for managers to increase firm-wide participation. If workplace education is a remedial measure in cases where employees are predisposed against saving, then the estimates of the effects of education on saving will be a lower bound on the effect of a universal programme. In fact, there is a strong positive effect of a firm running frequent retirement seminars on participation in — and contributions to — pension plans and this effect is larger for less senior employees. The participation of non-highly compensated employees in the pension plan is increased by 11.5 percentage points for those with frequent seminars compared with those with no seminars.⁷ For highly compensated employees, the increase is 6.4 percentage points. However, a key finding is that other forms of education — summary plan descriptions, newsletters — have no significant effect. So, it is not simply the amount of available information that matters; the medium does too.

⁶ See P. J. Bayer, B. D. Bernheim and J. K. Scholz, 'The effects of financial education in the workplace: evidence from a survey of employers', Stanford University, Working Paper no. 96-011, 1996, and B. Bernheim and D. M. Garrett, 'The determinants and consequences of financial education in the workplace: evidence from a survey of employees', Stanford University, Working Paper no. 96-007, 1996.

⁷ The mean participation rate for the sample is 60 per cent.

It is possible that the observed increase in pension saving is caused by people switching away from other types of saving. In the extreme, employers could be encouraging their employees to tie up ‘too much’ of their wealth in a pension rather than holding it in more accessible forms. This means looking not only at the effect of education on participation in pension plans but also at any effect on total saving. In fact, the evidence shows a positive and significant effect of the reported availability⁸ of workplace financial education on individuals’ pension saving and on their total saving. These results are not without potential problems. Individuals who are predisposed to save may be better able to recall the availability of workplace education programmes. And workplace education programmes may affect the way individuals report their saving, rather than affecting actual behaviour. Nevertheless, as the authors argue, the combined results of both studies ‘suggest that financial education in the workplace can exert a strong influence on personal financial decisions’.

Economic issues

Saving for retirement means planning for an uncertain future. How much I decide to save now for my retirement in 20 or 30 years’ time depends on what I think about my future employment and earnings, my health and life expectancy as well as future government policy, investment returns, annuity rates and prices. Much of this information is not known — and much of it cannot be known. Even the best-informed person will not be able to predict with certainty what will happen to their earnings, their health or government policy 30 years into the future. It is worth bearing this in mind in interpreting what people say about their future expectations of pensions and retirement. One implication is that if people say that they don’t know when they expect to retire or what their pension will be, this does not necessarily indicate that they do not have a retirement plan. It might imply that there are several possible outcomes and they can’t give a single answer (see Box 2). In addition, the uncertainty is likely to affect people’s ability to plan for their retirement. Unexpected shocks — such as a change in government pension policy or an unanticipated change in health — can have a big impact on individuals’ lifetime resources and mean that an individual’s *ex-ante* optimal saving plan fails to deliver the expected level of retirement income. Clearly, the more the government can do to create a stable environment — avoiding unexpected changes in policy and spelling out the implications of any policy change for individuals’ retirement incomes in the future — the easier it will be for individuals to plan for their retirement.

⁸ Looking at the effect of the reported *use* of workplace education would result in bias since there will be an element of selection in the people who make use of workplace education where it is available.

Box 2. Predicting the future: retirement expectations

Planning for retirement is likely to involve forming an expectation of when the person will retire, as well as saving for a pension. But the timing of retirement may depend on uncertain variables such as future health, state pensions and investment returns. If individuals are asked to say when they expect to retire, they may not be able to give a single answer, but may be considering a range of possible retirement ages, each of which corresponds to a different state of the world. One way to uncover individuals' underlying distribution of retirement expectations is to ask them to give the probability of having retired by certain ages. In the UK Retirement Survey, however, individuals were asked to report a single age at which they expected to retire.

How should we interpret these responses? If individuals report their most likely retirement age, it could sometimes look as though they got it wrong even though they have reported their best expectation. For example, assume that the whole population has a 50 per cent expected probability of retiring at 65, and a 25 per cent probability each of retiring at 60 and 62. The most likely retirement age is 65 and this is the age that everyone reports. Now assume that the objective probabilities match the subjective probabilities — in other words, that the whole population got it right. Yet half of them look as though they got it wrong. What if it was a 50 per cent chance of retiring at 65 and a 50 per cent chance of retiring at 60? In this case there is no 'most likely' expected age of retirement and the individuals might reasonably answer 'I don't know'!

