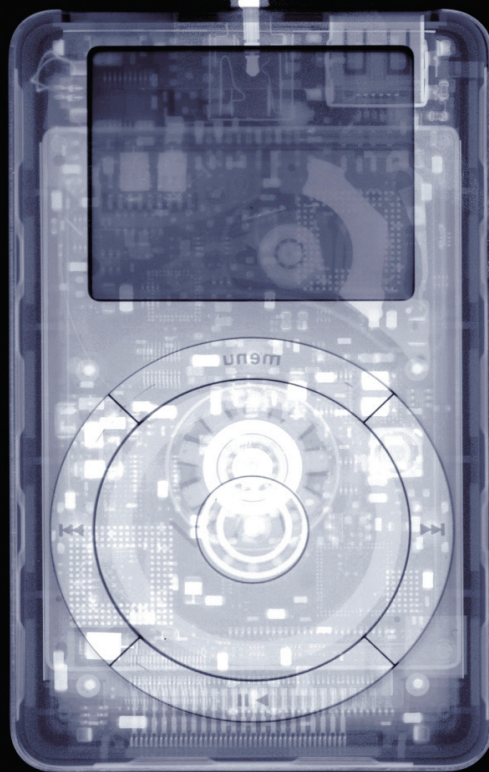


OCTOBER 2008

REFORM

Money's too tight to mention: will the IPOD generation ever trust financial services?



MONEY'S
TOO TIGHT
TO MENTION:
WILL THE IPOD
GENERATION
EVER TRUST
FINANCIAL
SERVICES?

INTRODUCTION

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Reform

Reform is an independent, non-party think tank whose mission is to set out a better way to deliver public services and economic prosperity.

We believe that by reforming the public sector, increasing investment and extending choice, high quality services can be made available for everyone.

Our vision is of a Britain with 21st Century healthcare, high standards in schools, a modern and efficient transport system, safe streets, and a free, dynamic and competitive economy.

The CII Group is the world's leading professional organisation for insurance and financial services. It maintains the professional, ethical and technical standards of the industry.

The CII works with corporate business to develop organisation wide solutions for ensuring ongoing competitive advantage through technical and professional competence of employees at every level.

Individually, qualified CII members commit to Continuous Professional Development (CPD) through enhancing their knowledge to maintain their professional standing. Its 92,000 members in 150 countries make up the largest professional body in the financial world.

As a society, we all rely on professionals to maintain accurate and relevant knowledge and to give appropriate and unprejudiced advice. The CII ensures that we can trust in the competence and conduct of insurance and financial services professionals the world over.

The **Personal Finance Society (PFS)** is part of the CII Group and is the leading professional body for financial advisers and related roles. With over 24,000 members, it promotes the highest standards of professionalism for the financial services profession, and sets the standards for technical knowledge, customer service and ethical practice across the entire financial advice community.

The knowledge, and how

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FOREWORD

Foreword

As the world's largest professional body for insurance and financial services, we are pleased to provide one of the most extensive projects yet undertaken on the financial habits and potential of young people aged 18-34. At this turning point in the UK economy, the retail financial services industry finds itself in a critical position regarding what we call the "IPOD generation".



We are now at a crucial economic time. Household-name financial institutions are dissolving as independent brands before our eyes. In addition, the costs of oil and food are rising dramatically. For all of us, money is increasingly becoming "too tight to mention."

A prolonged period of prosperity – what Mervyn King once called "the nice decade" – is now over. We now have a whole generation of people too young to remember double-digit inflation, double-digit interest rates, food or fuel shortages, or the three-day working week. This is the IPOD generation, and it is especially a crunch point for them.

The project findings paint a complex picture of this unique and under-reported group of adults. They reveal a paradox. The IPOD generation is arguably better off than its parents were, and are using financial products more intensively than previous generations, accessing banking, credit, and insurance at a relatively young age compared to their parents. Yet they remain fairly detached from the one set of products and services they need the most: pensions and investments, and the financial advice needed to access them.

What is striking is that IPODs possess the highest potential for appreciating the good value of advice. Trust and the ability to explain complex concepts are the cornerstones of their service expectation; and when asked what influences them in their choice of adviser, communication skills, independence and above all professionalism ranked the strongest.

So what does this all mean for our industry? Trust is supposed to be the foundation upon which our businesses should be built. Yet it is something that the public including IPODs are quickly losing in us. The case made in our report is that, despite the fact that IPODs are our future, they perceive the industry as failing them as a generation. Products are too complex, we fail to respond to their flexible lifestyles, and our distribution systems are confusing and cater to the needs of an older generations.

As the professional body for insurance and financial services practitioners, the CII Group including the Personal Finance Society (PFS) believe that restoring the IPOD generation's trust and confidence is paramount. First, we continue to promote a step change forward for professionalism in financial advice.

Secondly, by advancing professionalism in this industry, we are encouraging young and diverse people to choose insurance and financial services as a career, and in so doing, bringing fresh talent into the field. Thirdly, we are leading work on improving consumer access to high quality financial advice. Our new and improved www.findanadviser.org website went live this month, and provides access to a large and unbiased choice of financial advisers, all of whom have to be qualified members of the PFS and meet the public interest requirements associated with that. None has had to pay a site registration fee.

Finally, we are working closely with the FSA on improving financial capability. This report on IPODs follows earlier substantial research on the rest of the public by the CII and PFS on financial capability, published in July 2008; and we are supporting the Money Guidance pathfinder.

Plainly more needs to be done, and the industry, not the regulator, must lead the charge. I would like to thank Andrew Haldenby and Lucy Parsons at Reform for preparing this paper for us, and Populus for conducting the extensive suite of market research that has underpinned the findings. This paper sets out views and makes recommendations on a critical part of the population, and we hope the findings will resonate with the Government and industry alike. We hope it constitutes the start of a debate that we are keen to lead on rebuilding trust and confidence within the sector for this IPOD generation.

Trevor Matthews
President, the Chartered Insurance Institute
October 2008

EXECUTIVE SUMMARY

Executive Summary

Generation IPOD has had a uniquely gilded life with high expectations of future wages, financial security and consumer goods.¹ Following in the footsteps of their baby-boomer parents and lacking the good housekeeping of older generations, they have continued to party long past 1999. However, in the process of this acquisition they have run up huge credit card bills, smashed their piggy banks and are now staring at a broken housing ladder.

Reform and the CII have conducted a major research project about the financial position of this generation. The focus group and national survey research of 18-34s compared to other adults has found that IPODs have higher debts and lower savings.

- Over half of IPODs said they have debts of up to £10,000 and the same proportion that has no debt at all owe £10,000 or more. Whereas nearly a third of other adults said they have no debts, and only just over one in ten have debts over £10,000; however
- On the savings side, nearly a third of IPODs have no savings compared to fewer than one in ten of other adults. Meanwhile one in five of IPODs have savings of over £5,000, whereas a quarter of other adults have £20,000 or more.

This mobile, tech-savvy generation (89 per cent of IPODs would buy a financial product over the internet) have the raw skills to understand their position and the dawning sense of responsibility to do something about it. However they are hamstrung by a financial establishment determined to service the old and patronise the young.

Financial services have not adapted to the entertaining, fast-paced way that Generation IPOD like to consume information. The industry is still mentally domiciled in the suburbs of the 1950s relating to a vanishing generation of people who are interested in lifetime savings backed with job-for-life security. Inflexible products are presented in a complex way, yet often failing to disclose basic important information.

It is not surprising that IPODs place greater trust in friends and family rather than relying on price comparison sites or independent financial advisers (IFAs), whom a third of IPODs think are out of touch with younger generations:

- While half of IPODs use family and friends most often for getting advice on money matters, among other adults this was only a quarter;
- As for the reasons for this choice, IPODs cite trust, ability to explain clearly, and ease as their top three priorities, with cost being the least important.

Government has created a heavy burden of regulation and so-called “consumer protection” policies, yet has presided over excessively low interest rates and burgeoning personal debt. This has been mirrored by lack of Government fiscal control, with spending increases disproportionately benefiting the old, creating a huge national debt which younger taxpayers will be paying for over years. IPODs are well aware of this with 58 per cent expecting less state pension than their parents receive and 43 per cent expecting less from the NHS than their parents have enjoyed.

Things can only get worse. With the global credit crunch ransacking financial markets, this generation will struggle to pay off debts and find lenders prepared to finance house purchases. There may be a few silver linings – house prices will not be so astronomical – if IPODs are able to get mortgages.

The credit crunch provides a vital opportunity to reassess the approach to the finances of a generation, for IPODs themselves, government and industry.

A continuation of current trends would see ever-increasing distrust of government and financial institutions coupled with a lack of capability to do anything about it. A government that increasingly tries to protect the individual will find itself without the means to do so. It could spell the beginnings of a long downturn and a “generation of victims”.

The alternative path open to Government is to build an empowered, “saviour generation”, who feel capable of taking control of their own finances, understanding risk and actively providing solutions to the problems arising from the credit crunch. They could create a demand for new products, create new capability and lead a pathway out of the financial crisis.

¹ The label the IPOD Generation was developed by Reform in a previous report to describe the generation of 18-34 year olds in the UK. It is characterised as being Insecure, Pressurised, Overtaxed and Debt-ridden (IPOD). N. Bosanquet et al (2007), *Class of 2007: Inaction sinks the IPOD generation*, Reform.

CHAPTER 1:

IPODS AND THEIR MONEY

Chapter 1: IPODs and their Money

Key points:

- IPODs are the gilded generation: uniquely pampered, yet highly confused;
- They are arguably better off than their parents were, having grown up in relative political and economic stability and high consumer goods affluence;
- The consequence of this is a false sense of security, with IPODs lacking the instinctive fear of previous generations;
- They face unprecedented levels of debt, stemming from a dangerous combination of a “have it now” mentality and a period of historically low interest rates;
- They are trying to get on to a broken housing ladder exacerbated by high levels of stamp duty; finally
- They face limited savings brought about by a dependence on easy money, a working life spent debt-servicing. Combined with the obsolescence of defined-benefit final salary pension schemes, they risk retiring into poverty.

The IPOD generation

Reform has previously described 18-34 year-olds in the UK as the IPOD Generation: Insecure, Pressurised, Overtaxed and Debt-ridden.

Personally, they are open, idealistic and confident, and value transparency and innovation. The research carried out for the purposes of this report analyses the financial profiles of IPODs and their behaviour and attitudes when it comes to money matters.²

The oblivious generation

Reform's previous work with the research company Ipsos MORI found that young people are open, generous and tolerant. They are eager to improve society and are confident and demanding in most of their interactions.³ On money matters, however, the picture is rather different. While they feel an instinctive sense of security borne out of growing up in times of plenty, they are highly confused when it comes to dealing with their finances.

“You need someone to help you understand [money matters], otherwise it's just gobbledegook”

(Reform -CII IPOD Project, focus group, older)

Arguably, IPODs are better off than their parents were. Hard times are not something they have experienced. Young people have no memories of double-digit inflation, 30 per cent unemployment levels, the three-day work week, food rationing or the constant threat of nuclear war.

Instead, IPODs have grown up in a period of political and economic stability. Strong economic growth and consistently high employment have made the UK an attractive place to work.⁴ Young people have far more opportunities than their parents did

– particularly higher education and a global labour market - and the cost of living is cheaper.⁵

Average UK household disposable income has more than doubled in real terms over the last 40 years.⁶ While the cost of housing has doubled as a proportion of household budget in real terms,⁷ households are spending half as much on food and fuel than they did fifty years ago.⁸

Consumer goods affluence is also increasing. In the last five years alone, the number of homes with satellite, digital or cable television has jumped from 50 per cent to 80 per cent.⁹ While only 31 per cent of the poorest tenth of the population have computers, and only 20 per cent have internet connection, some 56 per cent of this group has mobile phones.¹⁰

The UK's housing boom of the last decade has seen the value of residential property rise at an unprecedented rate.¹¹ Those who have been able to take advantage of historically low interest rates to borrow more from mortgage lenders have felt they have made a secure investment. However current events are a stark reminder that house prices can go down as well as up.

IPODs are well aware of these facts. The Reform-Ipsos MORI report found that the majority of IPODs are highly optimistic about their finances, reasoning that if they are better off now than their parents were at the same age, and if they have more opportunities available to them, then they must have a more secure future ahead of them. Typical of their generous, idealistic outlook, they feel they have no right to complain about high levels of debt or fierce labour market competition, having grown up in this time of prosperity.¹²

The financial time bomb

The consequence of this is that the IPOD generation has been lulled into a false sense of security. They feel well off compared to their parents and grandparents and are far more optimistic about the economic outlook. They do not have the same instinctive fear as previous generations to push them into thinking carefully about their long-term financial prospects.

“We didn't really seem to have much when we were younger, but now there's so much more, like food's cheaper and even the alcohol, it's cheap all the time, and everybody's got more disposable money than they used to”

(Ipsos MORI, Edinburgh, 30 year old participant, Equalities Review project)

2 The CII and Reform commissioned Populus Research to conduct market field work in support of this project. They held two focus groups in London on 16 July 2008 with participants from across social grades and genders: Group A nine 18-24 year olds and Group B eight 25-34 year olds. Focus group comments will be referred to as “IPOD focus group younger” (Group A) or “IPOD focus group older” (Group B). Populus then interviewed 1001 18-34 year olds by telephone between 8 and 15 September 2008 a total of 36 questions.

Populus also interviewed a random sample of 1015 adults aged 18 and over online between 26 and 29 September 2008 a total of 16 questions. These interviews were conducted across Britain and the results weighted to be representative of all British adults. Hereafter, Populus research findings will be referred to as “Populus research 2008: Reform-CII IPOD report.” Full research findings are available upon request from the CII.

3 S. Castell, O. Sweet, A. Haldenby and L. Parsons (2008), *A New Reality: Government and the IPOD*

generation, Reform and Ipsos MORI. Hereafter Castell, Sweet, Haldenby and Parsons (2008)

4 Measuring Worth (2008), Datasets, GDP – UK. Real GDP per capita in 1967 was £8,721.97 compared to £20,455.68 in 2007 (using 2003 market prices as a base). Office for National Statistics (2008), Labour Market Statistics, Employment rate, UK, All, Aged 16-59/64. In 1971 the employment rate was 74.6 per cent and in 2007 it was 74.5 per cent.

5 Office for National Statistics (2008), Datasets: Household gross disposable income. Average

household gross disposable income was £6,188 in 1966 in real terms and £14,334 in 2007. Office for National Statistics (2003), *Social Trends 33*. Students in higher education in 2001-02 1,238,000 compared to 416,000 in 1970-71.

6 Ibid.

7 Ibid. Housing was 19 per cent of total household expenditure in 2006 compared to 9 per cent in 1957.

8 Ibid. 18 per cent in 2006 compared to 39 per cent in 1956.

Yet it is long-term issues that IPODs should be concerned about - the financial problems they face are largely ones of the future. Trends that have been emerging over the last decade are still in relatively early stages for economic trends and so may not yet have started to bite. As such, many young people are not as worried about their financial security as the data suggests they should be. The key financial areas impacting IPODs are analysed briefly below.

If the Chancellor of the Exchequer's predictions in late August (prior to the global banking crisis in the Autumn) are correct, this optimistic generation are about to hit the ultimate pessimism of the worst economic downturn in over half a century.¹³

Forever indebted

The IPOD generation has been virtually programmed to accept debt as a normal feature of adulthood. Part of the reason for this has been the new concept of student debt. In 1998-99, the funding of higher education was radically altered. Students were expected to contribute up to £1,000 a year towards their higher education, on a means-tested basis.¹⁴ At the same time means-tested government grants and loans became available.

Since their introduction, the Government has insisted that student loans are not "real debt". It claims that they "bear no resemblance to debt associated with credit cards or even bank loans" and that they are "more of an individual graduate tax, or a long term investment than a debt".¹⁵ Interest rates reflect the Retail Price Index making student loans one of the cheapest forms of borrowing available.

Detailed focus group and survey research of IPODs compared to other adult age groups conducted by Populus market research for this project suggests that there has been an attitudinal shift towards debt among this generation.¹⁶

Table 1: Average student debt and graduate salary, 1997-2007

Average age	1997	2007	% change
Average student debt	£6,525	£11,123	70.0
Average graduate salary	£19,843	£23,431	18.1

Source: uSwitch.com (2007), 11 yr debt sentence for today's graduates, 14 August; Reform calculation.

The student loan has become a normal part of life. This is largely because it has come to be seen as both necessary and unavoidable. Getting into debt to fund higher education is perceived as having a beneficial end.

