Banco de Portugal

EUROSYSTEM

SURVEY ON THE FINANCIAL LITERACY OF THE PORTUGUESE POPULATION | 2010

Presentation of key findings

18 October 2010

Banco de Portugal releases today the first results of its Financial Literacy Survey, through which it has sought to analyse the behaviours and attitudes of the Portuguese population with regard to financial issues and ascertain its degree of knowledge in this area.

The survey arises from a growing recognition, namely at the international level, that consumer decisions in retail banking markets, in addition to having individual financial effects, also have an important impact on macroeconomic and financial stability. In addition, consumer choices are increasingly difficult, given the diversity and complexity of the supply of financial products and services.

The findings of this survey allow the identification of areas where citizens show more significant weaknesses in financial information and understanding. Hence, they are a key instrument for defining the strategy to be developed not only with respect to financial literacy but also concerning the regulation of retail banking markets, led by Banco de Portugal within the scope of market conduct supervision.

At the beginning of next year, Banco de Portugal will publish the final report of the survey, with more detailed results and a deeper analysis.

This survey is the result of an in-depth work carried out by Banco de Portugal since early 2008, when it was specifically assigned market conduct supervision tasks. It is also an important step towards the development of other initiatives in this field.

The importance of financial literacy

Financial literacy reflects knowledge, attitudes and behaviours.

Citizens with adequate levels of financial literacy can make well-informed financial decisions, from managing the household budget to planning expenses and selecting appropriate financial products and services, including the investment of savings and the recourse to credit.

The concept of financial literacy goes beyond the financial knowledge usually associated with managing personal finances. It also involves how such knowledge affects the behaviours and attitudes of citizens when making decisions.

The need to promote financial literacy stems mostly from the growing diversity and complexity of available financial products, which hinders their evaluation and comparison by most citizens. This complexity also applies to the most common banking saving and credit products. For example, in retail markets there are loans with a grace period or deferred payment, and comparing them with the corresponding simpler alternatives is not always easy.

Financial literacy leads to a better management of personal finances.

Citizens who are more aware of the importance of savings and knowledgeable of its possible applications are also more capable of acquiring sound budgeting habits. Furthermore, the ability to identify financial needs and select credit products accordingly may prevent excessive indebtedness and its inherent default risk.

Being less able to make financial decisions can have particularly negative implications in a more unstable environment of uncertainty as to the employment situation and the tightening of credit standards.

The recent global crisis underscored the need for higher levels of financial literacy.

The importance of promoting financial literacy, as a complement to supervision and regulation of retail banking markets, is acknowledged at an international level, particularly in the wake of the recent global financial crisis. This greater focus results from the fact that the crisis revealed vulnerabilities in those markets, generally considered to be among the origins or having contributed to disseminating the effects of the crisis.

The high expansion of credit preceding the outbreak of the crisis proved not to be in line with the financial capacity of consumers (mainly in the US mortgage credit segment). On the other hand, the great complexity of some financial instruments contributed to a poor evaluation of their degree of risk. Nowadays it is consensual that such vulnerabilities could have been minimised if consumers had been more capable of selecting loans that were more adjusted to their financial capability and of investing their savings in products with an adequate degree of risk.

Furthermore, the international financial crisis was accompanied by a decline in wealth (driven by falls in real estate and financial asset prices). Restoring previous levels of wealth implies higher savings in most developed countries, for which a correct understanding of the risks associated with the various financial instruments and a capability to make sound decisions becomes very important. In addition, there has been an increased transfer of responsibility and risk to consumers in the preparation of their retirement.

Central banks assign a growing importance to financial literacy.

Central banks are now focusing on financial literacy, as an instrument to promote macroeconomic and financial stability, not only to prevent future crises but also as a way of contributing to a sustainable economic recovery.

Central banks in a number of countries have assumed a relevant role in promoting financial literacy: in addition to surveys similar to that now released by Banco de Portugal, they have also been involved in coordinating national strategies of financial education and even in defining and participating in specific initiatives, such as training the trainers.

Methodological aspects of the survey

The survey is groundbreaking in Portugal and was based on the best international practices.

2,000 face-to-face interviews across the whole national territory were conducted by Eurosondagem between February and March 2010, with an average duration of 45 minutes. The sample size allowed the average error margin to be limited to 2.2%, with a 95% probability.

Respondents, aged 16 and over, were divided according to five criteria: gender, age, NUTS 2 region (North, Centre, Lisbon, Alentejo, Algarve, Azores and Madeira), employment situation and level of education.

Interviews were based on a **questionnaire that included 94 multiple-choice questions covering five subject areas:**

1. FINANCIAL INCLUSION;
2. BUDGET PLANNING AND SAVINGS;
3. BANK ACCOUNT MANAGEMENT;
4. SELECTION OF FINANCIAL PRODUCTS;
5. FINANCIAL UNDERSTANDING.

