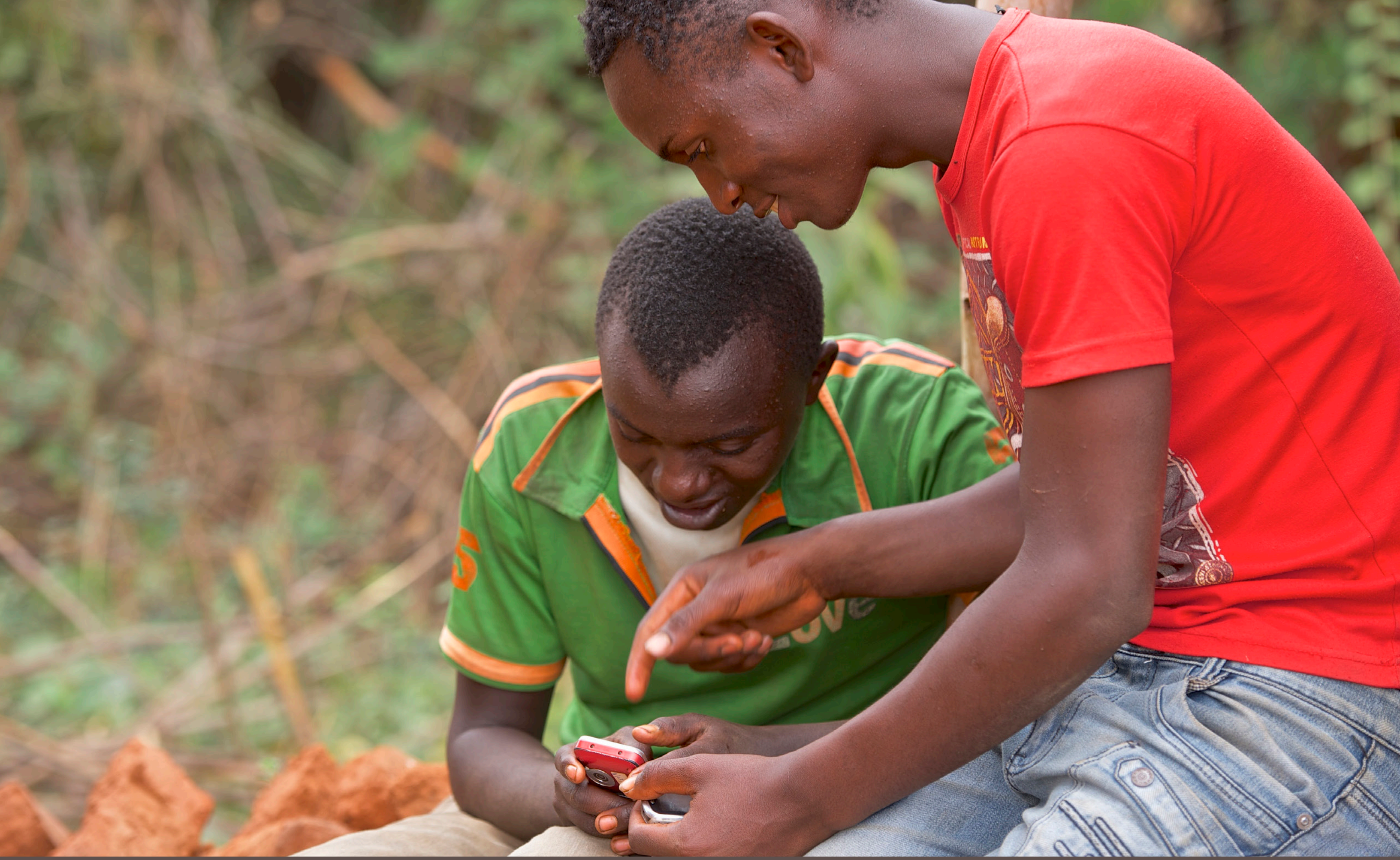

A Change in Behavior

Innovations in Financial Capability

Frequently Asked Questions (FAQs)

AUTHORS

Susy Cheston and Elisabeth Rhyne

CENTER for FINANCIAL INCLUSION | ACCION

JPMorgan Chase & Co.