“Student loans are scary, but at least you have something to show for it”

(Reform-CII IPOD Project, focus group, younger)

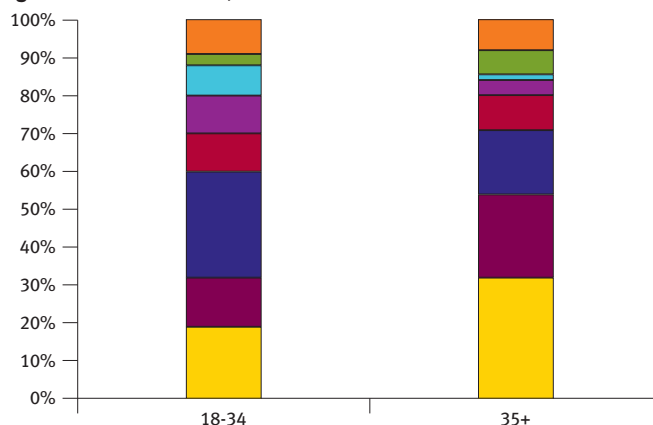
As such, university applications have been steadily increasing and were at record levels in 2007.¹⁷ Alongside this, tuition fees and student debt have risen significantly over the last ten years. The 2005 Global Higher Education Report found that Britain was the third most expensive place to study in the world, behind Japan and New Zealand.¹⁸ This was before the introduction of top-up fees, allowing universities and colleges to begin charging undergraduates up to £3,000 a year from 2006-07.

Since 1997, average student debt has increased in real terms nearly four times as much as average graduate salaries have increased (table 1).¹⁹

The maximum student loan available in 2006-07 was £6,170 a year (£4,405 outside London) – up from £3,145 in 1998-99.²⁰ A student in London who took out the full loan for a three year course would have a total debt of around £23,500 on leaving higher education.²¹

The average length of time to pay off student debt has also doubled since 1997 - from six to 11 years.²² Yet repayments are linked to earnings rather than time - automatically deducted from an individual's pay packet once earnings go over £15,000²³ - meaning that student debt is seen as less serious than other forms of debt.

Figure 1: Unsecured debt, IPODs versus other adults



Source: Populus research 2008: Reform-CII IPOD report.

Roughly how much debt do you have excluding mortgages?

- Don't know/prefer not to say
- More than £20,000
- £15,000-£20,000
- £10,000-£15,000
- £5,000-£10,000
- £1,000-£5,000
- £0-£1,000
- None

9 Ofcom (2008), The Communications Market: Digital Progress Report, Digital TV Q1 2008. Ofcom, Digital Television Update – 2003 Q4. Multichannel TV take-up on main sets was 87.2 per cent in March 2008 compared to 54.4 per cent in December 2003.

10 E. Dunn (2007), Family Spending 2007, Office for National Statistics.

11 Halifax (2008), House Price Index, August. In 2008 Q2 the average UK house price was £185,625 compared to £71,704 in 1998 Q2.

12 Castell, Sweet, Haldenby and Parsons (2008)

13 A. Darling (2008), "Economy at 60-year low, says Darling. And it will get worse", The Guardian, 30 August.

14 The Student Loans Company (2008), Student loans for higher education in England, financial year 2007-08 (provisional), Office for National Statistics.

15 Department for education and skills (2003), Student loans and the question of debt.

16 See for example, Rainer (2008), Why do the Young Pay More? Young People, Debt and Financial Exclusion; Personal Finance Research Centre (2007), Easy come, easy go: borrowing over the life-cycle; Populus research 2008: Reform-CII IPOD report.

17 UCAS website Facts & Figures. 398,327 applications for 1997 entry compared to 454,148 for 2007 entry.

“It’s not real debt though as you don’t have to pay it back unless you earn above a threshold”

(Reform-CII IPOD Project, focus group, older)

The introduction of the student loan has been a key factor in normalising the idea of debt among young people and has had a profound effect on the IPOD generation. Far from viewing indebtedness as a slight as previous generations did, young people today see it as a natural part of life, a socially acceptable state.

Other factors have also contributed to this attitudinal shift towards debt. The liberalisation of the financial services industry in the 1980s freed up the availability of cheap credit, and made other products easier to purchase.

A period of historically low interest rates has ensued.²⁴ The perceived ease with which people can borrow large amounts of money very cheaply has come to equate a sense that it can’t be bad otherwise it would not be allowed, particularly in relation to student loans which are handed out by government.²⁵ IPODs are on the whole far less risk averse than previous generations, so they are happy to take on debt when they think the benefits outweigh the costs – which is the case during times of low interest rates.

The Personal Finance Research Centre has also found a strong correlation between consumption and borrowing, linked to rising expectations of living standards and wealth borne out of a period of prosperity. Young adults are particularly susceptible to the social pressures of a “want it now” consumer society, and are prepared to borrow to bow to them.²⁶ Among this group, “the

use of credit to meet everyday expenditure was a way of life”.²⁷ This suggests a cohort shift rather than a generational one, suggesting that these trends will not necessarily lessen as the IPOD generation ages. Whereas in 2001, the national average of credit and store cards per adult was nearly one in two; today one in five IPODs own three or more.²⁸

These phenomena have led to a substantial increase in levels of personal unsecured (i.e. non-property related) debt. The UK population as a whole has record levels of unsecured debt. Total UK personal debt rose to some £1.4 trillion in 2008 - exceeding UK GDP for the second year running.²⁹ Among IPODs, the most common forms of unsecured debt are student loans, credit cards and store cards. 90 per cent of 18-24 year olds are in debt by the age of 21.³⁰ The mean debt among 18-34 year olds, excluding mortgages, is close to £6,000 – a third higher than the average £4,000 of 35s and over.³¹ Over half of IPODs have debts of up to £10,000 and a fifth have debts of over £10,000 (figure 1). Among other adults, a third have no debts, and only just over one in ten have debts over £10,000.³²

However, IPODs are not a homogenous group. A recent survey found that 43 per cent of young people said that the prospect of acquiring debt whilst at university is putting them off going at all - they would rather begin earning earlier.³³ Wealthier IPODs are more likely to have much more debt than poorer IPODs.

The broken housing ladder

The UK has a national obsession with property. Unlike most of our European counterparts, the British see housing as the solution to all future financial needs. Consequently, mortgages are not seen as debt but rather as an investment – and one of the best forms of investment.³⁴

This has not come without a cost. The young have suffered the most from the rising costs of housing, fuel and power in recent years: 17 per cent of expenditure for those under 30 is spent on housing, fuel and power, compared to only 9 per cent for 31-49 year olds.³⁵ The average age of first time buyers in UK has also risen, fluctuating around age 34, compared to under 30 in the 1970s.³⁶

Increases in stamp duty land tax in recent years have also made life more difficult for first time buyers. Over the last five years, the average stamp duty bill has nearly doubled - from £960 in 2002 to £1,751 in 2007.³⁷ The proportion of first-time buyers paying higher rates of stamp duty has doubled in the last two years from 5 per cent to 10 per cent.³⁸ The revenue raised from residential stamp duty has grown ten-fold in ten years, from £675 million in 1996-97 to £6,445 million in 2006-07.³⁹

This is a problem largely due to a combination of rising stamp duty rates since 1997 and the fact that at the same time thresholds have not been put up in line with increasing house prices (table 2).⁴⁰ The Government’s recent announcement that it is raising the lowest stamp duty threshold from £125,000 to £175,000 for a year from 3 September will bring the lowest threshold broadly in line with the current average house price.⁴¹ It remains to be seen whether this reduction will be sufficient to make a difference for first-time buyers, as we will discuss later.

Yet the insatiable demand for housing has meant a decade of rapid and unprecedented price increases in the British housing market. Average UK house prices have risen rapidly: from £46,300 in 1987, to £68,500 in 1997, to £196,500 in the third quarter of 2007 (although falling back to £174,200 by August 2008 as the housing market downturn has started taking effect).⁴²

Mortgage lenders have tried to relax their affordability policies to make home ownership more accessible to first-time buyers to combat rising property prices. First they tried to increase income multiples (the number of times a borrowers income that a lender will provide as a mortgage) for first-time buyers. As a result the industry average has steadily risen from 2.2 in 1989 to 3.4 in 2007.⁴³ However, some lenders have provided multiples as high as 5.0.⁴⁴

18 The Education Policy Institute (2005), Global Higher Education Rankings 2005.

19 uSwitch.com (2007), 11 yr debt sentence for today’s graduates, 14 August. Inflated to 2006-07 prices. Total student debt increased from £1.2 billion in 1997 to £3.2 billion in 2007.

20 The Student Loans Company (1999), Annual Report.

21 First Trust Bank (2007), Personal Finance: University Fees and Funds. Total made up of £17,960 in loans (£6,170 first 2 years and £5,620 final year) plus interest of £5,534. This excludes overdrafts and other debts.

22 Ibid.

23 At a rate of 9% of income.

24 Bank of England (2008), Statistical Interactive Database – official Bank Rate history. UK interest rates have been under 8 per cent since 16 October 1992.

25 Rainer (2008), Why do the Young Pay More? Young People, Debt and Financial Exclusion.

26 Ibid.

27 Populus research 2008: Reform-CII IPOD report.

28 Ibid; PricewaterhouseCoopers (2008), Precious Plastic: Consumer Credit in the UK.

29 Grant Thornton (2008), UK personal debt exceeds UK GDP for second year running. HM Treasury (2008), Public Finances Databank, July. UK GDP £1.399 trillion at latest estimate.

30 Rainer (2008), Why do the Young Pay More? Young People, Debt and Financial Exclusion.

31 Populus research 2008: Reform-CII IPOD report

Secondly, they tried to increase the maximum permissible loan-to-value (LTV: the percentage of the property that could be mortgaged) to stop first-time buyers from being discouraged from having to raise large deposits. Mortgage lenders were offering 95-100 per cent LTV, while some even went as high as 110 per cent to cover extra costs such as conveyancing.⁴⁵ The risk with this last policy is negative equity (having a mortgage that is worth much more than the value of the property).

The implications have split the IPOD generation: either they have taken advantage of the easy and cheap lending and accumulated big debts; or else they have struggled to get on the housing ladder even with the availability of cheap debt because of high house prices.

Since last year everything has changed as the housing boom bubble burst, and prices have finally started falling. The causes and consequences of this are closely linked to the credit crunch and general turbulence in the global economy and will be examined in chapter 2.

The smashed piggy bank

IPODs are also a consumerist generation, more inclined to spend and borrow than to save. If they unexpectedly received the sum of £1,000, IPODs would on average spend the biggest portion, and then split the rest almost evenly between saving and paying off debt.⁴⁶ Those 35 and over on the other hand would save the biggest chunk of such a windfall.

Nearly 30 per cent of IPODs have no savings (excluding pensions) whatsoever, and 60 per cent have either no savings or less than £1,000 worth (figure 2).⁴⁷ This compares starkly to results from other age groups. Only 7 per cent of 35s and over had no savings, while over a quarter have savings of £20,000 or more. Overall, IPODs have less than half the mean level of savings

Table 2: Stamp Duty Land Tax, 1997-2007

1997		2007	
Threshold	Rate	Threshold	Rate
£60,000	0%	£125,000	0%
£125,000	1%	£250,000	1%
£500,000	1.5%	£500,000	3%
£500,000+	2%	£500,000+	4%

Source: Institute for Fiscal Studies (2006), Rates and thresholds for stamp duty land tax.

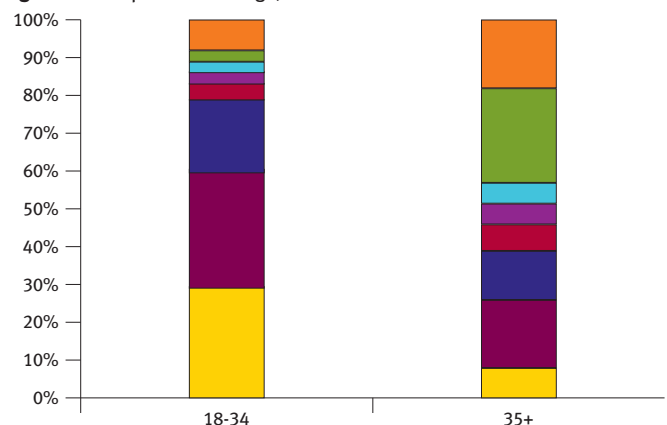
of 35s and over: £4,567 compared to £9,810. A part of this, of course is that older generations have had a longer time in which to accumulate savings.

IPODs cannot expect the same pensions net in retirement as previous generations. The 2008 Fidelity Retirement Index calculates that the typical British worker will retire on £215 a week.⁴⁸ This is less than what someone working a 40 hour-week on the minimum wage currently earns.⁴⁹ Given that the median weekly wage in the UK is £457, this represents a drop in income of 53 per cent for the average worker.⁵⁰ This compares to an average income for a pensioner household of £47 per week in 1979,⁵¹ when the average weekly earnings were £90 – a drop in income of 48 per cent.⁵²

The Fidelity analysis attributes the fall in pensions to the shift away from salary-related (defined benefit) pension schemes, under which the employer pays most of the contributions, to money purchase (defined contribution) schemes, under which the size of the pension depends on how well the investment from contributions has grown. Under the former, individuals could expect to retire on two thirds (66 per cent) of their pay after 40 years of work. While the latter averages out at just 38 per cent of final salary, or £174 a week for someone on the median income.⁵³ Largely this is because the move from defined benefit to defined contribution is often accompanied by a review of contribution levels, sometimes to the detriment of employees.⁵⁴

Fewer and fewer companies are now offering salary-related pension schemes. Falling investment returns and increased life expectancy of people in receipt of pensions have meant that employers have increased the rate at which they are closing defined-benefit final salary schemes enjoyed by the IPODs' parents' generation. A recent survey of pension scheme chairs found that only one in five operated such pension schemes

Figure 2: Non-pension savings, IPODs versus other adults



Source: Populus research 2008: Reform-CII IPOD report.

How much money do you have in savings excluding pensions?

- Don't know/prefer not to say
- More than £20,000
- £15,000-£20,000
- £10,000-£15,000
- £5,000-£10,000
- £1,000-£5,000
- £0-£1,000
- None

32 Ibid.
 33 thisismoney.co.uk (2007), Debt sentence for 2007 graduates, 14 August.
 34 Personal Finance Research Centre (2007), Easy come, easy go: borrowing over the life-cycle
 35 E. Dunn (2007), Family Spending 2007, Office for National Statistics.
 36 Council of Mortgage Lenders (2005), Understanding first-time buyers.
 37 Halifax (2008), The Average First Time Buyer Now Pays Stamp Duty Nearly Everywhere in the South,

10 March.
 38 Council of Mortgage Lenders (2008), "Stamp Duty Licked", Housing Finance Issue 2 2008.
 39 Ibid.
 40 Institute for Fiscal Studies (2006), Rates and thresholds for stamp duty land tax; HM Revenue & Customs (2008), Stamp tax rates; HBOS (2008), Historic data, UK average house price all houses (all buyers), annual data. Average house price for first-time buyers in the UK: £68,504 in 1997, £174,178 in August 2008.

41 Halifax (2008), House Price Index, August.
 42 HBOS (2008), Historic data, UK average house price all houses (all buyers), seasonally adjusted, quarterly data. Figures rounded to nearest hundred.
 43 Council of Mortgage Lenders, Regulated Mortgage Survey, Table ML2 UK: First-time buyers: lending and affordability.
 44 See for example BBC News (2006), "Abbey offer: groundbreaking or gimmick?", 1 November.
 45 Council of Mortgage Lenders, Regulated Mortgage Survey, Ibid.

46 Populus research 2008: Reform-CII IPOD report. Spending included: on luxuries, on necessities, on recreation and on gifts. Saving included: investments and pensions as well as more general savings.
 47 Populus research 2008: Reform-CII IPOD report.
 48 Fidelity International (2008), "Typical UK worker to retire on just £215 per week, less than the current minimum wage", 30 May.
 49 A worker who works a 40 hour-week on the minimum wage will earn a little over £220 a week.

which were open to new members, compared to one in three in the previous year.⁵⁵ Most of these schemes have now been transformed into defined-contribution money purchase schemes whereby the employee has to set aside a percentage of their salary.