A study by Richard Disney and Sarah Tanner ('What can we learn from retirement expectations data?', IFS Working Paper no. 99/17, 1999) used the two waves of the Retirement Survey (collected in 1988–89 and 1994) to compare when people said they expected to retire with when they actually retired. The majority of people gave the state pension ages as their expected retirement age. Two-thirds of the sample retired within one year of their expected retirement age. Men were more likely to retire earlier than expected than later, and this was correlated with worsening (self-reported) health. Nearly one-quarter of the sample said that they did not know when they expected to retire. The evidence supported the hypothesis that this group genuinely faced greater uncertainty. On average, the 'don't knows' exhibited greater instability throughout their employment history. They were also further away in time from their actual retirement.

Given the informational requirements, it may be extremely difficult for consumers to know exactly how much they should be saving for their retirement. It is more plausible that they could adopt a simple 'rule of thumb' ('save 10 per cent of your income', for example) that provides an approximation to the optimal saving plan. Indeed, there are some circumstances in which such approximations have been shown to be very accurate.⁹ But since a rule of thumb is only an approximation, it is hard to draw any conclusions

⁹ A. S. Deaton, *Understanding Consumption*, Clarendon Press, Oxford, 1992.

from the fact that any particular individual's saving does not follow the rule of thumb. It does not automatically imply that they are not saving enough. It might simply mean that their particular circumstances (life expectancy, family, etc.) dictate a different optimal plan.

Another potential problem is that saving for retirement is likely to be a one-shot game. People only save once for their retirement, so there is little possibility of learning from previous mistakes. Nor is it easy for younger people to learn from others' mistakes. Their contemporaries are in the same position of it being too early to tell, while pensioners, who could tell them how much they saved and whether it was enough, are likely to have faced very different circumstances. People have to get it right first time for themselves — although they can seek advice (see below) — and they only get to find out whether they have made the right decision when it is too late to do anything about it. In fact, they may never really know whether they made the right decision. Some unforeseen shock — to their health, to the markets or in government policy — might mean that their retirement plan is no longer the optimal one.

The uncertainty inherent in saving for retirement makes a pension quite different from other goods and services that people buy. It is hard for people to see what they are getting for their money when often it will only be a set of forecasts of future income, and this can create a sense of insecurity and a feeling of being exposed to new risks. In addition, there is some concern that providers make the process of buying a financial service more difficult than it need be through the excessive use of jargon. Also, by not presenting costs on a comparable basis, financial providers make it hard for consumers to see what they are getting and to shop around.

Advice and trust

A possible solution to the complexity of retirement planning is for individuals to seek advice from an expert. This could be advice on how much should be saved for retirement or where the money should be invested. For many people, this will be the efficient choice since they will be able to get the benefits of more information at the same or lower cost. But the factors (such as uncertainty and a long time horizon) that make retirement planning hard for individuals to do themselves also create problems for advice. How can someone evaluate the advice they have been given when they don't have enough information to plan for their retirement? The consequences of acting on the advice they have been given will not be known for a long time. And if everything turns out badly and they are left with a smaller pension than they thought they were going to get, it may not be possible to distinguish whether the advice was good and they were simply unlucky

(experiencing an unexpected fall in annuity rates, for example) or whether the advice was bad. When people can neither evaluate the advice they have been given nor judge it on its consequences, it is crucial that they can trust the person who is giving them the advice (see Box 3).

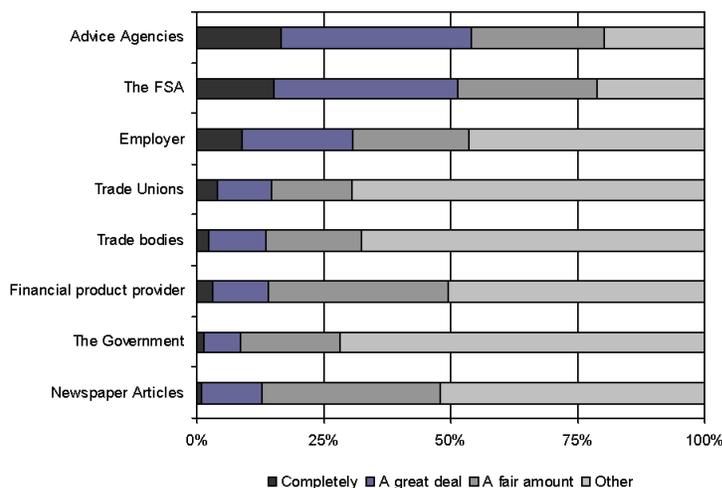
Box 3. Trust and financial planning: evidence from Italy