Q. Is there a conflict of interest when providers deliver financial capability interventions?

According to your "teachable moments" principle, lessons are most likely to be acted on when introduced at decision point, such as signing up for and using financial products or after events that trigger changes in financial behavior (new baby, moving to a new country, etc.). You note that lessons provided at other times are often forgotten or ignored. This principle leads you to recommend that financial service providers offer financial capability interventions at customer touch points. But aren't these "teachable moments" also the moments when providers make their money? And doesn't that present a danger that they could simply become "marketing moments"?

A. This is an important question. While providers have a significant and long-term interest in capable customers who use their products in a healthy way, providers may also have an overriding interest in sales, even when those sales are not in the customers' best interests (for example, when their product is more expensive than alternatives). At worst, providers may sell products that are inappropriate or even harmful for the customer.

But teachable moments are too important to pass up. They offer unique opportunities that should not be missed, and so far providers have not been sufficiently involved. For providers, capability-building is a smart approach to marketing, precisely because it focuses on helping customers get the most value out of their products. KGFS in India represents a creative solution showing that providers can be sensitive to the potential conflict of interest and devise structures to reduce it. KGFS trains front-line staff to offer custom-tailored advice, but it does not reward those staff through sales-based incentives. Providers can also contract with third-party financial capability organizations that interface directly with customers.

At the same time, we recognize there are other times and ways to help build capability, too, and a need for critical interventions from many sources – governments, social service organizations and customer advocates – to balance areas of provider bias.

- We suggest that governments should aim to build the skills customers need to be savvy consumers who can evaluate product offerings and protect themselves. In addition, governments have an essential role in fostering a safe marketplace through a sound consumer protection regulatory regime.

- Third parties that offer unbiased comparison shopping are also an important part of the mix. For example, Indian Money offers independent advisory services with referrals to providers.

The "teachable moments" principle makes a lot of sense in terms of introducing knowledge when people are most ready to act on it, but in using it, providers should ensure that customers are not pushed to act before they have had time to process the information and consider their options.

Q. Is there a business case for financial capability-building?

A. We see the provider value proposition for financial capability interventions in the form of more active product use, improved client retention, reduction in errors and misuse, and adoption of additional products. These are testable propositions, and while we have heard assertions about interventions meeting the performance targets set by financial institution, we would like to see providers gather and publish more relevant evidence.

Because financial institutions are not experts in financial capability development, and few of them will develop that expertise deeply, they may wish to turn to services like Juntos and RevolutionCredit, which interface with an institution's clients, or get design support from organizations like MFO, IPA, and ideas42. These organizations base their models on their ability to support positive customer behavior in a way that enables financial institutions to recoup their costs, whether through increased usage or savings, or improved underwriting.

Providers already devote significant resources to financial education. These resources could be more effectively deployed if they were more behaviorally informed and integrated with financial product design and delivery. The rich communications interfaces that new technologies offer create opportunities to build capability through product use at a very low cost, and there is the added potential benefit of using two-way channels to capture data so that providers can develop more targeted and even individualized products.

Q. What are the objectives of financial capability interventions?

A. The ultimate aim of financial capability interventions for the customer is to move toward financial health. Financial health involves the ability to use financial services to manage day-to-day cashflows and meet longer term goals. It involves the resilience to recover from shocks and the ability to plan for the future. Financial health may include maintaining a sustainable debt load and an ability to save. These are very broad – and idealistic – goals. It is especially difficult for very low income people living precariously to achieve stable financial health, however, and despite this, many lower income people are already expert at financial management using informal means.

Given the breadth of the financial health concept, most financial capability interventions are more targeted at specific skills and behaviors, with varying objectives. Some aims are short term and specific to use of a product, while others focus on longer term life skills. Provider interventions are often focused on ensuring that customers are comfortable using products and use them properly and actively. Examples are training offered by microfinance organizations to savings and borrowing groups prior to account activation, and the messages that accompany Banamex's Saldazo card which explain how to use the card's mobile features.