Having a consistent income over a long period of time is also becoming less common meaning it is harder for individuals to build up a pension. Occupational pension schemes are connected to an individual's job, and are not always transferable on moving job, or there can be heavy penalties for amalgamating schemes from different employments. Yet job flexibility is growing as the IPOD generation live more flexible lives and have more work opportunities available to them from the global labour market. In the UK the number of workers on temporary contracts has risen by a quarter in the last two decades - from 1.1 million in 1986 to 1.4 million in 2006.⁵⁶

Individuals in the UK fare worse than those in many counterparts in terms of average pensions. The average British worker is likely to receive 47 per cent of their salary in retirement, compared to the average German retiree who will get 56 per cent of salary and the average American retiree who will receive 58 per cent of salary.⁵⁷

These trends make it all the more important for IPODs to take responsibility for their pensions, both in setting them up and in regulating contributions. IPODs are aware of this, yet they are not doing it. Partly this is due to growing up in a time of historically low interest rates which have inculcated a "live for today" attitude. It is more rational to borrow than to save in times of low interest rates, so this is what IPODs have become used to and the debt to savings ratio has continued tipping away from savings. Pensions are seen as something too far away to be considered.

“It's hard to be interested in it [a pension] right now”

(Reform-CII IPOD Project, focus group, younger)

It is also due to a lack of understanding about how pensions work, and where to begin in setting one up. IPODs need the capability to be able to do this, or even to decide not to if that makes more financial sense.

“The whole pension thing is confusing; break it down so I know what it means!”

(Reform-CII IPOD Project, focus group, younger)

50 Office for National Statistics (2007), 2007 Annual Survey of Hours and Earnings.

51 Clerical Medical (2006), Pensions Report.

52 House of Commons (2004), Written Answers, 19 July.

53 Fidelity International (2008), "Typical UK worker to retire on just £215 per week, less than the current minimum wage", 30 May.

54 Ibid.

55 PricewaterhouseCoopers (2008), Are you managing your pensions business?, 3rd Survey of UK Pension Scheme Governance.

56 Office for National Statistics (2006), Labour Force Survey (LFS), Historical Quarterly Supplement, Table 24: Part-time and temporary work by industry sector (not seasonally adjusted).

57 Fidelity International (2008).

CHAPTER 2: TECH-SAWVY, FINANCIALLY INEPT

Chapter 2: Tech-savvy, financially inept

Key points:

- IPODs are potentially more capable of managing their money than previous generations;
- They have a strong sense of ownership, a desire to be in control of their finances and as such spend time budgeting and shopping around for products;
- They have an instinctive grasp of technology and see this as a key way to manage their finances;
- They are using financial products more intensively than previous generations, although on investments and equity based savings they lag considerably behind older people;
- IPODs instinctively rely on family and friends, and to a lesser extent price comparison websites, for financial advice;
- But they struggle with low financial capability, getting lost in the complexity of financial services; finally
- This is compounded by a sense of complacency holding them back from taking appropriate steps.

Potentially capable individuals

The desire to take control

IPODs have a strong sense of personal responsibility when it comes to managing their money. They accept that it is up to them to find out information about different products and services available and to make the right decisions.

The overwhelming majority of IPODs think that when they purchase a financial product it is their responsibility, or mainly their responsibility, to check that it is the right product for them (figure 3).⁵⁸ Nearly 60 per cent say managing their finances is very important to them, and over 40 per cent say they should be more in control of their finances (figure 10, p.28).⁵⁹

IPODs are taking their time when considering purchasing financial products (a week for mobiles and credit cards; a couple of months for a mortgage), preparing budgets and regularly checking their bank balance. Over a third of IPODs prepare a household or personal budget at least once a month (figure 4) - a greater proportion than other adults. Furthermore, over 70 per cent check their bank balance at least once a week (figure 5).⁶⁰ Finally, around 60 per cent say they have switched from one product or service provider to another to get a better deal.⁶¹

Figure 4: Propensity to prepare household budgets, IPODs versus other adults

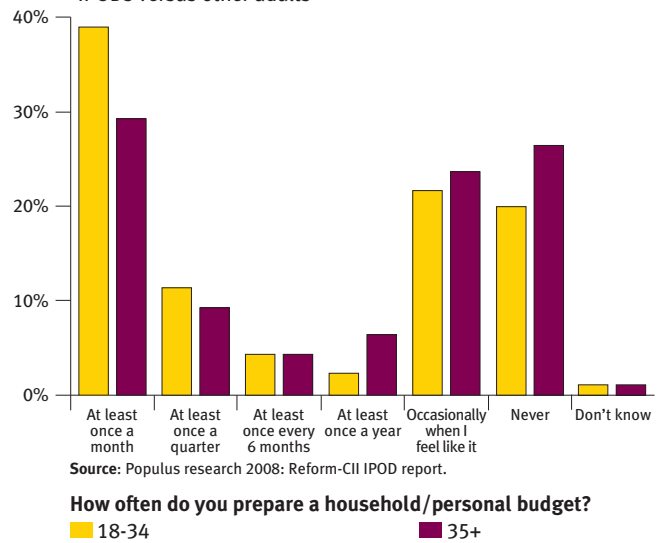


Figure 3: IPOD views on responsibility when purchasing financial products

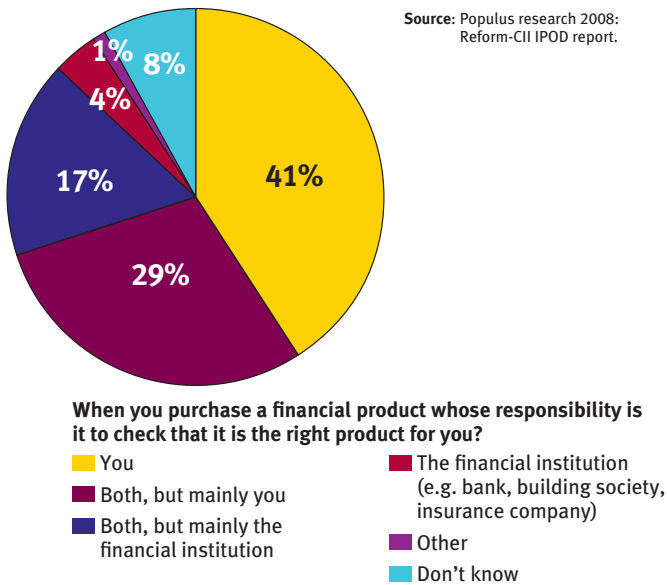
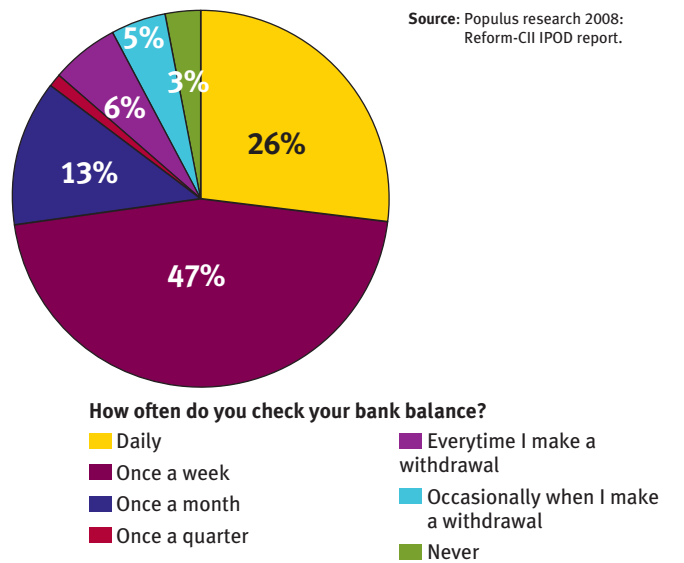


Figure 5: IPOD propensity to check bank account balances



58 Populus research 2008: Reform-CII IPOD report.

59 Ibid.

60 Ibid.

61 Ibid.

Tech-savvy

Having grown up during the technology revolution, the IPOD generation is far more informed than previous generations. The internet represents a potentially infinite stock of cheap information. Instantly, and without extra cost, a wealth of advice and product information on a variety of products and services can be accessed.

As such, where IPODs take action regarding financial matters, it is usually through technology media. The younger generations have an instinctive grasp of technology and naturally think of online solutions to their everyday problems. They like to be constantly engaged and networked, never far from a mobile phone or internet connection.

“Online banking helps because I can check [my balance] every day”

(Reform-CII IPOD Project, focus group, younger)

“The internet has made it [financial products and services] easy to understand”

(Reform-CII IPOD Project, focus group, older)

“People love sharing knowledge”

(Reform-CII IPOD Project, focus group, older)

The internet is used extensively by young people for day-to-day matters and general information searches. Over two-thirds of IPODs use the internet to a fair extent or to a great extent for general information, choosing products or services, buying products or services and social networking. Nearly 70 per cent of IPODs use the internet for online banking (figure 6).⁶² When

asked for the main reasons why this was the case, over half chose ease of access, with simplicity, comfort with technology, and the knowledge that they do everything online anyway as the next most popular (37%, 33% and 25% respectively took this choice).

Most young people have used price comparison websites with ease and feel comfortable doing so, particularly for less “major purchases” such as holiday insurance.⁶³ In their busy, time-pressured lives IPODs are more inclined to use online services that they can access quickly and instantly. Over 38 per cent of IPODs cited lack of time as a barrier to them making financial decisions, compared to 23 per cent of 35s and over (figure 20, p.37).

The internet is seen as a secure way to manage finances. Only 11 per cent of IPODs would not be happy to purchase financial products over the internet (and only a further 19 per cent would only be happy to do so for small purchases). The number of price comparison websites has grown significantly⁶⁴ and they are being used more often as a substitute for personal financial advice.⁶⁵ They show that people are willing to spend the time shopping around for the best deal.

There is a danger, however, that the move away from traditional means of finding information or advice on financial matters towards more modern, technologically-focused means will lead to even greater retreat and isolation of certain IPODs. Whilst young people as a whole are much more computer and internet literate than older generations, there is much less use by lower socio-economic groups (figure 7). The internet is used to a fair or great extent for online banking by 67 per cent of the wealthiest IPODs compared to only 41 per cent of the poorest; and by 67 per cent of the wealthiest for buying products or services compared to 39 per cent of the poorest.⁶⁶ Similarly, 79 per cent of the most wealthy said they were happy to use the internet to purchase financial products, compared to 57 per cent of the least wealthy (figure 7).

Figure 5: IPOD propensity to check bank account balances

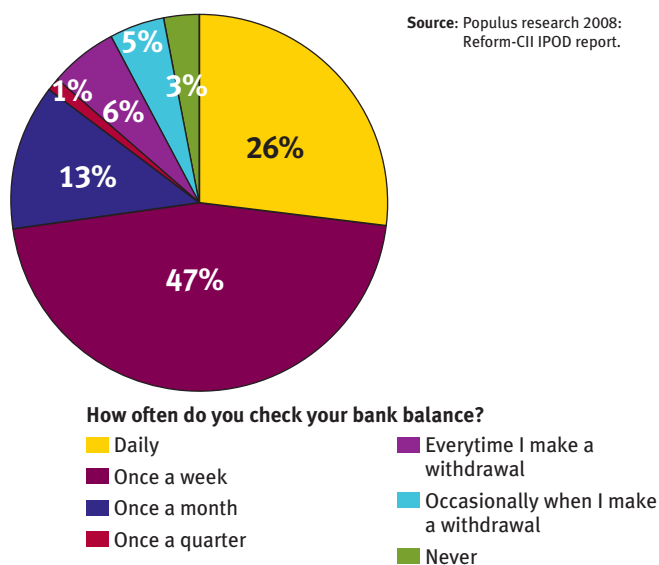
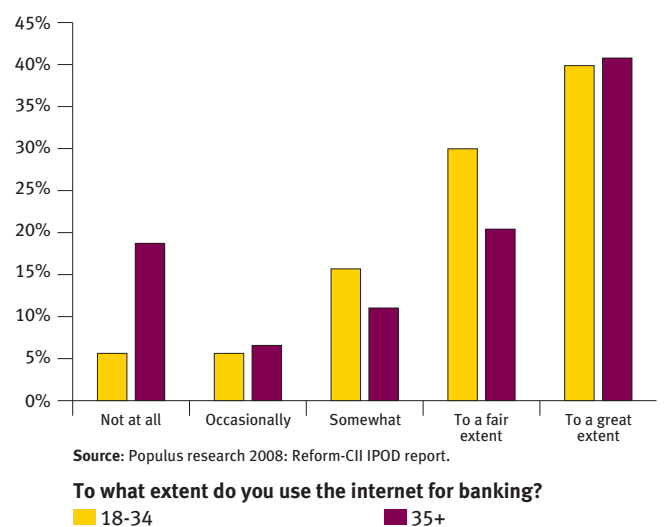


Figure 6: Use of internet for banking, IPOD versus other adults



⁶² Ibid.
⁶³ Ibid.

⁶⁴ Financial Services Authority (2008), Review into general insurance comparison websites, May.

⁶⁵ comScore (2008), Top UK Web Rankings January 2008. This shows month-on-month growth of traffic to moneysupermarket.com of 79%.

⁶⁶ Ibid.

Financial services junkies

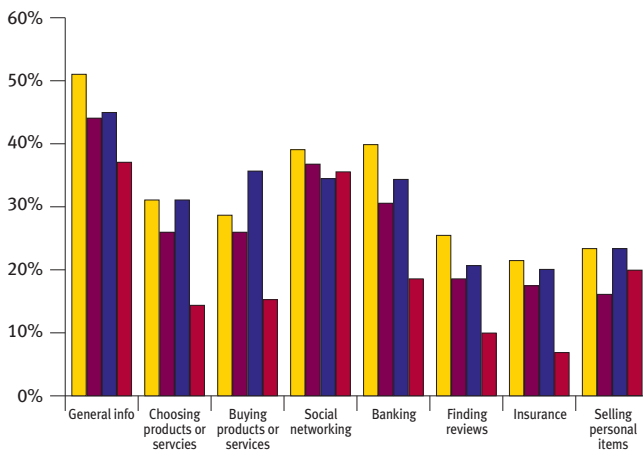
IPODs are using financial products more intensively than previous generations. They are taking on debt at an earlier age than previous generations and their lifestyles are demanding an increasingly flexible use of financial products. Over two thirds of IPODs have some debt and some savings; over 90 per cent have current accounts; nearly half have home contents insurance, while nearly a fifth have some kind of protection insurance; 15 per cent have some kind of equity savings and well over two-thirds have at least one credit card or store card.

Indeed, IPODs do not lag too far behind other adults in accessing most basic financial products, given the differences in age and life stages (figure 8).

On access to financial products, the youngest, poorest IPODs are far less likely to hold products beyond the basic ones such as current accounts, and in particular they usually lack long-term and risk-mitigation products such as life, home or travel insurance.⁶⁸ Over half of the poorest IPODs have no savings compared to only 13 per cent of the wealthiest (figure 9); although conversely far more of the wealthiest IPODs are likely to have a higher level of debt.⁶⁹ Poorer, younger IPODs are less likely to prepare budgets than their older, richer peers and less likely to switch products or providers for a better deal.⁷⁰

These statistics suggest the development of a serious divide among IPODs, with younger, poorer IPODs using more traditional ways of managing their finances and being far less active, while older, wealthier IPODs are making greater use of more modern means and being more active. This is a worrying trend given that it is the poorer IPODs who probably need to take more action in managing their money. Nevertheless, the signs are still positive that IPODs as a whole are using a range of financial products more intensively than previous generations and are thinking about and seeking information regarding their finances.

Figure 7: IPOD reasons for using the internet, by social class grouping



Source: Populus research 2008: Reform-CII IPOD report.

To what extent do you use the internet?

AB C1 C2 DE

Financially inept

The paradox of the IPODs is that they are a generation which, on the one hand is using financial services with greater intensity; but on the other hand, is using them with less knowledge and confidence. The main cause of this is the vast gap between IPODs and the financial services industry that has been forming over the last two decades.

Lost in jargon

On a personal level, IPODs are an extremely confident generation. Yet when it comes to money there is a huge sense of uncertainty and trepidation. Fear of revealing their lack of understanding prevents many young people from even attempting to get started.