The survey methodology was based on the best international practices and sought to ensure the quality of results and their extrapolation from the sample to the whole population.

The conduct of face-to-face interviews (not via the telephone or internet) allowed the questionnaire to encompass a wide range of subjects. It also improved the response confirmation process and led to pro-active respondent participation.

Survey findings

Survey findings make it possible to identify financial education priorities.

The information obtained through the survey shows areas where the financial knowledge of the population is more limited; it also characterises – in greater detail than the existing statistics – the behaviour of the population with regard to saving, household budget management, bank account management habits, etc.

In addition, the survey also made it possible to gather information on aspects that are generally hard to obtain otherwise, namely the perception and attitudes toward factors particularly relevant to financial decision-making, such as product selection criteria, the importance assigned to different criteria or the motivations to save.

The key findings of the survey are presented according to subject areas. In the following analysis it is difficult to make international comparisons due to the low number of countries where such surveys have been held, and to the fact that these are adapted to the respective socio-economic situations. On the other hand, this being the first financial literacy survey held in Portugal, it is also not possible to make a comparison over time.

1. FINANCIAL INCLUSION

The rate of financial exclusion in Portugal is similar to that of other developed countries.

Access to a bank account is considered the major indicator of inclusion in the financial system, for being a key requirement for access to other banking products and services. It is also instrumental to the purchase of some goods and services. In this context, it is an important indicator of social integration.

In Portugal, 11% of respondents report not having a bank account. This result is close to that obtained in other countries: 10% in the United Kingdom, 15% in the US and 13% in New Zealand.

Most respondents who report not having an account are not part of the labour force (74%) and more than 50% are aged 16 to 24 or 70 and over.

When stating the main reason for not having a bank account, 67% of respondents report that their income level does not justify it and 17% refer that another person's account is sufficient.

2. BUDGET PLANNING AND SAVINGS

Financial literacy is instrumental for household budget planning.

Adequate household budgeting implies correctly forecasting future income, planning expenses, and saving, particularly to respond to unexpected situations.

A very significant percentage (89%) of respondents considers household budget planning to be "important" or "very important". However, when questioned on whether they save (a key aspect for proper budget planning), the percentage of affirmative answers is much lower: 52% of respondents report saving (although, of these, only 56% do so on a regular basis).

Although this can be accounted for by the fact that the first question focus on attitudes (i.e. what the respondents consider to be the correct way to act), while the second concern actual behaviour, it may also show that respondents do not consider saving as a necessary requirement for correct household budget planning.

The percentage of respondents who report saving stands at the level of the lowest values recorded in countries where such surveys have been held: 52% in the US or 58% in the Netherlands, compared with 71% in New Zealand or 82% in Australia.

Although these results are not quite surprising vis-à-vis international comparisons of statistics on national saving rates, according to which Portuguese indicators are relatively lower, the findings of the survey cannot be used to draw conclusions on the volume of national saving: firstly, because the question did not focus on the amount of savings; secondly, because the frequency of saving is unknown. In fact, this question intended to ascertain saving habits and to which extent saving was a concern of the Portuguese population. It did not aim at providing information on saving rates, which is made available through other data sources.

The Portuguese seem not to be sensitive to saving.

In this context, answers to questions on the destination and main motivations of savings seem to indicate that the population is not very sensitive to the importance of saving.

Hence, only approximately 20% of respondents report saving in a medium to long-term perspective, by investing resources in time deposit accounts or making other financial investments. In fact, 54% of respondents who report saving consider as such the money left in a current account to spend on a later stage. The standard practice of depositing excess funds in a current account may indicate a certain inertia towards saving, which usually stems from a lack of sensitivity as to its importance or a lack of knowledge concerning its possible applications.

When questioned about the motivation for saving, most savers (58%) indicate precautionary reasons (i.e. to address unexpected expenses); 14% reporte saving as a way of accumulating wealth (for purchasing durable goods or preparing for retirement) and 15% refer relatively immediate purposes, such as holidays and trips.

Finally, saving decisions are also largely determined by financial restrictions: most respondents who report not saving (88%) refer insufficient income as the main reason.

3. BANK ACCOUNT MANAGEMENT

Proper management of the bank account may prevent unnecessary costs.

A proper management of the bank account is necessary to correctly plan the household budget and avoid overdrafts, which are costly. Results demonstrate that respondents show concern about managing the bank account and monitoring their balances and movements on a regular basis: 54% report monitoring the bank account more than once a week and 7% even state doing so on a daily basis.

However, 25% of respondents with access to a bank overdraft report using it (11% "very often" and 14% "not often"). Despite concerns with account monitoring, the recourse to this type of credit, which is relatively more expensive, may suggest a certain lack of knowledge of its costs and of other financing alternatives on the market.