Differences of objective can give rise to misunderstandings in the discussion of financial capability, as proponents of financial education tend to pursue broader, longer term objectives, while proponents of financial capability tend toward narrower aims for their intervention. The narrower focus is chosen partly in recognition of the challenges associated with behavior change. These differences also have implications for the ways we measure impact.

Q. How can the success of financial capability efforts be measured? What are the metrics? Where is the evidence of impact?

A. For financial capability interventions connected with a specific product, metrics can be straightforward: increased product uptake, reduced dormancy, higher savings balances, and the like. (We caution against using product sign-up as the only measure, which we saw in a number of instances, as it has little to do with greater capability.) We found that measurement by providers is spotty at best, and conclude that such measurements should be applied much more regularly than they are today. Broader financial capability interventions are more difficult to measure, as they aim at changes over time that result from use of financial services and improved financial decision making.

The ultimate objective of financial capability building is to enable customers to move toward greater financial health and resilience. At present, the methods for measuring financial health involve detailed qualitative information gathering. It is not easy to use these methods for verification of causal links to specific interventions. This is an area where additional work is needed.

In the course of our study, we reviewed many studies showing that traditional classroom-based financial education may increase knowledge but does not necessarily result in improved product use or financial decisions. You can find these studies in the extensive footnotes of the paper. Yet many of the behavioral approaches are new enough that there has been little opportunity for rigorous evaluation. All those involved in building financial capability must commit to evaluation and measurement of financial capability interventions, including both internal monitoring and impact evaluation by objective outside parties.

Q. Why not focus on making products simpler and more suitable? If products are simple, intuitive, and designed with customers in mind, maybe customers won't not need capability-building interventions.

A. Great point. Simple and intuitive products are an important – and under-used – strategy for increasing financial capability. We even considered making this an eighth principle. As financial inclusion efforts create a rapid influx of new, less educated customers, it is important to ensure that entry-level products are easy to use and suitable, while at the same time working to build the capability of those customers so they can learn to use more complex products. The high dormancy among entry-level accounts suggests that many customers do not understand how to make more and better use of them. As new technologies transform the mechanics of using financial products, intuitive design can go a long way, but it may need to be supplemented by capability building to help people get accustomed to new ways.

Q. Did you find any interventions that are scalable?

A. Most of the innovations we found are relatively new. Many are still in pilot, and therefore, small and lacking in data on long-term impact and scalability. Some interventions, like reminders and defaults, are being used with hundreds of thousands of accounts, and can already be considered scalable. However, industry-wide use of such techniques beyond advanced economies remains in the future, as most of the interventions we found are located within a few forward-looking financial institutions rather than broadly adopted. Technology can play a big role in bringing down costs and delivering larger scale interventions, for example through the use of mobile phones for two-way messages and the use of data analytics to understand customers. The winning approaches will be sustainable and scalable.

Q. Do providers—and their front-line staff—have the capacity to build financial capability? Building financial capability is a different skill set from running a financial services organization. And front-line staff may not be much more financially literate or capable than the customers they serve.

A. At this point, few financial service providers have deep capacity in financial capability building, and even less in behaviorally informed approaches. While investing in such capacity may pay off over time, a faster solution is to bring in consultants specialized in the design of financial capability interventions or service providers that interface directly with the financial institutions' customers.

Many product-linked interventions require front line staff or banking agents to communicate with or assist customers at the point of sale or transaction. They may need to explain the characteristics of a product or demonstrate how it is used. This kind of assisted learning can be especially important for low-income customers who need help with new technologies, as well as new financial services. This issue becomes more complex when the growing network of banking agents is taken into account. Because front line staff and agents often occupy similar socioeconomic levels as customers, they may have difficulties carrying out these functions if their own financial capability is weak. Thus, investments are recommended to build the financial capability of front-line staff and agents, to train them well, and to provide aids (for example, scripts or flip books, as promoted by Microfinance Opportunities) that help them communicate correctly with customers.

Q. Is there a role for classroom-based education?

A. Financial education—including traditional classroom-based education—does not have a strong track record of leading to more effective financial behaviors. And it does not always take into account the time constraints, learning styles, social norms, literacy levels, and other characteristics of base-of-the-pyramid customers.