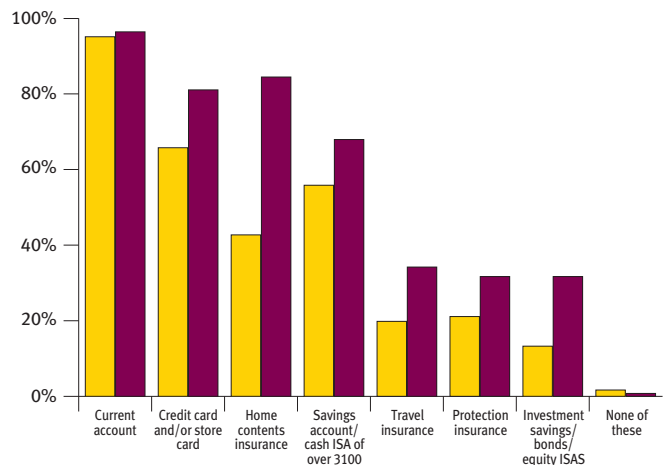
“It [the small print] is all so wordy, I just wouldn’t read it”

(Reform-CII IPOD Project, focus group, younger)

Even where consumers have sound basic knowledge, getting lost in the jargon or small print can quickly cause them to lose their confidence. IPODs are less confident in dealing with money matters than 35s and over. A third of IPODs say they do not understand financial products enough and only half feel confident in making financial decisions - compared to 58 per cent of 35s and over (figure 10).

There is also a serious lack of knowledge regarding financial products and issues among this age group. While many IPODs are able to say that ISAs are a tax-efficient way of saving, they cannot explain why. In fact, research by the National Consumer Council found that around 15 per cent of 18 to 24 year-olds think an ISA is an iPod accessory, and one in 10 believe it is an energy drink.⁷²

Figure 8: Financial product access, IPOD versus other adults



Source: Populus research 2008: Reform-CII IPOD report.

Which of the following products do you currently have?

18-34 35+

67 Ibid.
68 Ibid. See also Resolution Foundation (2006), Closing the advice gap: Providing financial advice to people on low incomes.

69 Ibid.
70 Ibid.

71 AEGON UK (2007), Distribution and Financial Advice Consumer Research: Phase II, July, <http://www.aegon.co.uk/industry/shaping-our-industry/research/opinion-leader-research/index.html>

72 Prudential (2005), “Do we know our iPods from our ISAs?”, 30 August.

Only a quarter of IPODs were able to answer a standard question in relation to mortgage repayments and pension contributions (figures 11 and 12).⁷³ This shows that three quarters of IPODs simply do not have a sense of two of the major financial questions that they face.

Even more surprising, many IPODs are happy to use financial products that they do not entirely understand. Among those with pensions there is a real uncertainty over the type of pension they have, how much their employer contributes or what type of pay-out they can expect in retirement.⁷⁴ Six to seven per cent of IPODs do not know even roughly the level of savings or of debt that they have.⁷⁵ Nearly half do not know the rate of interest they are being charged on their main credit card or overdraft (figure 13).⁷⁶

Compounded by complacency

This may be linked to a fundamental lack of knowledge and confidence, but there is also a real sense of complacency among young people. Perplexingly, IPODs say that they are concerned about their finances, but do not seem to be taking action to manage them more effectively. Half of IPODs are concerned that they are not saving enough (figure 14); 60 per cent would like to be saving more and borrowing less; and almost two thirds want to get out of debt as quickly as possible.

This is a difficult paradox for the finance industry to respond to. Young people accept that managing their finances is their responsibility and that they need to be doing it better, but yet they do not take appropriate steps and they are moving further and further away from the financial services industry. As described in Chapter 1, having grown up in a time of economic prosperity, IPODs do not have the same inbuilt safety sensors as previous generations and are far less risk averse with their finances.

This suggests that their complacency and tendency to take more risks could start to reverse with a downturn in the economy. If IPODs need something to kick them in to action, the credit crunch could be just the thing.

Figure 9: IPOD access to savings by social class grouping

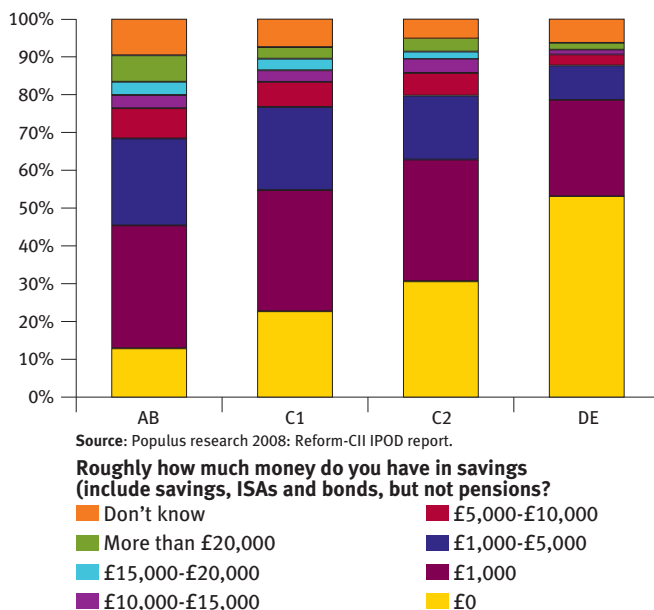
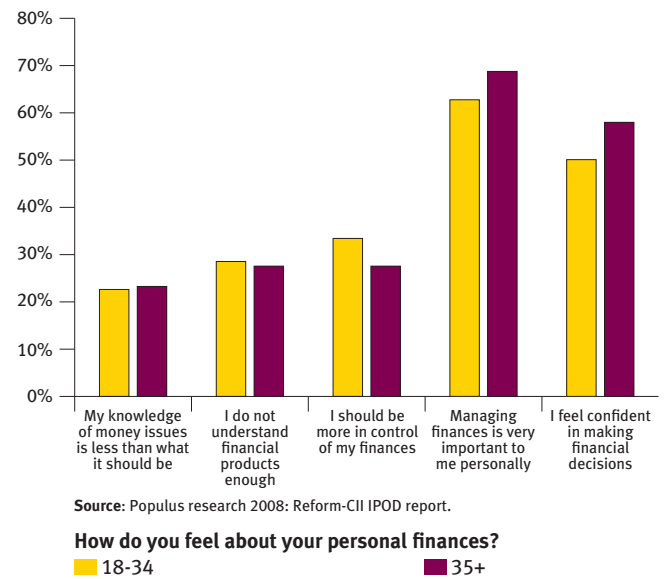


Figure 10: Perceptions of general financial situation, IPOD versus other adults



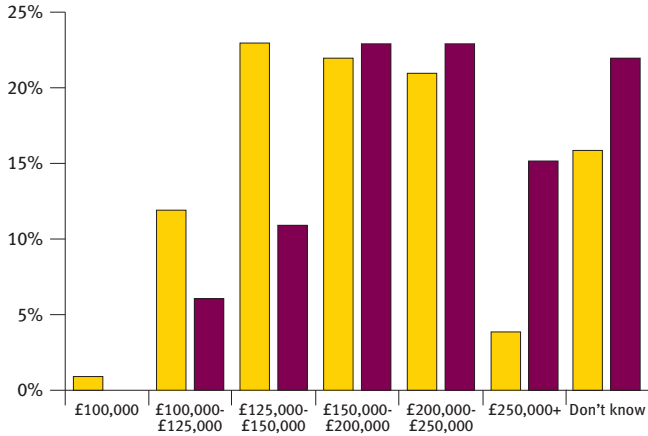
73 Financial Services Authority (2008), www.moneydeclar. On a mortgage of £100,000 over 25 years paying interest at 5% you would expect to pay back around £175,000 in total. Hargreaves Lansdown (2008), Pensions questions; How much should I be saving in a pension? A typical industry view is that the proportion of salary that individuals half their age on starting the scheme - hence 12.5% if started at age 25. For IPODs, this would give a range of 9-18% of salary.

74 Populus research 2008: reform-CII IPOD report.

75 Ibid.

76 Ibid.

Figure 11: Question on mortgage repayments, IPODs versus other adults

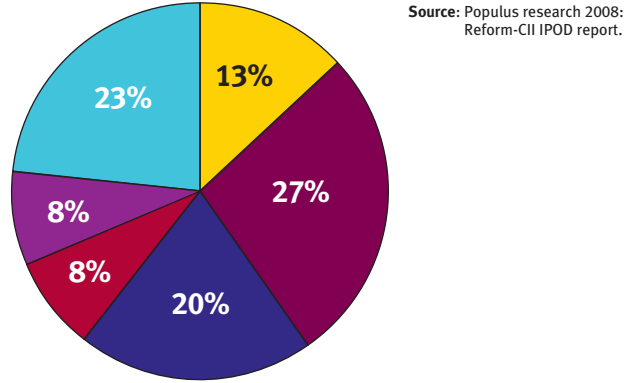


Source: Populus research 2008: Reform-CII IPOD report.

If you had a mortgage of £100,000 over 25 years paying interest at 5%, how much would you expect to pay back in total?

18-34 (Yellow) 35+ (Purple)

Figure 12: Question on pension contributions, IPODs only

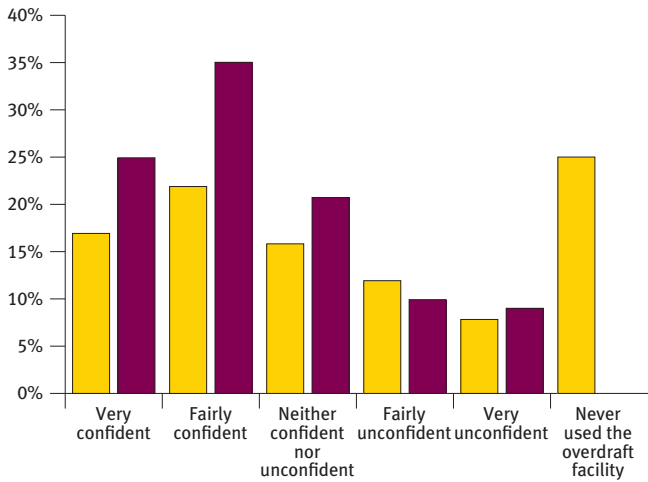


Source: Populus research 2008: Reform-CII IPOD report.

If you were to start saving for a pension from age 25, what percentage of your (pre-tax) salary should you contribute each month to live comfortably in retirement?

0% - 4% (Yellow) 5% - 9% (Purple) 10% - 14% (Blue) 15% - 19% (Red) 20% or more (Dark Purple) Don't know (Cyan)

Figure 13: IPOD knowledge of credit card/overdraft interest rate

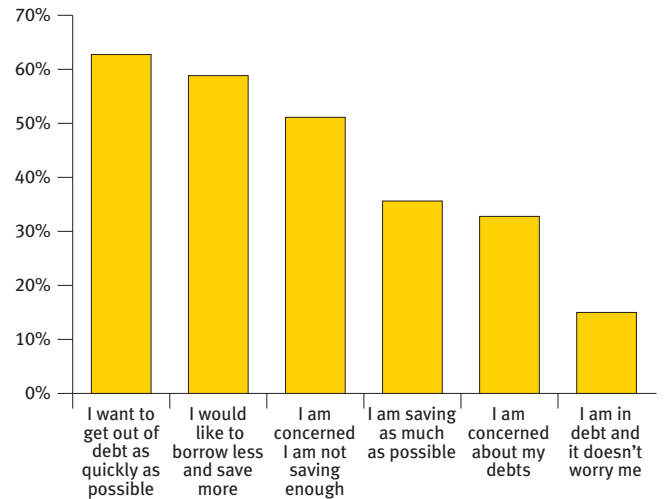


Source: Populus research 2008: Reform-CII IPOD report.

How confident are you that you know the interest rate you are paying on your overdraft and main credit card?

Overdraft (Yellow) Main credit card (Purple)

Figure 14: IPOD perceptions on debt versus savings



Source: Populus research 2008: Reform-CII IPOD report.

How do you feel about debts and savings?

CHAPTER 3:
THE FINANCIAL
ESTABLISHMENT:
SERVING
THE OLD,
PATRONISING
THE YOUNG

Chapter 3: The financial establishment: serving the old, patronising the young

Key points:

- There has been concern about the poor financial capability of Britain's young, and efforts have been made towards improvement;
- The growing regulatory burden since the 1980s has pushed up the costs of providing financial advice exponentially, and has priced the IPOD generation out of the market;
- At the same time it has tacitly removed the onus on consumers to take responsibility for their own understanding of financial matters;
- The situation has been compounded by a financial services industry geared towards older generations, using outdated models and providing complex and inflexible products not suited to IPODs' lives;
- An information void is frustrating IPODs' attempts to take control;
- The plight of IPODs is being compounded by a growing tax burden without the expectation of the rewards enjoyed by previous generations; and
- A decade of public spending increases has resulted in a rising fiscal deficit, which will also push up the tax burden on the IPOD generation.

Financial education

There has been concern in government about the poor financial capability of young people in Britain. There have been efforts towards improvement in recent years. From September 2008 "economic wellbeing and financial capability" became part of the national curriculum for 11 to 16-year-olds.⁷⁷ Given that the national curriculum is already very crowded, there is a danger of loss of quality as time per subject decreases. The value of this initiative will become clear over time.

Smaller scale initiatives have also been introduced, particularly under the umbrella of "corporate responsibility". The appetite of employees and members of financial institutions for giving something back to the community seems to be growing. There are positive examples of providing assistance to teachers teaching financial education in schools or working with local communities to provide advice and raise financial capability.⁷⁸

The provision of financial education is supported by consumers and by IPODs specifically.⁷⁹

“Teaching [financial education] at school would have really made debt hit home”

(Reform-CII IPOD Project, focus group, younger)

“It would be really useful at 12 to understand what a credit rating is”

(Reform-CII IPOD Project, focus group, younger)

Most young people feel that becoming aware of financial issues at an early age would be beneficial. But IPODs also have a sense that financial capability is something that grows with experience and learning from mistakes is important.

“Most people at uni have to learn from their mistakes”

(Reform-CII IPOD Project, focus group, younger)

This idea of corrections occurring after some initial pain is being seen in the global finance industry currently, and the knock-on effects on IPODs may push them into action.

The great divide – IPODs and the financial services industry

A large body of research in recent years has found that young adults in the UK are less financially capable than their elders. What is not so clear is whether this is an age or a cohort phenomenon. Is it largely lack of experience, meaning that as this group age they will become as capable as the generation before them, or is it that this particular cohort of young adults are less capable than previous cohorts?

Both factors play a part. IPODs at the older end of the group tend to be more aware of financial products and more confident in their understanding of them.⁸⁰ This is linked to the fact that financial products are consumed at different points over the life cycle and the stages of this cycle are getting later.⁸¹

But it also seems that there has been a significant decline in the capability of young adults in this generation compared to the previous generation, and stark changes in their patterns of financial behaviour. A vast and potentially dangerous gap has developed between IPODs and the financial services industry.

A generation priced out of the market

The 1980s saw the liberalisation of the financial services industry. State control over the domestic financial system, from lending and deposit rates, to credit allocation and movement of capital, was reduced and barriers to international competition removed. Together with policy changes by lenders, these acts changed the nature of the environment and the industry considerably. Financial institutions diversified into new activities, lenders began borrowing from other financial institutions in the

77 The Times (2007), "Children to get lessons in money - and debt", 9 July. Ed Balls, the Children, Schools and Families Secretary, said: "Money plays a crucial part in all our lives...I want teenagers to start learning early how to make the most of their money and savings once they start work".

78 The ICAEW, HSBC, RBS-Natwest and Norwich Union are examples.

79 Populus research 2008: Reform-CII IPOD report. See also, Chartered Insurance Institute (2008), Financial capability: the Public's Perspective in the Current Economic Climate <http://www.cii.co.uk/research>

80 Populus research 2008: Reform-CII IPOD report.
81 Ibid.

world's financial markets to finance their personal lending and greater price competition developed.⁸²

At the same time, it was believed that liberalisation necessitated regulation. Several pieces of legislation were passed in the 1980s laying down substantial compliance requirements on financial institutions.⁸³ These were passed with the aim of "protecting" the consumer, but they have in fact had the opposite effect. Greater regulation has worked to infantilise the population, making them less capable to deal with financial matters themselves, and it has had negative effects on consumer behaviour. IPODs have grown up in an era when consumers no longer feel the need to inform themselves about products and market information; a knowledge gap results meaning more regulation is deemed necessary to continue protecting them.

The nature of financial services advice has also changed hugely in recent decades. The financial adviser of the 1960s and 1970s was perceived as "the man from the Pru" - a trusted family adviser, his role was very much tied to the local community. His job was to know what was going on in his area and to be ready to door knock in the neighbourhood offering his advice when needed. His products were poor by today's standards, but he was seen as a trusted adviser knowing he would be ousted from the community if he behaved unethically.

Research by AEGON UK has identified a longing for the man from the Pru by people of older generations.⁸⁴ They value the concept of an old-fashioned "personal bank manager" who manages all your financial matters and with whom you have a long relationship. Pre-liberalisation borrowers also expected to have a longstanding – if not lifetime – relationship with financial institutions: one bank for banking and loans, one building society for a mortgage.