With regard to the criteria for selecting a bank, few respondents (9%) indicate criteria related to costs or expected returns from bank products; rather, they point out the recommendation from relatives and friends (35%) or practical aspects, such as the bank branch's proximity to their home or workplace (23%), as the most relevant criteria. These results are compatible with 74% of respondents indicating that they "don't know" or "know only approximately" the value of fees charged by banks on their accounts.

Results on the criteria for selecting a bank are similar to those obtained in the US, where 31% of respondents reported recommendation from relatives, friends or co-workers and 23% the convenient location of the bank branch, as main criteria.

4. SELECTION OF FINANCIAL PRODUCTS

The selection of products should be adequate to consumer needs and profile.

Selecting financial products suitable to the needs and profile of the consumer is instrumental to foster saving habits and responsible attitudes towards indebtedness. Given the complexity and great diversity of the supply of these products in the market, it is especially important that the selection is based on the comparison of the characteristics of various available alternatives.

The standardised pre-contractual information provided to consumers prior to purchasing banking products allows for a comparison of costs and benefits. However, survey findings show a low propensity of respondents to analyse and compare products; and, when they do, the selection process is not well thought-out.

In fact, most respondents report analysing pre-contractual information (83%), but only 8% compare products.

Reference should be made to the concern about analysing the available information. However, the fact that this information is not used by the purposes it serves illustrates, to a certain extent, The selection of financial products should result from a rigorous comparison of alternatives.

the difference between the concept of financial literacy and that of financial information. In fact, the simple release of information does not mean that recipients gain the knowledge that will help them make decisions or influence their behaviour.

With respect to the selection criteria, the advice taken at the bank branch (54%) or that from relatives or friends (25%) is given priority. The importance of banks in providing advice and financial information shows the trust placed in these institutions, although it may limit the assessment of alternatives existing in the market.

Incorrect answers regarding the knowledge of interest rates applicable to the banking products they own confirms that respondents do not carefully consider the characteristics of the selected products. In fact, 69% of respondents do not know or know "only approximately" the value of the interest rate applied to their savings. This share reaches 65% in the case of interest rates on loans.

From among the criteria for selecting a home loan, only 4% of respondents indicate the annual percentage rate of charge (APR) – a measure that covers all loan-related costs – and 18% mention the interest rate.

With regard to criteria for selecting consumer credit, 23% of respondents report as most relevant the convenience of obtaining a loan at the place of purchase of the product. This proves the importance of "points of sale" in credit intermediation, resulting from a certain inertia in the selection of banking products. However, the instalment value is the criterion most often referred to for selecting a loan, be it for house purchase or consumption.

In the case of credit card holders, of the 43% not paying off the balances in full at the end of the month, only 22% report knowing the exact value of the interest rate associated with the card.

5. FINANCIAL UNDERSTANDING

Overestimating knowledge may lead to incorrect financial decisions.

Questions on financial understanding sought to directly evaluate the knowledge of respondents. Answers show literacy gaps with regard to various important concepts for financial decision-making – which is consistent with the results, already analysed, of the sections of the questionnaire on attitudes and behaviours.

When questioned on the concept of Euribor, only 9% of respondents answer accurately and only 17% know the meaning of a spread on a reference interest rate.

Although most respondents (73%) correctly identify the balance in an account statement, only 46% know how to calculate that balance after a simple debit operation is performed or have an idea of the concept of bank overdraft. Results are also less positive in the evaluation of the degree of risk of financial products.

Results are more satisfactory as regards knowledge of the relationship between the interest rate and the inflation rate and of the individual responsibility for paying off a loan taken out jointly with another person.

Results on financial understanding generally show a positive correlation with the level of education: respondents with university studies show higher performances.

The number of incorrect answers to the questionnaire (instead of the "don't know" alternative) may indicate that respondents overestimate their own financial knowledge. This conclusion is actually similar to that observed in surveys held in other countries..

Main findings

The survey made it possible to identify needs to promote financial literacy across all segments of population (notwithstanding the best results obtained among respondents with university studies). Sample stratification and the breakdown of questions into subject areas allow for the identification of population segments and subject areas with the most significant needs. This will make it possible to better target the future activity of Banco de Portugal within this scope.

Raising the awareness of the population concerning the importance of savings, as a way of accumulating wealth to meet long-term objectives, and not only for immediate purposes, should be considered a priority.

Financial education needs were also detected with respect to the alternative possibilities for the investment of savings.

As regards access to credit, the population should be made aware of the importance of a proper evaluation of loans based on all the associated charges and also on the time profile of the responsibilities assumed, to the detriment of a short-term approach, which tends to highlight the monthly instalment value.

It is also important to make the population aware of the need for a prior comparison and evaluation of banking products and services, based on objective criteria.