The issues of trust and financial planning are addressed in a paper by Luigi Guiso, Paola Sapienza and Luigi Zingales ('The role of trust in financial development', University of Sassari mimeo, 1999). They argue that the greater the level of trust, the more people will use financial advisers and the better informed their portfolio choices will be (which they equate with holding a greater share of wealth in equity). Their study is based in Italy. Putnam, a US social psychologist, argued that one of the reasons for the difference in economic development between the North and South of Italy was different levels of trust. Guiso, Sapienza and Zingales use his measures of trust across Italian provinces and look at the relationship between trust and portfolio allocation (controlling for other effects). They find that increasing the level of trust from its value in the lowest-trust province to its value in the highest-trust province raises the portfolio share invested in stocks by 13 percentage points. It also lowers cash holdings by 30 per cent and increases the probability of using cheques by 40 per cent.

Who are consumers likely to trust for information on financial services? A survey carried out on behalf of the FSA (summarised in Figure 1) revealed that advice agencies (such as Citizens' Advice Bureaux) are seen as the most trustworthy, possibly reflecting their independent status. While it would be wrong to infer too much from a single survey, it is interesting to see the relative lack of trust in the government and financial service industry (but not employers), but encouraging that people regard the FSA as relatively trustworthy.¹⁰

¹⁰ It should be pointed out that very few people had prior knowledge of the FSA and had to have its role explained to them. Their answers should be interpreted as how trustworthy an institution such as the FSA would be in principle, rather than how trustworthy it is in practice.

Figure 1. To what extent would you trust information from ...?



Source: BMRB, survey conducted for FSA, July 1999.

Qualitative evidence from focus group discussions confirms a low level of trust in financial advisers that cuts across gender, age and social class (see Box 4). A key concern is that so-called independent financial advisers are not independent. A similar view is held by the National Consumer Council, which thinks it would be more accurate to call them salesmen rather than advisers.¹¹ People place far greater trust in their friends and are more willing to take advice from them than from the experts. Also, there is a concern that advisers will sell them things that they do not want, reflecting the industry’s own view that financial products are ‘sold and not bought’. Finally, doubt is cast over the competence of financial advisers, which may reflect the publicity given to recent cases of pension and endowment mis-selling.

Box 4. Evidence from focus groups: financial advisers

Who can you trust? You can't trust the person selling it to you. Male ABC1 aged 55–64

[Financial advisers] just blind you with science ... they're just trying to sell you this, that and the other ... and even an independent financial adviser may not be independent ... it's not just whether they're corrupt and they're just looking at the commission, it's also how competent they are. Female ABC1 aged 25-34

¹¹ Source: K. Rowlingson, C. Whyley and T. Warren, *Wealth in Britain: A Life-Cycle Perspective*, Policy Studies Institute, London, 1999.

I'm a bit worried that the commission aspect comes into it and ... they'll try to sell you stuff that you don't really want to buy. There's a lot of bad ones out there. Male ABC1 aged 25–34

Those people ... it's their job to invest money ... but they can come unstuck. Male C2DE aged 55–64

Source: J. Banks and S. Tanner, 'Perceptions of saving: an economic analysis of focus group evidence', IFS mimeo, 1999.

Is there a role for the government?

Making better-informed saving decisions is likely to involve a costly investment of an individual's time or money. It involves a two-stage process — acquiring information (i.e. finding out where the information is and getting hold of it) and processing it (i.e. transforming the information into better-informed saving decisions). An alternative is for people to seek advice — but that too will have costs. If consumers are rational, they will acquire and process information up to the point where the marginal costs of doing so are equal to the perceived marginal benefits, i.e. how useful the individual thinks the information is and what he or she thinks are the benefits of better-informed saving choices. The fact that information acquisition is costly means that a rationally-informed individual is extremely unlikely to be fully informed.¹²

The perceived costs and benefits of acquiring and processing information — or seeking advice — will depend on a number of factors. One is the individual's financial literacy, which will affect how difficult (i.e. costly) it is for them to process additional information. Another is the total amount of information that is available. In general, the more information that is out there, the easier (and cheaper) it should be for people to become better informed. The obvious exception is 'information overload' — a massive increase in the supply of information which makes it easier for people to acquire information but more costly for them to process what is available. The form in which information is presented and its quality matter as well as the quantity. Factors that affect the perceived benefits of investing in information will include how wealthy the person is, how heavily they discount the future and what they perceive to be the penalties of not saving for themselves (which depend on the levels of the state pension and means-tested benefits, for example).

¹² Office of Fair Trading, *Consumer Detriment under Conditions of Imperfect Information*, London, 1997.