The man from the Pru and personal bank managers were able to engage with people and to offer personalised advice, rather than simply focusing on selling products, because there was a greater margin on financial products at that time. This radically changed in the 1980s as regulation grew. Standards have risen hugely as a consequence, in terms of both qualifications and process.⁸⁵ But the change to process has not been as positive. The shift to a linear "fact finding" process – where advisers must understand all the financial circumstances of a customer before being able to provide advice – has driven up exponentially the unit cost of providing financial advice.

The unintended consequence is that regulation has gradually forced financial advice out of the general market and into the domain of the wealthy minority. Financial companies have less incentive to engage with the average consumer who walks in to their office with a few hundred pounds to invest, and equally it is unlikely that such a consumer could afford their advice either.

The Association of British Insurers (ABI) has calculated that the total costs of advice in the UK savings and investment market doubled between 1990 and 2000, with the breakeven case size

for IFAs increasing from £180 Annual Premium Equivalent to over £800.⁸⁶ The ABI finds that the main cause is the opportunity cost of lost productivity due principally to greater document filling time per customer. The impact of this was that by 2000 consumers who could not afford to save more than £70 per month, or make an £8,500 lump sum investment, became unprofitable to service. This translated into "a form of social exclusion" with 11 million households in the UK being priced out of the savings and investment market.⁸⁷

In today's terms, this profitability floor has probably increased to around £10,000. This is almost half the national average salary - £24,000 – meaning that the man on the street has been truly priced out of the market.⁸⁸

The Government has recognised that this has been a problem for several years, finding in its 2003 Sandler Review of the retail savings industry that regulatory activity had had "a significant impact on cost structures, through requiring greater compliance activity, higher spending on training and competence, and a lengthening of the time spent with each customer".⁸⁹

In the FSA's more recent Retail Distribution Review, it highlighted the consequence of this in pricing less wealthy consumers out of the market:

"Many consumers who have the means to save are simply unable to afford advice relating to their financial situation. Moreover, some consumers may not be able to access advice because the costs of regulatory requirements, and the ways in which many firms apply these requirements, limit the number of firms willing to serve certain types of consumer."⁹⁰

However, it is not just a matter of banks turning away those without sufficient funds, but also a sense among customers with less money that they will be seen as a waste of time. This is particularly borne out in the Sandler Review's finding on the public's use of independent financial advice by socio-economic group (figure 15).

Hence poorer individuals are less likely to seek financial advice themselves, as well as being less likely to be targeted by banks aiming to attract new customers. A vicious circle ensues.

“It's all aimed at older people who can invest in bonds”

(Reform-CII IPOD Project, focus group, younger)

Young people tend to have less money than older generations, meaning that it is this group who have suffered particularly from these changes in being priced out of the financial services industry. This is reflected in the proportion of IPODs who would consider using an IFA: only 15 per cent of 18-21 year olds compared to 42 per cent of 30-34 year olds (figure 16); and 19 per cent of the least wealthy compared to 53 per cent of the most wealthy.

82 The Open University, Learning space.
83 V. Robb (1997), The Genesis of Regulation, Bank of England. The key legislative acts of the 1980s were: the Financial Services Act 1986 (regulated comprehensively all areas of investment business); the Building Societies Act 1986 (gave building societies a completely new legal framework for the first time since the initial comprehensive building society legislation in 1874); the Banking Act 1987 (strengthened the Bank of England's statutory powers), the

Gower Review 1984 (set out recommendations for a comprehensive regulatory regime for the securities and investment industry and a system for "recognising" self-regulating organisations).
84 AEGON UK (2007), Distribution and Financial Advice Consumer Research: Phase I, March. <http://www.aegon.co.uk/industry/shaping-our-industry/research/opinion-leader-research/index.html>

85 HM Treasury (2002), Sandler Review: Medium and Long-Term Retail Savings in the UK.

86 Ibid.
87 Oliver Wyman & Co (2001), The future regulation of UK savings and investment: Targeting the savings gap. Annual Premium Equivalent is what the price would be if paid once for a year's period.

88 Office for National Statistics (2008), Patterns of Pay, January.

89 HM Treasury (2002), Sandler Review: Medium and Long-Term Retail Savings in the UK.
90 Financial Services Authority (2007), Discussion Paper 07/1: A Review of Retail Distribution.

The IPODs' predicament highlights the dangers of over-regulation. It is a case study in the unintended consequences of a state that has overstretched itself: regulation has ended up hurting the very people it was designed to protect. While regulation may "protect" a consumer from not buying a "bad" product, it also prevents them from buying "good" products or advice.

IFAs – an outdated model

This gap between IPODs and the financial services industry is not, however, solely the result of over-regulation by government. The IFA is an old-fashioned, outdated model which simply does not appeal to today's young people. The industry must acknowledge and respond to this if it wishes to close the gap.

When seeking financial advice, IPODs instinctively turn to a family member or friend most often as a ready source of honest, trustworthy advice (figure 17).⁹¹ Over 40 per cent of IPODs would use family or friends for financial advice most often, compared to only a quarter of 35s and over who on the whole prefer to do it themselves - using aids such as websites or newspapers.

“I always talk to my mum before making any [financial] decision. It's good to have someone you really trust”

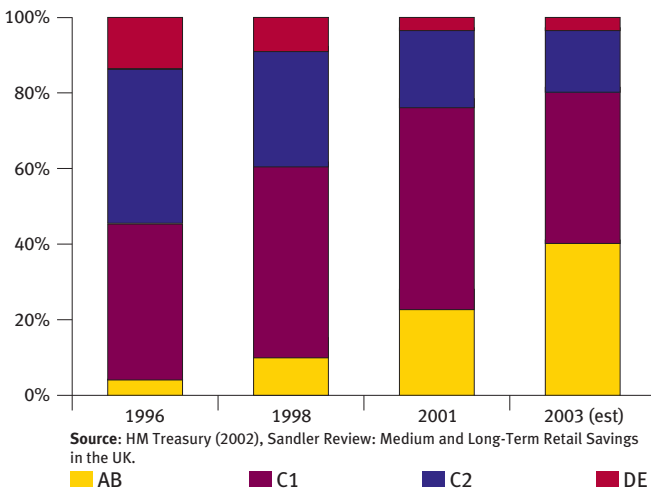
(Reform-CII IPOD Project, focus group, older)

“I go to my cousin”

(Reform-CII IPOD Project, focus group, older)

A large proportion of IPODs seem to have little awareness even of IFAs, and only a third of IPODs would consider using one

Figure 15: Socio economic breakdown of consumers purchasing through IFAs



while nearly half are unsure or have never thought about it.⁹² Those who have consulted IFAs tended to do so only for "major purchases", such as mortgages, pensions and life insurance:

“IFAs are for big decisions; you should be in charge of day-to-day stuff”

(Reform-CII IPOD Project, focus group, older)

Even in such cases where IFAs have been used, IPODs prefer to have a recommendation from a friend or relative first, and to double check the advice and recommendations they have been given afterwards.

“It was the dad of one of my parents' friends, but he was really helpful”

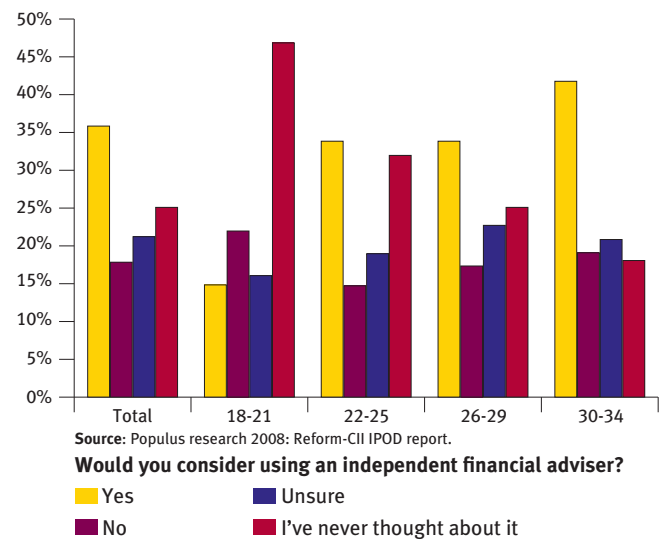
(Reform-CII IPOD Project, focus group, younger)

“I think they're trustworthy, but you'd still get a second opinion”

(Reform-CII IPOD Project, focus group, younger)

There are several reasons for IPODs' scepticism of IFAs, the first of which is a lack of trust. Reform's previous research with Ipsos MORI⁹³ found that one of the attributes that IPODs value most strongly is honesty. Whether in their interactions with corporate organisations or with government and politicians, IPODs want transparency and openness. Trust is the main driver motivating IPODs to seek financial advice from family and friends - it is not something they feel they get from the financial services world (figure 18).

Figure 16: IPOD perceptions of IFA usage, by age bracket



91 Populus research 2008: Reform-CII IPOD report.

92 Ibid.

93 Castell, Sweet, Haldenby and Parsons (2008)

IPODs are highly sceptical that IFAs can give truly independent advice.

“They’re trying to sell you something. I’m not stupid; I wouldn’t take anything they say as Gospel”

(Reform-CII IPOD Project, focus group, younger)

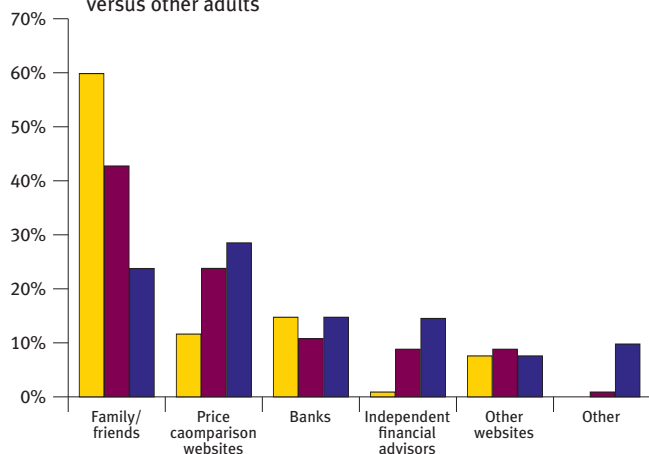
Most IPODs said that via word of mouth, people always have at least one “bad story” to tell about the industry. Only a fifth of IPODs agree with the statement that IFAs are honest and only just over a third think that they are independent.⁹⁴ This is not independent in the legal definition, but in terms of treating the individual’s needs as their sole concern, as opposed to making money. IPODs are fully aware that IFAs are out to make a financial gain, even though some do not really know how commissions might work.

“They’re not a charity; it’s to get some financial gain”

(Reform-CII IPOD Project, focus group, older)

Secondly, there is a perceived lack of professionalism of IFAs across the population as a whole. IFAs are often referred to as “salesman” and people do not have the same respect or regard for financial advisers as for other professionals such as doctors or lawyers.⁹⁵ IPODs generally have a similar view of IFAs than other adults, with less than half believing they are “professional” (figure 19).⁹⁶

Figure 17: Preferred sources of financial information and advice, IPODs versus other adults



Source: Populus research 2008: Reform-CII IPOD report.

What source do you use to get financial advice or make financial decisions most often?

18-24 25-34 35+

Irresponsible marketing for profit motive is a key factor turning IPODs off financial advisers. There is a feeling that products are often targeted at people too young to understand them, particularly in the case of overdrafts and credit cards.

“At 19 years old to give a credit card to someone who may not be mature enough to have one is stupid. It ruins them and they’re in debt for the rest of their life”

(Reform-CII IPOD Project, focus group, younger)

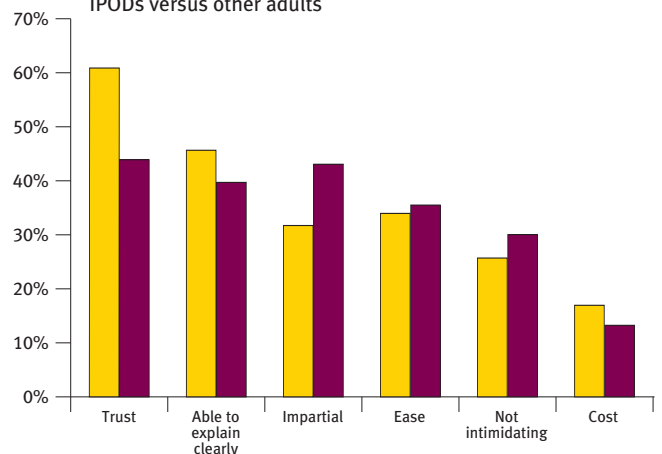
This clearly makes the need for advice and financial education all the more pressing. It also shows that it is not a “simple gap” between financial services and IPODs, rather a more complex relationship that involves greater intensity of use coupled with poor understanding.

This is backed up by frustration at the complexity of financial products and the failure of industry professionals to provide simple information to enable consumers to compare and choose products and services. While almost all IPODs agree that it is important to read the small print when purchasing financial products, most admitted that in practice they did not always do this because they felt they would not understand it so there was no point. There was some feeling that the small print was made complex on purpose to detract customers from reading it.

“It’s complicated to stop you reading it”

(Reform-CII IPOD Project, focus group, older)

Figure 18: Drivers for using preferred source for financial advice, IPODs versus other adults



Source: Populus research 2008: Reform-CII IPOD report.

Why do you use a particular source of financial advice most often?

18-24 35+

94 Populus research 2008: Reform-CII IPOD report.

95 AEGON UK (2007), Distribution and Financial Advice Consumer Research: Phase I, March. <http://www.aegon.co.uk/industry/shaping-our-industry/research/opinion-leader-research/index.html>

96 Populus research 2008: Reform-CII IPOD report.

More than just scepticism of IFAs' motives and intentions, IPODs have a distrust of the general process of making financial purchases. Young people are used to making significant purchases, for example of technology items such as televisions, computers and games consoles, and so they are used to the process of receiving advice as part of the purchase. They expect advice on which product to choose to be bundled free with a purchase like when they shop in Comet or John Lewis.⁹⁷ They are therefore averse to paying for this advice when it comes to financial purchases.

The format of advice received from IFAs is similarly somewhat alien to IPODs and a barrier to use. Many IPODs felt that when an IFA had been consulted the advice provided had been unhelpful because it had not provided a clear course of action.

“I had an IFA talk about pension funds with me but he didn't tell me what to do”

(Reform-CII IPOD Project, focus group, younger)

This resonates with Reform's findings on the debate over choice in public services.⁹⁸ While IPODs embrace the concept of choice, they want most of the work to be done for them so that they are presented with a limited range of options from which to choose and clear information to help them make the right choices. From IFAs, they want to be given a clear recommendation, not a list of several complex products to choose from.⁹⁹

Finally, there is a general feeling among IPODs that IFAs are remote from younger people, which perhaps helps explain many of the points outlined above feeding in to their scepticism. Most IPODs feel that IFAs are aimed at older people, and that there

is a link between a customer's wealth and their value. There is a belief that IFAs are disinterested in younger people who have less money to spend and invest.

“There's nothing that says 'you're 17, this is what you should do'”

(Reform-CII IPOD Project, focus group, younger)

IFAs themselves are also viewed rather stereotypically and unfavourably by IPODs.

“Old, boring, but informative”

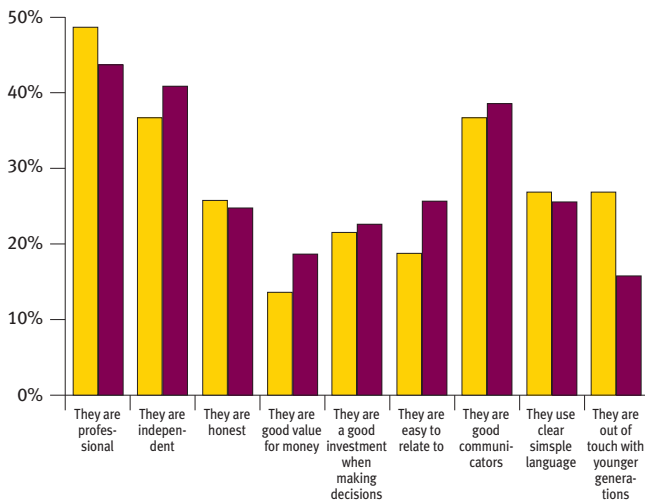
(Reform-CII IPOD Project, focus group, younger)

This adds to the sense of distance between IFAs and IPODs. Less than a fifth of IPODs agree that IFAs are easy to relate to, and a quarter think that they are out of touch with younger generations (figure 19).¹⁰⁰

Reform's previous research highlighted that entertainment is essential for this generation.¹⁰¹ In the same way that young people respond to consumer branding for products such as mobile phones or iPods, sources of financial advice must provide information in innovative and exciting ways to attract their attention.