Yet if done well, it can help build financial capability, and we support the inclusion of financial education in K-12 curricula. The paper outlines seven behaviorally informed practices for enhancing financial capability interventions—and good classroom education often follows those practices. Many teachers make learning fun, help students learn by doing, reinforce learning through social interactions, use rules of thumb, and customize experiences to meet the different learning styles of their students. All of this is in line with what has been known for decades about participatory adult education, as well as effective education of children.

That said, too many financial education and financial literacy programs are not delivered well. In the course of this project we encountered examples where the people delivering the training were themselves only minimally informed. Moreover, quite often the curricula are focused on concepts of questionable use and application. For example, it is good to understand interest compounding—but it is only useful if customers have the opportunity to save money in an interest-bearing account or manage loan repayments. We found financial education programs that explain the role of the central bank in the economy, and we cannot figure out how low income people could apply that knowledge in managing their own financial lives.

In the end, what counts is behavior. Given the high level of resources poured into financial education and questionable evidence about effectiveness, it is essential to monitor and evaluate the impact of the full range of means to build capability.

Q. Is there a contradiction between the practices of "rules of thumb" and "customize it?" How can you create rules of thumb when each customer is unique?

A. These two concepts would most likely be used in different, though complementary, ways and at different times.

Rules of thumb are bite-sized, easy to understand prompts for action. They make it easier to translate concepts into behavior, and are most relevant for recurring, day-to-day activities. For example, you can talk about the link between handwashing and the spread of disease, or you can say, "Wash your hands before you cook." Or you can talk about compound interest rates, or you can say, "Save a little every day." The broad concepts that go into rules of thumb tend to be applicable to a wide range of people. A recent comparison of financial advice given to consumers in the U.S. found that they all provided similar precepts which boiled down to just a handful of key messages.

Customization involves tailoring support to a customer's specific situation, and it may be more applicable for assisting with specific decisions, such as whether to borrow and how much, or helping customers monitor their own behavior. Some Fintech solutions allow for automated messages that are customized based on customer characteristics and behaviors, thus lowering the costs of customization. Several online apps in the U.S. are linked with a customer's bank account and provide alerts when a customer spends above his monthly budget.

Q. How long does it take to build capability using behavioral approaches?

A. There are some opportunities for “quick wins” that are also long lasting, such as when nudges and defaults are used to set up systems that assist people to work toward their goals. This is the case with commitment savings accounts or automatic contributions to a pension fund, which can have long-lasting impacts. Short-term interventions designed to assist people to become comfortable with new financial products or delivery channels (for example the simulations provided by Fundación Capital to help benefit recipients learn to use ATMs) can also make a long-lasting difference.

On the other hand, as with any effort to build healthy behaviors, financial capability is a long-term investment. For most of us, positive behaviors need reinforcement throughout our lifetimes. Juntos, which provides personalized SMS messages that accompany the use of savings accounts, reports that the effect of its messages on behavior has a typical life cycle, which tapers off over time. Juntos aims to help establish habits over a period of several months, but for longer term reinforcement, variation may be needed.

This issue is one of the challenges to traditional financial education programs for adults which generally are carried out once or in a single series of sessions. To that end, financial institutions should review how behavioral practices can be integrated into all levels of their operations to take advantage of multiple touch points with customers. The “make it social” principle emphasizes the value of all actors reinforcing healthy behaviors and playing their part to build capability, including providers, government, social service organizations, and others.

Q. What is financial capability? How is it different from financial education and financial literacy?

A. This study defines financial capability as the combination of knowledge, skills, attitudes, and behaviors a person needs to make sound financial decisions that support financial well-being. Financial education and financial literacy focus on information and knowledge transfer while financial capability emphasizes actual behavior. At the same time, people may define financial capability in their own contexts according to their specific needs. Ultimately, financial capability supports financial empowerment and financial health, and must be measured based on whether or not the customer is better off.

Q. Aren't poor people already good at managing their money? Low-income clients are said to be good at managing the few resources they have, so why do they need assistance with financial capability?