From this very brief discussion, it is clear that there is scope for government intervention to influence the costs and benefits of consumers becoming better informed and so raise the rational level of information that people choose to invest in. But it is unlikely that simply making more information available will have a big impact. It may make it easier for people to acquire information but not necessarily easier for them to process it. More effective policies are likely to include education programmes to raise financial literacy and ensuring that information is clearly written, jargon-free and relatively easy to understand.

There are strong economic — as well as social — arguments in favour of government intervention. There are additional social benefits (externalities) from people making better-informed saving choices. First, if people reach retirement without having saved for themselves, then the cost falls on other people to support them through the benefit system. Second, better-informed consumers are likely to shop around more for financial services, making the market more competitive and thus reducing prices for everyone including the uninformed (so long as financial service providers cannot discriminate). If people only take into account the private costs and benefits and not the social costs and benefits, the level of information they acquire and process will be suboptimal.

Also, without government intervention, it is unlikely that financial service providers will provide enough of the right type of information. There is a classic ‘free-rider’ problem at work here. Each financial provider has an incentive to provide specific information about the advantages of their particular brand of pension. But there is far less of an incentive to provide information about the merits of pension saving in general, since it will not only benefit the firm that provides the information, but could be of potential benefit to other firms. There is a role for the government to provide — or to require firms to provide — information of a more general nature.

Policy implications

There is a strong economic case for government intervention to make people better informed about saving, particularly for retirement. There is also the practical consideration that information is likely to be an important policy tool for the government to achieve its target of increasing saving, and possibly a more effective one than tax incentives. Finally, there is a strong moral argument for intervention by a government that is shifting responsibility on to individuals to provide for their retirement but acknowledges that people are confused and have lost faith in the system. If the government expects people to bear more of the burden of retirement planning, it has a responsibility to ensure that they are no longer confused and that their faith is restored.

It is important to be clear at the start about the limitations of financial education as a policy to raise the level of saving. There are many possible reasons why people do not save for their retirement. One might be that they are poorly informed, but there are several others. For example, means-testing of benefits may act as a disincentive to people to save for themselves since it will result in benefit withdrawal. Another possibility is that people are very short-sighted about the future, although it is possible that financial education might affect the way people view the future. Or people may simply have more pressing financial needs. Providing financial education is not a solution to these other problems. The government should be clear about the target audience, and about what other policies might be needed for other groups in the population.

Saving for retirement inevitably involves some uncertainty. No one can predict perfectly what will happen to their earnings, their employment, their health, rates of return and government policy over the next 20 or 30 years. But the government can help reduce the level of uncertainty to make it easier for people to plan for retirement. This means avoiding unexpected policy changes and making clear the implications of changes in policy for individuals' future income in retirement. This could take the form of regular pension statements telling people how much income they can expect to receive from the state in retirement, something the government is currently proposing. The government can also make it easier for people to become better informed about saving by raising the level of financial literacy and ensuring that the information provided is clear and simple (and sufficiently general). These measures, although not a substitute for regulation,¹³ form a key part of the FSA's consumer protection role.

Evidence from the US shows a direct effect of financial education on saving behaviour. Financial education in high schools had a positive effect on people's saving rates in adult life, while workplace education raised participation in and contributions to pension schemes, and not at the expense of other saving. But these results do not come cheaply or easily. A programme of financial education in schools will only have effects in the medium to long term and is likely to have fairly high short-run costs. For current workers, education programmes in the workplace might have a more immediate effect, but the US experience found that only frequent seminars made any difference. Simply providing one-off seminars or written material did not have an effect. Making people better informed about saving is likely to involve a serious commitment of resources.

¹³ See V. Nye, *Financial Education and the Role of the Regulator: The Limits of caveat emptor*, Centre for the Study of Financial Innovation, London, 1999.

An alternative to people being better informed themselves is giving them access to advice that they trust. Cases of mis-selling of personal pensions have led to some distrust of financial advisers, and there is some scope for rethinking the current system of independent financial advisers. A possible alternative is advice from employers. The US evidence suggests that, where information and advice are available from employers, they are the primary source for more people than any other single source. The FSA has also found that people are more likely to trust employers than the government or financial advisers. The introduction of stakeholder pensions provides an opportunity for greater employer involvement, since all firms with more than five employees will be required to offer stakeholder access. But the additional costs (and responsibility) of providing advice are likely to be too much of a burden for employers. The government's proposals are for information and advice to be provided in the workplace, but by stakeholder providers. However, for the reasons we outlined earlier, there will need to be government intervention to ensure that providers offer enough general advice and information. An enhanced role for voluntary sector organisations has also been suggested. These are bodies which people find trustworthy, but there may be some concern about their competence if unregulated.