The points outlined above highlight a growing gap between financial advisers and IPODs. This distance means that young consumers are averse to the two stage process needed in financial product purchases – first working out what is needed (e.g. that you want a mortgage or some kind of insurance), and secondly deciding how to get it and which specific product (e.g. a fixed-rate mortgage over 25 years paying £500 a month).

Figure 19: Perceptions of IFAs, IPODs versus other adults



Source: Populus research 2008: Reform-CII IPOD report.

How do you view independent financial advisers?

18-34 35+

97 AEGON UK (2007), Distribution and Financial Advice Consumer Research: Phase I, March. <http://www.aegon.co.uk/industry/shaping-our-industry/research/opinion-leader-research/index.html>

98 Castell, Sweet, Haldenby and Parsons (2008)

99 Populus research 2008: Reform-CII IPOD report; AEGON UK (2007), Distribution and Financial Advice Consumer Research: Phase I, March.

100 Populus research 2008: Reform-CII IPOD report. 101 Castell, Sweet, Haldenby and Parsons (2008)

IPODs' scepticism of IFAs means that they are unlikely to seek advice from them on the first step as they are doubtful that it will be independent. This step is therefore often simply skipped altogether, and can then lead to difficulty or inertia in trying to get advice from friends or use the internet to compare products in the second stage as they are uncertain about what product is needed in the first place.

This sceptical view of IFAs is most apparent among less wealthy IPODs. Of the poorest IPODs, 36 per cent think that IFAs are professional, and 28 per cent that they are independent. This compares with the wealthiest, of whom 56 per cent think that they are professional and 43 per cent that they are independent.¹⁰²

However, IPODs' suspicion of financial advisers and rigour in seeking recommendations and double checking advice with family or friends is positive. It signals their sense of personal responsibility and a level of awareness, and gives hope for new formats for financial advice. In particular, it points to self-regulation and other ratings style websites.

Information vacuum

A major frustration to young people is that when they try to take action with their finances they are impeded by a lack of easily available factual material. IPODs are voracious information consumers. They are used to, and capable of, consuming and absorbing vast quantities of information, in a way that previous generations are not inclined to. The average 16-25 year old in Britain now spends 19 hours per week online.¹⁰³

But when it comes to financial services and products they are not able to find the detailed information they require.

“The true cost should be easier to see”

(Reform-CII IPOD Project, focus group, younger)

“It's all out there if you look hard enough but it should be shoved in our faces”

(Reform-CII IPOD Project, focus group, younger)

A lack of clear information is the most common obstacle cited by IPODs as impeding them in making financial decisions (figure 20).¹⁰⁴ An information revolution is needed within financial services so that the necessary level of granular, detailed information is provided.

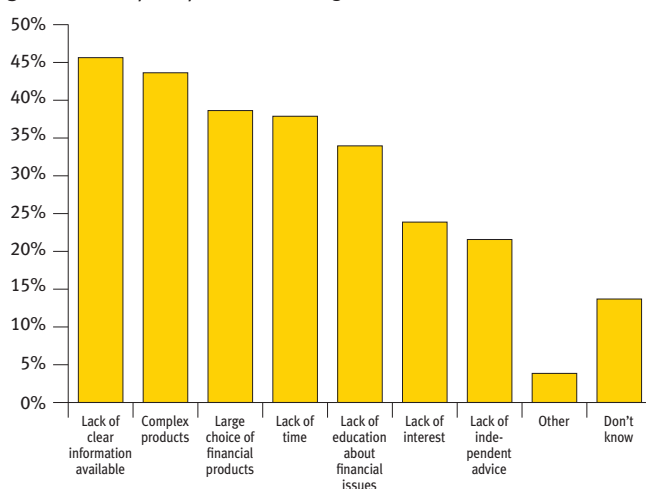
Complex and inflexible financial products

As well as a lack of easily available granular information, IPODs are being pushed out of the financial world by products that do not suit their needs. Financial products of today are overly complex, too many in number and inflexible. There are a far greater number of products available today and the concept of choice is illusory.¹⁰⁵

The FSA has linked this phenomenon to the UK's strong economic standing. It argues that consumer wealth is a driver of both demand for financial advice and the complexity of products offered. Historically, countries where large sections of the population have typically been wealthy have developed more complex financial products to meet more complex (and tax-efficient) needs.¹⁰⁶

At the same time, the greatly increased costs of regulation have stifled innovation. The lives of IPODs are highly flexible in a way that has not been seen in previous generations. They view financial products in relation to life stages rather than age, and this is impacting significantly on their behaviour as consumers.

Figure 20: IPOD perceptions on making financial decisions



Source: Populus research 2008: Reform-CII IPOD report.

What makes it difficult for you to make financial decisions?

102 Populus research 2008: Reform-CII IPOD report.

103 Face (2007), Tech Tribe Report 2007.

104 Populus research 2008: Reform-CII IPOD report.

105 For further discussion on this view, see for example, M. McAteer (2008), "Increasing longevity: blessing or a curse for financial services?" CII Thinkpiece, (June). <http://www.cii.co.uk/thinkpiece>

106 Financial Services Authority (2007), Discussion Paper 07/1: A Review of Retail Distribution. Spain is a good example of an economy that is now emerging from this position into one where large numbers of people have amassed wealth. Not only are new products entering the market to cope with more complex needs but correspondingly, albeit slowly, a demand for independent financial advice is emerging around making the best use of these.

“I got life insurance when we had kids, in case something happens, it’s good to know they’ll be sorted”

(Reform-CII IPOD Project, focus group, older)

IPODs are more willing to take on financial products to fund a variety of steps, such as gap years and sabbaticals, finding fulfilment in charity work or pursuing a lifetime goal. While the concept of the “gap year” has been around for several decades, its popularity increased greatly in the 1990s. Currently every year around 200,000 18-25 year olds in Britain take time out either as a full gap year or as shorter gap months, with the average traveller spending around £4,000 on a year abroad.¹⁰⁷ In 2007, around 29,000 young people deferred their entry to university.¹⁰⁸

As young people become more switched on to the opportunities afforded to them by a growing global labour market, jobs are no longer for life. IPODs are staying in a job for only 16 months on average, compared to three years for Generation X and five years for the baby boomers:¹⁰⁹ it is estimated that the average university graduate in the UK will change jobs 11 times.¹¹⁰ The number of temporary contracts is rising¹¹¹ and a quarter of the UK’s workforce is planning an employment break in the next year.¹¹² More than a quarter of all employees in the UK now are working under some kind of flexible working arrangement.¹¹³ These trends mean that a consistent income over a long period of time is less common.

At the same time, life stages are being pushed back. On average, people in the UK are several years older now when they marry, have children, get their first job and buy their first home (table 3). Over a quarter of recent graduates have postponed starting a family and marriage, and over half have suspended buying a house, by an average of six years.¹¹⁴ The average age of gap year students is rising – now at 23 years.¹¹⁵

Table 3: Relative average ages for life stages, 1971 versus 2006

Average age	1971	2006
Mothers at first birth	23.6	27.6
Women at first marriage	22.6	29.1
Men at first marriage	24.6	31.4
First-time buyers	31.0	33.0

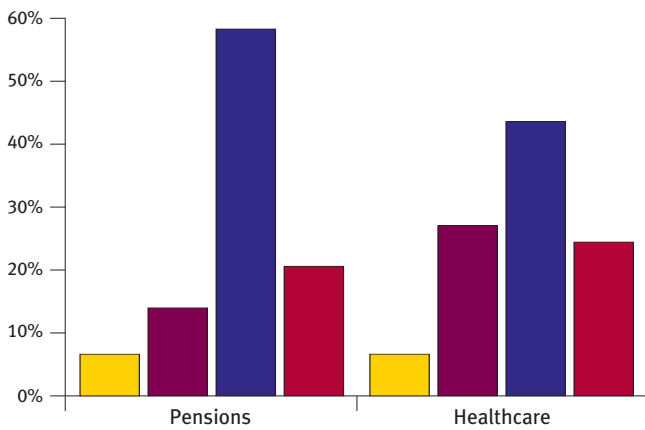
Source: Office for National Statistics (2008), Social trends 38; The Daily Telegraph (2006), “An early sighting of the coy first-time buyer...”, 4 April.

These trends explain part of the retreat of IPODs from the financial services world. Their “prolonged youth” during benign economic times has allowed them to put off behaving responsibly, but has saddled them with financial time bombs. The response from government and the industry is doing little to help, with a continued focus on age rather than life stages. Financial products need to be adapted to suit the needs of this generation of consumers. They must be as flexible as IPODs’ lives and as simple as IPODs need them to be.

Public finances in the red

While IPODs’ financial security is being jeopardised as they are becoming less and less engaged with financial services, at the

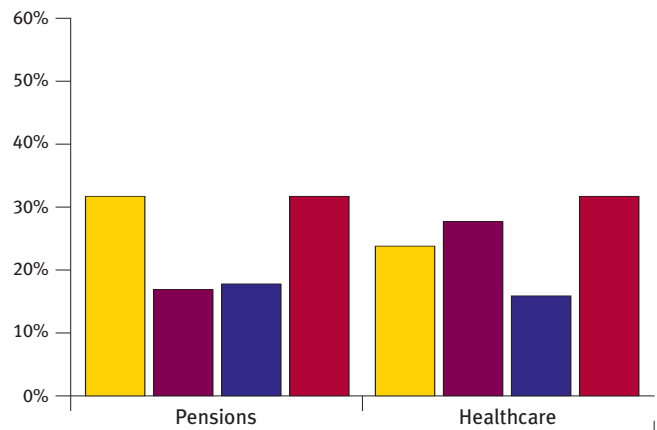
Figure 21: IPOD perceptions of own state entitlements compared to their parents



Source: Populus research 2008: Reform-CII IPOD report.

- I think I will receive a more generous entitlement
- I think I will receive about the same entitlement
- I think I will receive a less generous entitlement
- Don't know

Figure 22: IPOD perceptions of own state entitlements compared to their children



Source: Populus research 2008: Reform-CII IPOD report.

- I think I will receive a more generous entitlement
- I think I will receive about the same entitlement
- I think I will receive a less generous entitlement
- Don't know

107 Jones, A. (2004), Review of Gap Year Provision, Department for Education and Skills; Bebo (2008), “Credit crunch hits gap year travels as trips shrink by half”, 18 August.

108 UCAS (2008), Accepted applicants deferring for one year, Statistics online.
 109 Plomb, C. (2008), “This generation doesn’t believe in a job for life”, The Daily Telegraph, 11 April.
 110 WikiAnswers (2008), “How many times will the average college graduate change jobs?”.

111 Office for National Statistics (2006), Labour Force Survey, Historical Quarterly Supplement, Table 24: Part-time and temporary work by industry sector (not seasonally adjusted).
 112 Norwich Union (2007), “Bosses face £7.9 billion bill as soul-searching workers take ‘conscience career breaks’”, 3 July.

113 Office for National Statistics (2008), Social Trends 38.
 114 uSwitch (2007), “Degrees of debt consign graduates to 11 year ‘debt sentence’”, 13 August.
 115 Bebo (2008), “Credit crunch hits gap year travels as trips shrink by half”, 18 August.

same time, the Government has created an extremely perilous economic environment for them.

Spending the kids' inheritance

By 2021 there will be 48 pensioners for every 100 people of working age; this compares to 30 pensioners per 100 people in the mid-1990s.¹¹⁶ For the first time in history, there are now more pensioners in the UK than there are under 16s.¹¹⁷ An ageing population means that IPODs are supporting a growing number of pensioners through a heavier tax burden, and without being able to expect many of the rewards of previous generations.

This has not been made clear to the nation's young people, however. Taxes and spending have risen significantly to uphold the principle of "free at the point of use" education and healthcare for all, while at the same time the tax burden has shifted more heavily onto the young. Yet the Government has continued to insist that the level of free public services enjoyed by previous generations will continue for future generations.

IPODs nevertheless do seem to have grasped the reality to an extent. They do have a sense of the changing welfare bargain: they appreciate that they will receive less generous entitlements than their parents, and that their children will receive even less (figures 21 and 22).¹¹⁸ They are wrong not to be preparing for these greater burdens that they will face.

In the 2008 Budget, the abolition of the 10p starting rate of income tax came into force. The Institute for Fiscal Studies calculated that even after the compensation introduced in May, households with earnings under £11,800 will lose from the tax and benefits changes announced in the 2007 Budget and subsequently.¹¹⁹ The main losers will be single childless adults, many of whom will be young people, while older people will benefit disproportionately.¹²⁰

Table 4: Total managed expenditure, 1999/00 – 2007/08

	TME (cash terms, £ bn)	TME (real terms 2007-08 prices, £ bn)	TME, % GDP
1999-00	342.9	419.2	37.0
2000-01	364.1	439.1	37.5
2001-02	389.1	458.2	38.4
2002-03	421.0	480.8	39.3
2003-04	455.5	505.6	40.1
2004-05	492.6	532.1	41.2
2005-06	524.2	554.2	42.0
2006-07	549.8	565.9	41.5
2007-08	583.8	583.8	42.0

Source: HM Treasury (2008), Public finances databank, August.

As outlined in chapter 1, recent changes to taxes on capital – largely the failure to increase stamp duty thresholds in line with house prices - are also likely to benefit older people more while being detrimental to younger members of the population.¹²¹

The increased tax burden on the IPOD generation will have major consequences. It will restrict their ability to invest in themselves and in their futures, and will mean they are in a weak financial position to deal with economic downturns – the credit crunch will seriously affect this generation. However, on the scale of economic trends these changes are fairly young and as such the full impacts have not yet been felt. IPODs are therefore not yet making noises about the shifting tax burden and as this group are the least likely to vote, politicians are not yet making noises on their behalf.¹²²

A lost decade

The last decade has seen a significant growth in the overall tax burden on the population as a whole in order to fund a decade of increases in public spending. As highlighted in Reform's report *A lost decade*, April 1999 began a nine-year period of significant increases in public spending – an increase of five percentage points of GDP from 1999-2000 to 2007-08 (table 4).¹²³ This is the largest and longest public spending increase since 1975, and has been associated with stable growth not recession as with the previous two periods of spending growth.¹²⁴

As well as taxation, the fiscal deficit and public sector net debt have also been rising steadily since 2001-02, slightly lagging the spending increases (table 5).¹²⁵

The level of unfunded pension liabilities is growing rapidly. A 2006 study found that public unfunded pension liabilities total £720 billion.¹²⁶ Independent experts forecast that every family in Britain will have to pay £43,000 to fund the pensions that public

Table 5: Fiscal deficit, 1999/00 – 2007/08

Year	Net borrowing, % GDP
1999-00	-1.7
2000-01	-1.9
2001-02	0.0
2002-03	2.3
2003-04	2.9
2004-05	3.3
2005-06	3.0
2006-07	2.3
2007-08	2.5

Source: HM Treasury (2008), Public finances databank, August.

116 Financial Services Authority (2003), Towards a national strategy for financial capability.

117 Office for National Statistics (2008), "Ageing: More pensioners than under-16's for first time ever", 21 August.

118 Populus research 2008: Reform-CII IPOD report.

119 Institute for Fiscal Studies (2008), "18 million families set to lose if 'one-off' giveaways not extended", 21 May.

120 Ibid.

121 See N. Bosanquet et al (2007), Class of 2007: Inaction sinks the IPOD generation, Reform.

122 For recent voter turnout by group, see Castell, Sweet, Haldenby and Parsons (2008), p12.

123 N. Bosanquet (2008), A lost decade: Counting the opportunity cost of public spending 1999-2008, Reform.

124 Ibid. These were from 1979-80 to 1982-83 and 1988-89 to 1992-93 when public spending grew by 3.7 and 4.8 percentage points of GDP respectively.

125 Ibid.

126 Hammond et al (2006), Simply Red: The True State of the Public Finances, Centre for Policy Studies.

127 N. Record (2006), Sir Humphrey's Legacy: facing up to the cost of public sector pensions, Institute of Economic Affairs.

sector workers have been promised.¹²⁷

Rules made to be broken

Speculation over the Government's possible revision of the "golden rule" to allow for greater borrowing is alarming given these numbers and is in total contrast to international best practice.¹²⁸ The OECD has criticised the UK Government's golden rule for only requiring the budget to be in surplus or balance over the cycle, and not the accumulation of surpluses, therefore failing to prepare the public finances for the long-term challenges of an ageing population.¹²⁹

The OECD has warned that much tighter fiscal policy will be required in the future if the golden rule is to be respected and has pointed out that the Government's fiscal policy options have been limited by excessively loose policy in times of strong economic growth.¹³⁰ The IMF's 2006 UK Article IV Consultation similarly urged fiscal tightening from the British Government and recommended an expenditure rule.¹³¹

While the UK has seen its overall fiscal position steadily worsen in recent years other major economies have demonstrated concerted efforts at fiscal tightening. The fiscal deficit has decreased only marginally compared to international counterparts (table 6).