A. Studies such as Portfolios of the Poor have corroborated what many microfinance providers have observed for years—that poor people generally do very well with managing the little bit of money and assets they have, including using informal services such as loans from family and friends or informal savings groups. The urgency around building financial capability is based on the influx of people entering the formal financial system for the first time—people who have never been exposed to formal services before. High levels of dormancy are one of the signs that people do not know what to do with a deposit account when they've got it. At the same time, research on financial capability needs to emphatically acknowledge that people already know a great deal and have an existing baseline of financial capability. We need to take what people already know as a point of departure.

Q. When you attempt to change customer behavior, how do you avoid being paternalistic?

A. The emphasis is not on controlling client behavior, but on providing the necessary tools so that clients can create the behavior that they themselves want to improve their financial lives. What's important is empowering the client to be able to make a free and informed decision with full agency. The provider can offer guidance and the customer should always have the ability to take the product or not.

At the same time, pioneering behavioral economists Richard Thaler and Cass Sunstein ("Behavioral Economics, Public Policy, and Paternalism" *[American Economic Review Vol. 93, No. 2, May 2003, pp. 175-179.]*) point out that, "In many situations, some organization or agent must make a choice that will affect the choices of some other people." Financial service providers are in the position of putting forth the options from which customers may choose—and it is better for those options to encourage positive financial behaviors. That does not mean they are coercive. Nudges that make it easier to sign up for a retirement plan than to opt out might be considered paternalistic—but is a nudge in the opposite direction less so? Thaler and Sunstein propose "an approach that preserves freedom of choice but that authorizes both private and public institutions to steer people in directions that will promote their welfare."

Q. What opportunities do governments have to adopt and support more behaviorally informed approaches?

A. There are many key roles for governments, including:

- Incorporating behavioral principles into national financial inclusion and financial education strategies

- Leveraging existing touch points with customers, such as social benefit transfers and employment channels

- Reducing the barriers to innovation for financial service providers to allow them to test products and programs that are informed by behavioral insights and help them move away from programs/products that are proven to be ineffective (but not mandating how financial service providers deliver capability building)

- Ensuring client protection, such as through monitoring the advice given by financial service providers as well as setting limits on overly aggressive marketing

- Building behaviorally informed practices into school curricula

- Engaging all of the ministries and agencies that have the potential to support financial capability

Q. Do the same strategies work for all customers?

A. Everything starts with understanding customers and their needs. While we usually refer to customer segmentation in terms of identifying and serving different markets, customer segmentation can help providers analyze what customers know, what they need to know, and how they can best learn. This underscores the "Customize It" principle, but it also points to the value of improved data collection and analysis, which can help providers design interventions to be relevant to specific client needs. In addition to segmentation by education level, experience using technology, gender, age/life cycle, etc., psychologists point out the need to take different learning styles into account. And messages need to be reinforced or repeated through multiple means.

Q. What's the use of building financial capability when customers do not have access to the products?

A. Financial capability interventions that assist people to use formal financial services are only useful if products are available. There is currently a supply constraint of meaningful financial products, and mass financial education efforts sometimes proceed without regard for availability and access. This brings home the point that financial capability building and financial inclusion should go hand in hand.

Q. Do all the behaviorally informed practices have to be followed?

A. We identified seven behaviorally informed approaches that we found to be promising and effective, but not all of them will work in all circumstances or for all customers, and no innovation can employ them all at once. For instance, "make it social" is felt to be very significant in some cultures, and creating a social fabric to support positive financial behaviors and reinforce knowledge can be key. Yet at the same time, financial decisions are very private, so the "make it social" principle should not be interpreted as requiring a social component to each intervention. Similarly, "make it fun" builds on the insight that people are more engaged when learning is fun—but financial service providers also need to be credible, and there is a role for more straightforward approaches as well.

We are grateful to participants in roundtables held in Washington, Mexico City and New Delhi, for their insightful questions and comments, which led to the creation of this FAQ document.

This project and its outcomes would not be possible if not for the generous financial support from JPMorgan Chase & Co. However, the views and opinions expressed in the report are those of the authors and do not reflect the views and opinions of JPMorgan Chase & Co or its affiliates.