The burden on future generations

The burden on the taxpayer is growing. An ageing population means that the economically active will have to support increasing numbers of dependents.

The Treasury's latest annual review of long term fiscal matters is over-optimistic. It forecast that public spending would rise to 40.8 per cent of GDP by 2017-18 and to 44.5 per cent by 2057-58 (excluding dividend and interest payments). The public finances are expected to move into deficit by only 1 per cent of GDP over the period. These numbers are good by OECD standards and the Government concluded that "the UK is equipped to deal with the fiscal challenges arising from demographic change over the coming decades".¹³²

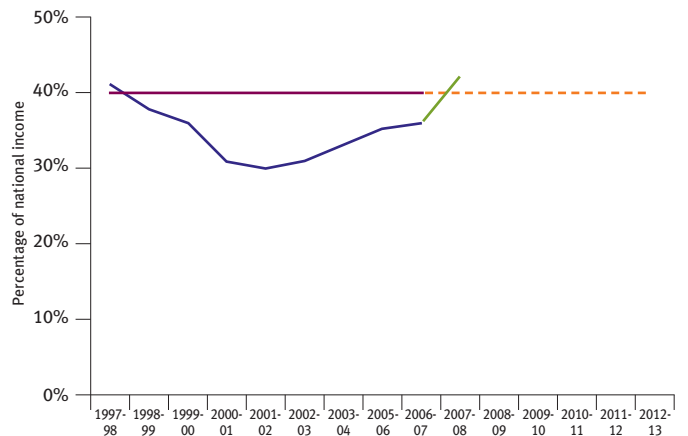
But these forecasts were already being unpicked before the impact of the credit crunch. For example, the 2008 Budget forecasts that government debt will remain just below the 40 per cent of GDP ceiling (the Sustainable Investment Rule) up to 2012-13. This projection is based on very optimistic assumptions, and indeed this ceiling has already been breached if the Northern Rock and other global banking crisis rescues are included in the figures (figure 23).¹³³ The IMF also expects this rule to be broken.¹³⁴

Table 6: Government net borrowing as percentage of GDP

	2003	2006	Percentage change
OECD average	-4.0	-1.8	-0.6
UK	3.3	2.8	-0.2
France	4.1	2.6	-0.4
Germany	4.0	1.6	-0.6
US	4.8	2.6	-0.5
Japan	7.9	2.9	-0.6

Source: OECD Factbook 2008

Figure 23: Will the Sustainable Investment Rule be met?



Source: G. Tetlow (2008): Meeting the Fiscal Rules?, The Institute for Fiscal Studies.
 — Ceiling — Including Northern Rock
 — Budget - - - - Ceiling forecast

128 The golden rule states that over the economic cycle the government will borrow only to invest and not to fund current spending.
 129 Organisation for Economic Co-operation and Development (2007), Economic Survey of the United Kingdom: Making the most of globalisation.

130 Organisation for Economic Co-operation and Development (2008), Economic Outlook June 2008.
 131 International Monetary Fund (2007), Country Report No. 07/91, United Kingdom: 2006 Article IV Consultation.

132 HM Treasury (2008), Long-Term Public Finance Report: An Analysis of Fiscal Sustainability.
 133 G. Tetlow (2008): Meeting the Fiscal Rules?, The Institute for Fiscal Studies.

134 International Monetary Fund (2008), IMF Executive Board Concludes 2008 Article IV Consultation with the United Kingdom.

CHAPTER 4:

THINGS
CAN ONLY
GET WORSE

Chapter 4: Things can only get worse

Key points:

- The credit crunch has brought the precarious state of IPODs' finances into relief: the financial time bomb has exploded;
- Government borrowing is likely to continue rising, with the burden of debt placed disproportionately on the younger generations;
- Debt fuelled by low interest rates will grow as the economic climate worsens;
- The housing bubble has burst, the impact will hit first-time buyers particularly hard; however
- There could be some positive effects, with some IPODs being able to benefit from falling house prices.

A debt explosion

Government borrowing, already at very high levels, is likely to continue rising. Public borrowing will be £65 billion higher than planned over the next three years according to the Treasury's projections on tax revenues and the Bank of England's latest growth forecasts.¹³⁵ This would mean £467 more debt to pay back per person.¹³⁶

In the national media, economists have been voicing their fears at these possible levels of borrowing. Jonathan Loynes, of Capital Economics, has said: "The state of the public finances continues to go from dreadful to even worse. If this rate of increase is sustained, borrowing will hit £70bn this year". Meanwhile, Andrew Goodwin, an economist from the Ernst & Young ITEM Club, warns: "If recent trends are sustained, borrowing would reach £64bn for the year as a whole. Moreover, with the economic outlook likely to worsen over the coming months there is a good chance that the outturn could be even worse."¹³⁷ Roger Bootle of Capital Economics has suggested the

size of the Government's annual budget deficit could hit a record £100 billion if the UK suffers a recession this year or next.¹³⁸

There have been warnings that public spending plans must be revised in light of the current economic climate – either spending will need to be drastically cut from planned levels (by 3 per cent, according to the National Institute of Social and Economic Research)¹³⁹ or taxes will need to rise further.

Belt tightening

Over 60 per cent of IPODs currently say they feel concerned about their financial future (figure 24).

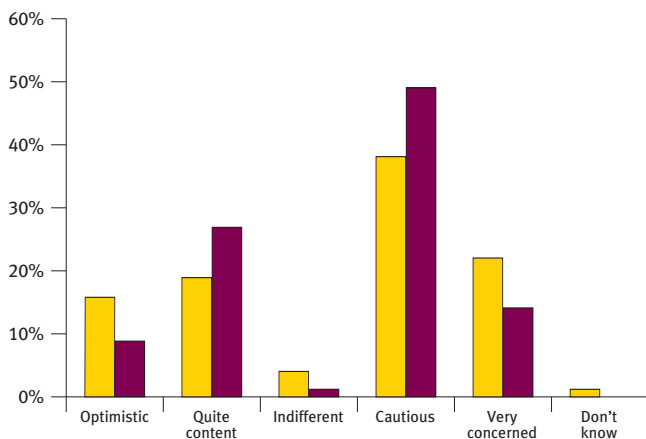
“Now I have to be less extravagant, I'd never been to a Morrison's before in my life!”

(Reform-CII IPOD Project, focus group, older)

This is not that far behind other adults of which nearly two-thirds are similarly concerned.¹⁴⁰ This may be a positive side effect of the credit crunch given that an economic downturn will likely affect the IPODs more than any other generation. Nearly half of IPODs, and particularly the older and wealthier ones, say that they have already changed the way they manage their finances in response to current economic conditions.¹⁴¹ A further third say they expect to make changes in the future (figure 25).

These views can be perceived as positive: as the credit crunch effects become starker, IPODs will have to alter their behaviour and they will have to be able to manage their money effectively.

Figure 24: Perceptions of financial future, IPODs versus other adults

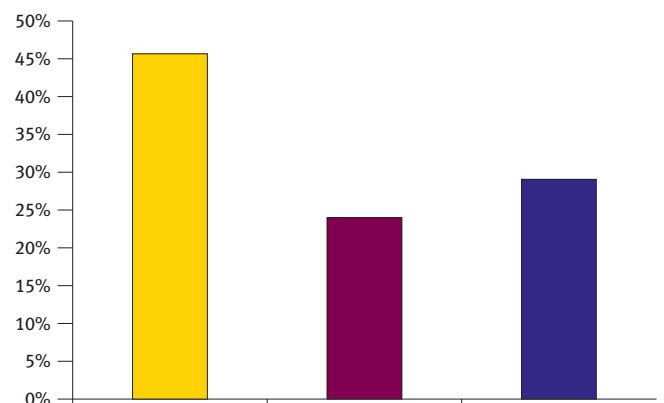


Source: Populus research 2008: Reform-CII IPOD report.

In financial terms, which of these best describes how do you feel about your future?

■ 18-34 ■ 35+

Figure 25: IPOD perceptions of economic climate changing their finances



Source: Populus research 2008: Reform-CII IPOD report.

Has the current economic climate changed the way you manage your finances?

■ Yes ■ No ■ Not yet, but I think it may in the future

¹³⁵ The Financial Times (2008), "UK public borrowing to overshoot forecast", 14 September.

¹³⁶ Ibid.

¹³⁷ The Guardian, 2008, "Public finances show worst August deficit on record", 18 September.

¹³⁸ The Daily Telegraph (2008), "Gordon Brown has 'lost his grip on the economy' as borrowing soars", 18 July.

¹³⁹ National Institute of Economic and Social Research (2008), "After the dust has settled", 16 September.

¹⁴⁰ Populus research 2008: Reform-CII IPOD report.

¹⁴¹ Ibid.

They will be forced to take more responsibility for their finances, including understanding them better.

IPODs will have less money to spend on more costly goods. Higher food and fuel prices in particular have pushed disposable incomes down to their lowest level since 1997. With a fall of 15 per cent over the last decade, the average family now has £1,210 per month to spend after covering essential bills, down from £1,425 last year.¹⁴² This will particularly hit the poorest members of society – many of whom are IPODs.

They may therefore have to adjust by curbing some of their passion for flexibility and change, for example, sticking in a job for longer than 16 months and postponing gap years or sabbaticals. This has already started happening - a recent Bebo poll has found that the “gap year” has shrunk to the “gap six months” as students are cutting back.¹⁴³

Debt fuelled by low interest rates

The current credit crunch turmoil is in part related to a structural problem with the global economy of recent years. Helped by improved technology and low wage economies like China, global inflation has been low in the past decade. Global interest rates have been kept far too low, particularly by the Federal Reserve, the Bank of England and the European Central Bank, not reflecting the real cost of capital. In 1991, UK interest rates were 12 per cent.¹⁴⁴ In October 1992, then Chancellor of the Exchequer Norman Lamont increased interest rates to 15 per cent in a bid to remain in the European Exchange Rate Mechanism (ERM).¹⁴⁵ Since then interest rates have fallen steadily, reaching a historic low of 3.5 per cent in 2003.¹⁴⁶

As a result the debt to savings ratio has become out of balance. At a time of such low interest rates, with the exception of saving for a tangible outcome such as a deposit for a house, it is irrational to save and more rational to borrow and spend. This is what the IPOD generation has done.

But the problem is that they have accumulated too much debt. And much of it is based on interest rates which are likely to increase as the credit crunch evolves. First-time buyers have bought houses on the assumption that the high interest rates of the 90s are a thing of the past. Students are paying interest on their university loans based on the Retail Price Index which has already started going up.¹⁴⁷ And there will be pressure from universities to increase the maximum tuition fee when it is reviewed in 2009.¹⁴⁸

Further, most IPODs are unaware of the effect that the current ripples in the global economy will have on what savings they have. A recent survey showed that almost 40 per cent of 18-34 year olds, while knowing what inflation was, did not understand how it affected their savings.¹⁴⁹ Nearly 40 per cent also had no idea how their savings were affected by taxation. These people will be unprepared when they discover that they can buy less with their savings as prices have been pushed up by inflation.

The burst housing bubble

Prior to the events of last summer, the UK had undergone the biggest investment boom since the “Dot com Bubble” of the late nineties. Buoyed by historically low interest rates and overly loose lending conditions, the UK’s insatiable demand for spending saw house prices rocket. Average UK house prices shot up from £61,700 in 1995 to £196,500 in the third quarter of 2007 – eight times the average salary.¹⁵⁰

Then the bubble burst. The credit crunch has brought massive distress for financial institutions. It means an end to the era of easily available cheap credit and as housing finance has dried up, prices and sales have plummeted. Average prices were down 10.9 per cent this August from last year, returning to the 2006 level.¹⁵¹ The number of houses sold in Britain in August 2008 was less than half the figure of the previous year.¹⁵²

First-time buyers – many of whom are IPODs - have been hit the hardest, unable to get a mortgage and a foot on the ladder. As discussed earlier in this report, the Government’s temporary raising of the lowest stamp duty threshold from £125,000 to £175,000 for a year from 3 September 2008 will bring some relief to this group in particular. In the second quarter of 2008 the average price paid by a first-time buyer was well under the £175,000 threshold – at £144,283 – meaning that the average first-time buyer would pay no stamp duty in the coming 12 months, saving around £1,443.¹⁵³ This should halve the number of first time buyers paying this tax.¹⁵⁴

However, the Council of Mortgage Lenders and the Royal Institution of Chartered Surveyors (RICS) believe that this move will be “something of a curate’s egg” and do little to support the housing market.¹⁵⁵ RICS estimates that only 1 in 10 transactions (representing an injection of £250 million into the market) will be affected by the stamp duty freeze which is not enough of an incentive for buyers to enter a falling market.¹⁵⁶ The last stamp duty holiday was introduced at the end of 1991 and did little to halt the fall in house prices. Indeed, the Conservative Government rescinded the measure eight months later having realised that it was the fundamentals of the problem that needed to be tackled: high interest rates.¹⁵⁷

However, a commonly held view is that it is disposable income and the labour market that are the key drivers of the housing market.¹⁵⁸ As set out above, disposable income has started falling. The number of people in employment has also dropped, down 16,000 over the quarter to July 2008 to 29.5 million (although this is up 333,000 over the year).¹⁵⁹ Redundancies were also up 28,000 over the quarter and 18,000 over the year.¹⁶⁰ However, at the same time the number of jobs has risen, up 26,000 on the quarter and up 142,000 over the year to over 30 million.¹⁶¹

142 uSwitch (2008), “Disposable income drops for first time since 1997: UK households £2,500 worse off this year than 2007”, 26 August.

143 Bebo (2008), “Credit crunch hits gap year travels as trips shrink by half”, 18 August.

144 Bank of England (2008), Changes in bank rate, minimum lending rate, minimum band 1 dealing rate, repo rate and official bank rate.

145 BBC (1992), On this day, 16 September 1992: UK crashes out of ERM.

146 Bank of England (2008), Statistical Interactive Database: Official Bank Rate history.

147 The Student Loans Company (2008), Student loans for higher education in England, financial year 2007-08 (provisional), Office for National Statistics. In financial year 2007-08 the interest rates used to adjust the outstanding balances on student loans were 2.4% (as measured by the March 2006 RPI) up to the end of August and 4.8% (as measured by the March 2007 RPI) from the beginning of September. In August 2008 the RPI was 4.8%.

148 The current maximum tuition fee is £3,000.

149 National Savings and Investments (2008), “British savers still largely unaware of real effects of inflation and tax”, 23 July.

150 Halifax (2008), House Price Index, August. Office for National Statistics (2008), Patterns of Pay, January: UK average salary £24,000. Prices rounded to nearest hundred.

151 Ibid.

152 The Guardian (2008), “UK property sales drop to lowest level since 1959”, 24 September.

153 Halifax (2008), House Price Index, August.

154 Ibid. Halifax calculations are: The proportion of first-time buyers (FTBs) who would have paid stamp duty if the threshold had been £175,000 over the past year would have been 31% rather than the 60% of FTB purchases that were above the existing threshold of £125,000. A threshold of £175,000 rather than £125,000 would have removed 80-90,000 FTBs from the stamp duty tax net over the past year.

Silver linings

The credit crunch may not be all bad news for IPODs. The housing boom accelerated price growth, freezing young people out of the market. IPODs can now be the beneficiaries of the credit crunch effects as house prices fall and affordability goes up. The fall in prices is effectively a redistribution of wealth from home owners to buyers and first-time buyers in particular will benefit from the stamp duty holiday.

Additionally, to escape the falling prices, many owners have moved into the letting market which is depressing rents. After a peak at £1,209 per month in September 2007, UK average rents have more than halved over the last year to £572 in September 2008.¹⁶² This may be good for IPODs who tend to be in the lower earnings brackets and also make up a large proportion of renters.

Of course at the same time, credit is likely to remain harder to get so mortgage deals may not be so favourable for some time to come.

IPODs can however take some comfort in the UK's position compared to its G7 counterparts in some areas (at least prior to October of this year). The liabilities that the younger generations are going to have to face in the future are generally smaller than those in competitor countries, particularly in terms of unfunded public pension liabilities and national debt (table 7).

IPODs themselves have not let the current economic turmoil dampen their unique optimism. Less than half say they are cautious or concerned about their financial futures.¹⁶³ This may rapidly change as the full impacts of the credit crunch start to unfold.

Table 7: Public debt, UK versus other G7 economies, 2007 (est.)

Country	Public debt, % GDP
UK	43.6
US	60.8
France	63.9
Canada	64.2
Germany	64.9
Italy	104
Japan	170

Source: CIA Factbook 2008, <https://www.cia.gov/library/publications/the-world-factbook/geos/xx.html>

155 Council of Mortgage Lenders (2008), CML press release, 2 September.
 156 Royal Institution of Chartered Surveyors (2008), Response to Government housing proposals September 2008.

157 R. Clark (2008), "A Stamp Duty Holiday? Not that Mistake Again", The Daily Telegraph, 6 August.
 158 See for example R. Bootle (2005), What are the principal economic drivers of house prices?, Capital economics; Halifax (2008), House Price Index, August.

159 Office for national Statistics (2008), Labour market, Employment, "Employment rate falls to 74.7%", 17 September.
 160 Ibid. The redundancy level to July 2008 was 138,000.

161 Ibid.
 162 See The Guardian (2008), "Tenants sitting pretty as rents fall", 15 August.
 163 Populus research 2008: Reform-CII IPOD report.

CHAPTER 5: VICTIMS AND SAVIOURS

Chapter 5: Victims and saviours

The credit crunch is a turning point for IPODs, for financial services and for the economy and society more widely.

The pivotal role is played by IPODs themselves. In one scenario they are a generation of victims, withdrawn and pessimistic. They are (partly at their own instigation) left out of the effort to rebuild trust and confidence after the credit crunch. Their talents are wasted, and both economy and society suffer.

In the other, the credit crunch is the wake-up call that IPODs need. They are able to match their wish to be responsible for their financial affairs with the capability to do so. They drive much-needed innovation in financial services. Their talents are harnessed to find the way out of the credit crunch crisis. They are a generation of saviours.

Two scenarios: summary of trends		
Financial services	Victims	Saviours
Distrust of financial services	↑	↓
Regulation	↑	↓
Costs of advice	↑	↓
Innovation	↓	↑
IPODs		
Willingness to engage with industry	↓	↑
Investment in training	↓	↑
Investment in savings	↓	↑
Economy		
Investment	↓	↑
Growth	↓	↑
Length of downturn	↑	↓

Scenario A: A generation of victims

*“The joy of seeing expensive suits sobbing into their beers in Canary Wharf”*¹⁶⁴

In this scenario, financial services turn from trusted friend to public enemy. Society’s reaction to the credit crunch will be based partly on schadenfreude. More importantly, people will display a much greater nervousness about engaging with institutions and their products.

The recent interventions by governments in the financial markets will be just the beginning. The prevailing idea will be that institutions cannot be trusted to provide for their customers’ futures. Governments will be urged to play a much greater role by taking on the costs of risk.¹⁶⁵ They will need to impose much

greater regulation on financial markets in order to prevent events like the credit crunch happening again.¹⁶⁶

The result is that the divide between IPODs and industry will widen even further. IPODs will withdraw out of mistrust; industry won’t reach out because the cost of offering advice will rise even higher (under heavier regulation). Industry will also find it harder to innovate given the increased cost of regulation.

The taxpayer burden grows

This scenario will put greater pressure on the taxpayer. This is partly due to the direct cost of bailing out institutions. But the long term costs are more important. If the IPOD generation fails to save for retirement, the taxpayer will have to make up the difference.

The downturn lengthens

This scenario will see investment by individuals fall. The result will be slower growth. A different economic and business climate will reduce confidence; people are less likely to take risks and be entrepreneurial if their finances are in a fragile state. Business start ups, patents and general entrepreneurial activity have all declined over the last decade.¹⁶⁷

A heavily leveraged society will also contribute to economic volatility. Individuals who are already in debt will have to cut back on consumption more violently when the bad times hit. Financially literate individuals are more likely to save in the good times so that they can smooth consumption over the economic cycle.

A generation of victims

This bleak scenario sees the waste of the talents of a generation. The IPOD generation considers the recovery from the credit crunch as someone else’s problem. They opt out of decisions about their financial future. They avoid financial products that would help them invest in themselves and their futures. They prevent a debate about a new and sustainable welfare bargain between government and individual.

There are major social and economic penalties. The UK’s young people are a generation commonly dependent on their parents and the State. They are more inward-looking and less mature. Global opportunities are seized by more go-getting generations elsewhere. Taxes rise and investment and growth falls. Without IPODs’ youth and energy, the post-credit crunch reconstruction is more prolonged and painful.

Scenario B: A generation of saviours

In this scenario the credit crunch energises a generation to take control of its financial affairs. Financial capability is no longer the last taboo; it becomes an integral part of individuals’ daily lives and a new part of our national debate.

164 A. Miles (2008), “A cautionary tale of guzzlers and squirrellers”, The Times, 17 September. “Millions of people up and down the country are feeling a sort of horrified delight at the fate of the city bankers: look at all the comments pouring into the news websites if you don’t believe me.”

165 L. Zingales (2008), “Why Paulson is wrong”, <http://faculty.chicagosb.edu>. “The decisions that will be made this weekend matter not just to the prospects of the U.S. economy in the year to come; they will shape the type of capitalism we will live in for the next fifty years. Do we want to live in a system where profits are private, but losses are socialized? Where taxpayer money is used to prop up failed firms? Or do we want to live in a system where people are held responsible for their decisions, where imprudent behaviour

is penalized and prudent behaviour rewarded? For somebody like me who believes strongly in the free market system, the most serious risk of the current situation is that the interest of few financiers will undermine the fundamental workings of the capitalist system. The time has come to save capitalism from the capitalists.”

166 A. Darling (2008), speech to the Labour Party conference, 22 September. “We need to look as well at the culture of huge bonuses which have distorted the way decisions are made. It’s

essential that bonuses don’t result in people being encouraged to take on more and more risk without understanding the damage that might be done, not just to their bank, but to the rest of us in the wider economy.”

167 N. Bosanquet et al (2008), A lost decade: Counting the opportunity cost of public spending 1999-2008, Table 11.

The IPOD generation use financial services creatively to manage the increased complexity of their lives. They enjoy engaging with a more innovative and approachable financial sector. A relationship of distance turns into a fruitful partnership.

Government reacts to the credit crunch by doing all it can to increase innovation in financial services. It adjusts regulation in order to reduce the cost of financial advice, and steps up its current policy of improved public financial capability in cooperation with the industry, through a combination of projects in the education system, the workforce and a national, impartial Money Guidance service. Consumers also co-operate via the internet to rate the performance of financial advisers and institutions, and so reduce the need for external regulation. Collaboration and information take regulation's place.

This scenario sees a quicker recovery from the credit crunch. It also sees major long term economic benefits. There is a simple benefit in terms of higher investment. More importantly, the ability of individuals to invest in themselves supports higher economic growth.

A new partnership

In this scenario government will look to do all it again to rebuild trust between individuals and financial services. It will give the sector the space to develop new products to meet IPODs' more mobile, flexible lives - for example, more short-term savings options for tangible things such as a house or sabbatical. Already, a fundamental re-examination of financial products and their distribution systems is under way through the FSA Retail Distribution Review, into which the CII and other professional bodies are advancing the concept of professionalism to introduce a step-change in the quality and availability of financial advice.¹⁶⁸

IPODs will use financial services to make more sense of their increasingly complex lives. They will form relationships with companies that last through what will be longer working lives. Last year saw the largest annual increase in employment, with half of this increase being attributable to workers over the age of 50.¹⁶⁹ Nearly 8 million people over 50 are now continuing employment.¹⁷⁰

That will mean a new openness and creativity on the part of the industry. What is clear is that the industry can no longer provide opaque financial products. Their technical experts need to adapt to relate products to modern day consumers. Many products are based on structures of the past, such as pensions which are extremely inflexible and do not reflect the flexible lifestyles of IPODs. Individual firms are already undertaking groundbreaking research examining how distribution models could be better suited to the needs of customers including IPODs.¹⁷¹ The onus lies on the industry as a whole to turn their research recommendations into widespread practice.

Co-operation and collaboration

IPODs are not, and should not be, bystanders in their economic lives. In this scenario, the credit crunch will be a positive force. It will shock the IPOD generation from its complacency into a new and more mature understanding of risk and responsibility. It will encourage them to understand the demands of their financial circumstances and act to manage them better.

IPODs' attitudes towards personal investment in capability will also be realigned. The notion that they can rely on a brother-in-law or an employer to give them all the financial advice they need must be dispelled. They must build their own abilities to navigate the financial services world as a matter of priority, and the Government and industry must help them to do this through the multi-faceted and stepped up national financial capability strategy as described above.

The prize of greater financial capability is a valuable one. A study by Australia's Commonwealth Bank Foundation of the economic and social impacts of financial literacy in Australia found that increasing financial literacy by a modest amount amongst the 10 per cent of least financially literate Australians over ten years would contribute A\$6 billion (£2.6 billion) per year to the country's GDP and create over 16,000 new jobs.¹⁷² For the individual, this would mean an average annual increase in personal income of \$3,200 (£1,400). These benefits would arise out of better decision-making in the workforce, in capital investment and in savings. Other potential indirect benefits highlighted included reduction in welfare costs and bolstering of national savings.

Self-regulation will be a central part of this scenario. Social networking - used by 60 per cent of IPODs compared to 18 per cent of 35s and over¹⁷³ - will be the model on which new confidence in financial services is secured. As in the eBay model, approval ratings for financial advisers will harness the experience of thousands of users and identify strong performers without the need of costly regulation.

The rise of eBay, Wikipedia and the other children of the Web 2.0 revolution should have a significant impact on regulation of financial services. Some have predicted that the rise of online peer review mechanisms and the wealth of information that the internet makes accessible would consign consumer regulation to the dustbin of history: empowering the consumer to such an extent that he could protect himself.

This is a view that has been criticised recently, but Web 2.0 innovations still hold potential lessons for regulation. The peer review mechanism remains central to the self regulation of these websites. The online pharmaceutical industry in the US provides another interesting example of what the market can do when the state steps back from regulation: third parties have taken on the role of regulators and have developed widely recognised internet "seals of approval". And studies have found that this model is more flexible and responds faster to industry innovation.¹⁷⁴

¹⁶⁸ Chartered Insurance Institute (2007), A professional body for retail financial services, Retail Distribution Review Position Paper 1, November. See also Chartered Insurance Institute, Chartered Institute for Bankers in Scotland, Institute of Financial Planning, Securities and Investment Institute (2008) Edinburgh Declaration: A Joint Statement of Principles for Professionalism in Financial Services, April.

¹⁶⁹ Insurance Day (2008), Changing generations special report, 12 May.

¹⁷⁰ Ibid.

¹⁷¹ AEGON UK (2008), Distribution and Financial Advice Consumer Research: Phase III, Aug; see also N. Hurman (2008), "The future of financial services distribution: listening to consumers" CII Thinkpiece 6 (August).

¹⁷² Commonwealth Bank Foundation (2004), Improving financial literacy in Australia: benefits for the individual and the nation - A Commonwealth Bank Foundation study of the economic and social impacts of financial literacy in Australia.

¹⁷³ Populus research 2008: Reform-CII IPOD report.

¹⁷⁴ J. Polonetsky (2006), I Am My Brother's Keeper: A Distributed Model Of Consumer Protection And Self-Protection.

Price comparison websites for insurance will be an important factor in shifting the IPOD generation away from traditional IFAs, all while they remain significant consumers of financial products. In this scenario the weaknesses in the early development of the sites are addressed and rectified.

The rapid growth of price comparison sites highlights the cultural shift that has occurred: IPODs are increasingly using the internet for financial transactions and expect not to pay for the role traditionally performed by IFAs. The internet will be a major tool in closing the gap between IPODs and the financial services industry, but provided it is not burdened by regulation in the way the current industry is. There are positive signs that this can be avoided by harnessing the tools of Web 2.0 and improving consumers' capacity to wield them, through financial education.

A generation of saviours

In this scenario the IPOD generation solves the problems that their elders have bequeathed to them. It is their dynamism and ideas that drive the credit crunch recovery and – along the way – redraws the financial services map. It inaugurates a period of investment and growth.

This generation is independent and optimistic. It contributes to UK society – to its parents and to the government – rather than acting as a drain upon it. It displays global leadership. Their increase in capability means a new welfare bargain can be drawn between the government and individual, easing the burden on the taxpayer.

CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

Chapter 6: Conclusions and recommendations

In his recent book *The Subprime Solution*, Robert Shiller, Professor of Economics at Yale University, argued that financial capability is the key to the recovery of the credit crunch:

“The key to the subprime solution, to preventing the future crises like the current one, as well as mitigating its after-effects, is democratising finance – extending the application of sound financial principles to a larger and larger segment of society, and using all the modern technology at our disposal to achieve that goal.”¹⁷⁵

This report's analysis agrees with this positive scenario. The core idea is that more capable young people will work successfully with a more innovative financial services industry. The benefits of this new partnership will be profound – in the short term, a faster recovery from the credit crunch; in the medium term, a rise in growth and investment.

The reverse scenario would be – in Shiller's terms – that financial capability becomes concentrated in an ever more narrow section of society. This would prolong the credit crunch downturn and restrict growth. It would also mean a new social divide between capability “haves” and “have-nots”. This divide would follow existing social divisions of age and wealth, and so contribute to the poor social mobility which is now a key concern of UK politics.

Access to advice

Shiller goes on to argue that government can support positive change by subsidising financial advice for all:

“The government needs to reverse this bias [against low income groups] and effectively subsidise fee-only, comprehensive financial advice for everyone. One way to do this would be to set up a co-pay arrangement ... under which the practitioner can apply for partial reimbursement of fees.”¹⁷⁶

The idea of greater access – and reduced costs of advice for consumers – is surely right. The question mark over Shiller's solution in the UK lies in the cost to the taxpayer. On past estimates, IFAs provide over 6.5 million interviews per year.¹⁷⁷ The cost of reimbursement to the taxpayer will necessarily run into the hundreds of millions of pounds, at a time when the public finances are already worsening by the day.

As a result, the power of the internet – in particular social networking – appears to offer the greatest hope in the medium term. What is needed is to rate the effectiveness of advice and products with minimum regulation. Self-recommendation via internet websites can do this. The credit crunch is the first bank crash of the digital age. Its solution may well be found online.

A new partnership

The key challenge is to build a new partnership between the IPOD generation and the financial services industry. The industry can design a range of new products which are directly targeted to the concerns and time horizons of younger customers. Shorter term products could then be used to encourage a smaller amount of savings for the very long term. What Keynes called the “magic” of compound interest then comes in to play.

The industry seems most comfortable when it is related to a vanishing generation of people who are interested in lifetime saving backed with job for life security. The industry is still mentally domiciled in the suburbs of the 1950s. There must be a new start in which the industry designs products for this new generation whose prospects and attitudes are much different. Financial services need to connect with a generation which must work it out for themselves.

Recommendations

The way forward lies in an advance on the demand side – through greater capability on the part of young people. Industry must respond, and government can help it to do so. In an ideal scenario:

IPODs

- See financial capability as a core life skill;
- Rate financial advisers and products via social networking, in order to ease the costs of regulation;
- Understand the need to invest in themselves throughout life; and
- Demand innovative solutions from the financial services industry

Industry

- Considers and implements measures to reduce the costs of advice;
- Considers and introduces improved delivery channels and options for a changed world;
- Develops more flexible products;
- Improves quality and professionalism of financial advisers;
- Ensures better availability of easy to understand information;
- Introduces a range of measures and systems including pricing, remuneration and general principles of business to improve public trust in advisers;
- Actively supports and promotes the government's efforts to enhance financial capability; and
- Enhances training provision of staff.

¹⁷⁵ R. Shiller (2008), *The Subprime Solution – how today's financial crisis happened and what to do about it*.

¹⁷⁶ *Ibid.*
¹⁷⁷ *The Independent* (2006), “Advisers in the window, but we just walk on by”, 11 June.

Government

- Allows increased innovation in financial services industry;
- Adjusts regulation to reduce cost of advice;
- Enhances public financial capability within the education system, through the workforce, and through a national money guidance provision;
- Supports and promotes professionalism in the financial advice industry.

A more capable society would be a stronger society.

The recommendations outlined above offer a faster economic recovery from current difficulties. They use new technology to bridge the gap between IPODs and industry. They see a new level of financial capability support a new era of innovation and prosperity.

Personal notes:

