Financially Vulnerable Consumers
Identifying and researching vulnerable customers (Part 1)
There is growing debate within the financial services industry about vulnerable customers, and the financially vulnerable generally: how best to identify and meet their needs, and how to protect them from buying the wrong products or otherwise being exploited. But who exactly are the financially vulnerable, and makes a customer vulnerable?

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Introduction

There is growing debate within the financial services industry about vulnerable customers, and the financially vulnerable generally: how best to identify and meet their needs, and how to protect them from buying the wrong products or otherwise being exploited. But who exactly are the financially vulnerable, and makes a customer vulnerable?

Taken together, the terms ‘vulnerable customers’ and ‘financially vulnerable’ commonly seem to refer to those with educational or mental health issues, which could act as an impairment to making the right judgements when selecting or using financial services products, or to describe people with large debts or on-going costs to service and limited income with which to do so, as well as lack of savings to fall back on.

However, the issue of how best to define these types of consumers is blurred by the fact that most people do not generally apply themselves adequately to the purchase of financial services products, especially the longer term ones. Understanding is often poor, and (often incorrect) assumptions are frequently made and seldom checked. This creates circumstances in which it is easy for a wide range of consumers to make ill-informed and ill-judged financial product decisions.

The issue of poor financial decision making on an increasingly wide scale will become more pronounced as more people who could be described as disadvantaged in terms of knowledge and understanding of financial products accumulate them: auto enrolment of employees into their employer’s workplace scheme will mean that more people across the whole social spectrum will own a pension, and over their working life are likely to accumulate several such pensions. Understanding how best to manage them through judicious combination will require a degree of understanding of the
subject that most simply will not have. Providers will be faced with increasing numbers of people holding products of which they have little or no understanding.

All of this is against a background in which one of the FCA’s key strategic objectives is to address forward looking risks in the conduct of financial services. Among the risks mentioned are products that are not in consumers’ long term interests, and the issue of poor consumer understanding of risk and return leading consumers to take on more risk than is appropriate.

While these risks apply to all consumers, they are heightened among those who are more vulnerable to being misled (deliberately or otherwise) or exploited.

In this context of generally low financial knowledge and capability, it is worth looking more closely at what makes people specifically ‘financially vulnerable’ and what the implications are for providers attempting to manage their relationships with their vulnerable customers. In doing so we have divided potentially vulnerable consumers into a number of broad groups – and it will be clear that in our view vulnerability in financial services extends a lot more widely than the loose definition cited above.

Inevitably there is some overlap between these groups, and it is possible for people to move between them, but they do form a useful basis for considering both who might fall into a vulnerable category and what providers and researchers might want to bear in mind when dealing with them.
Educational issues

The most obvious educational issues that have a bearing on financial services are numeracy and (especially) literacy. In addition we would include dyscalculia and dyslexia: although these are not the result of lack of education, (education can nonetheless help, e.g. through the teaching of coping strategies), they present providers and researchers with similar issues.

Numeracy

The Department for Business, Innovation & Skills published the Skills for Life survey in December 2012. This revealed that 22% of adults (aged 16-65 for whom English is their first language) have numeracy skills of a seven to nine year old, or below. Those with numeracy problems are likely to have difficulty in understanding important information regarding product costs and in particular their cumulative effect, and may struggle with basic tasks such as budgeting and managing income and outgoings – and this issue may be compounded when credit is introduced. Understanding payslip information, price labels and offers in shops (e.g. 20% off vs buy two get one free) or working out the best deal that is affordable become extremely challenging tasks. Equally with savings and investment products they are likely to struggle with compound growth. When factors such as charging and inflation, and their effect on growth, are combined with compounded growth figures, those with numeracy issues are likely to encounter real problems: the fact that people who have no problems with basic numeracy also struggle with this sort of arithmetic is a clear indicator of this.

Literacy

Poor literacy and illiteracy present even greater challenges. There is a basic assumption throughout
the financial services industry that customers can read and write, yet we have encountered research respondents who can do neither. The considerable efforts which (some) providers go to to express their product literature and marketing communication in plain English are wasted on people who have problems with even basic language comprehension. These consumers are at a disadvantage when faced with any sort of written product description or information request: any form which they need to fill in on paper or on screen could be beyond them.

To put this in context, according to the National Literacy Trust around 17% of the UK's population (one in six) in 2010 had a literacy level at or below that expected of an 11-year-old, and there are concerns among educationalists that this situation is declining further. The issue here is that whilst they can understand straightforward texts on familiar subjects, reading unfamiliar or complex information (such as that used to describe financial products) can cause problems.

While the media rail about immigration and its impact on employment and wider society, it also has implications for financial services. For most immigrants English is likely to be a second language, and their grasp of it may be quite poor, especially in the early part of their residency in the UK. Again the implications for comprehension of financial services marketing, product literature and form filling are that immigrants with little English are likely to face a real struggle.
**Computer skills**

As financial services make greater use of IT and allow/ encourage their customers to do the same, the question of IT literacy also becomes an issue. While many people are wary of using computers to manage their finances for security reasons, there is also still a lack of knowledge and confidence among some consumer groups in using computers at all. This issue goes beyond the bounds of IT affordability, as people’s attitudes to computers cross wealth boundaries. Age is a better indicator of attitudes towards domestic IT, but even here it is easy to find exceptions. We have interviewed elderly people who are quite comfortable using computers and younger people who want nothing to do with them. According to the ONS, 17% of UK homes currently have no internet access, and this figure is likely to continue to fall. As it does so, online access to financial services products is likely to become more widespread and more of the norm, increasing the risk of marginalising those who do not follow this practice.

The Department for Business Innovation and Skills 2011 Skills for Life Survey shows that over half of the population have word processing skills at, or below that expected of an 11-year-old (entry level three). This equates to over 20m people who may struggle to use technology effectively.

Lack of IT literacy need not present a major problem to users of financial services as long as the providers are able and willing to maintain other channels of purchase and communication. However, those avoiding using computers for financial services are arguably disadvantaged when more competitive deals on the same products are available online and through other channels. Barclays has recently conducted a study that reveals that more than 5.1m people over 65 have never been online, and that they could save themselves up to £742 per year on household bills by...
embracing the internet and taking advantage of online deals and discounts. This is widely apparent in other areas of retailing (and there is already some debate about the fairness of discounted energy supplies for those managing things online), it is already common in general insurance, and it could spread more widely to other areas of financial services. The risk here is that people will seek to benefit from the advantages of an online approach without fully understanding how to do so (and get it wrong), or will become, or feel, excluded by their inability to use or access IT. In both cases they risk being disadvantaged by falling behind the prevailing trend in financial services distribution and maintenance.

Whilst individuals can display different skill levels across literacy, numeracy and computer skills, feeling more comfortable with one than the others, there is a high degree of correlation between them – those that struggle with literacy are more likely to also struggle with numeracy and so on.

However, research has shown that people tended to be aware of their weaknesses and strengths in these areas, with relatively few making over-claims about their abilities. On the contrary, if anything evidence suggests that people tend to underestimate their own performance in these areas – suggesting that they are very aware of their lack of skills and knowledge. We have often interviewed individuals who are very open about their inability to spell or punctuate etc.
Physical and mental impairment

Physical impairment need not be a barrier to understanding financial services communication, but it can still represent a problem for form filling either on paper or on screen. Equally it can make it difficult to use bank branch facilities, including ATMs, to visit financial advisers or to use debit or credit cards. Despite recent improvements in disability legislation and accessibility, this is still particularly true for people who have difficulty walking, writing or using a keyboard, as well as those with impaired sight. People with impaired sight also face greater challenges in attempting to educate themselves about financial products.

Mental impairment is in some ways more complex. There are a range of mental illnesses as diverse as schizophrenia (comparatively rare) and depression (not uncommon), which can affect people's ability to make sound financial judgements, even with relatively simple products. The concern here is that their poor judgement could be exploited, e.g. with regard to debt. For example, we have interviewed people with mental illness who need to be constantly on guard against irrational impulsiveness and the consequent risk of uncontrolled spending, e.g. on their credit card.
Ill health and bereavement

People diagnosed with serious illnesses or who have recently been bereaved are likely to be emotionally vulnerable, and their judgement may be impaired. They may struggle even more than most people to apply themselves to financial services issues, as their focus is likely to be elsewhere. In this context they are at risk of poor financial decision-making and vulnerable to ill-informed or exploitative advice. For those diagnosed with serious illnesses, their spouses are likely to be facing similar emotional turmoil and may be even less able to apply themselves to financial issues, as their focus, both mental and emotional, is likely to be on the health of their partner. It is important at such times to claim for any income protection or critical illness benefits available to help families manage during the crisis, but times of turmoil are exactly when things are missed or forgotten and mistakes are made.

The risk of being financially disadvantaged is heightened in these circumstances: people are forced to make financial decisions on their own behalf, or on that of the person who is ill, or dealing with probate/ sorting out an estate. These decisions can often be quite time pressured, and for many they will involve products, processes and even concepts which are quite unfamiliar.
Old age

As new products and new ways of buying and managing them come on stream, it is easy for the elderly to feel left behind. This is particularly true where an elderly person is having to make financial product decisions for the first time: e.g. where a recently deceased spouse used to manage all the household finances, and the widow or widower suddenly has to come to grips with products (and possibly a multiplicity of products at the same time) which are completely unfamiliar to them. As an illustration of this, we have interviewed widows who had never written a cheque before their husband died.

In such circumstances they are likely to place greater reliance on advice, either professional or from friends and family, and thus are vulnerable to poor advice, whether it is well intentioned or not.
Poverty

Poverty begets financial vulnerability, and this can lead to a vicious circle. Those with low income and/or total reliance on benefits are likely to find it difficult to make ends meet, especially if they have young families to support. Equally, less well-off consumers are probably more vulnerable if they are presented with a series of complex and unfamiliar decisions that require evaluation of a number of options, as making wrong financial decisions can have worse consequences than for the better off (they have less or no money to lose).

This is not simply a phenomenon of rising unemployment (currently 7.8%): according to DWP statistics almost 1,000,000 people were driven into poverty in 2012, and children living below the poverty line are now twice as likely to come from working families struggling on low incomes and falling wages as those whose parents are unemployed.

The risk to these people is that they incur ever higher debts in their efforts to make ends meet. Unable to obtain credit from mainstream providers, they are particularly vulnerable to payday loans and other forms of high-cost credit which they are ill suited to manage or repay.
Behavioural economics and the financially vulnerable

Behavioural economics theory seeks to explain why individuals make decisions which are flawed and not necessarily in their own best interests. A range of behavioural biases that apply to all consumers have been widely identified but the relative strength and impact varies across groups. Behavioural economics is a relatively new discipline, and to date not much research has been done looking at the effect on specific consumer groups. However, some initial evidence, as well as common sense, suggests that vulnerable consumers may be more prone to, and are therefore more likely to be disadvantaged by, some specific biases.

This heightened inclination towards particular biases may be amplified by the consumers’ situation – for example, lower socio economic groups may be more financially disenfranchised than other groups (less access to financial advice and/ or marketing information) and less competent to make decisions, and so more likely to rely on flawed assumptions and ‘rules of thumb’. Other evidence suggests that consumers who are prone to one bias are more prone to others – and so vulnerable consumers are more likely to have several issues impacting on them at the same time. Equally, cognitive competency, numeracy and literacy levels are also correlated with the presence of biases.

Whilst not an exhaustive list, we have identified a number of biases which are more likely to be prevalent amongst, and have a greater impact on, the vulnerable consumer.

The first of these is **Context bias**. People are strongly influenced by how a proposition is presented, whether it is positively or negatively framed and how many/ what other options are within the choice set. For example, an investment opportunity with an ‘80% chance of losing’ or a ‘20% chance of gaining’ may seem like two very different products to a consumer, although the probabilities of growth or decline are the same. Whilst providers obviously want to sell their products, the way in which they are marketed needs to ensure that consumers are not unduly
influenced by hyperbole. This applies particularly to the financially vulnerable, who may be less well placed to judge a product’s ‘true’ merits or feel they have a more limited set of options than the broader consumer market.

**Default bias** occurs where the effort is too much or the task too complex to complete. This means that individuals lack the cognitive capacity to absorb all the information available and make an informed decision. Rather they use a number of (often flawed) heuristics or short cuts, or simply ‘go with the flow’ and accept the suggestions made to them (either by an adviser or by the provider). This has very real implications for financial services providers in terms of what defaults are used and whether these have a positive or negative effect on consumer outcomes (consumer outcomes being another key focus of the FCA’s mandate). The tendency towards defaults also means that market activity may be lessened – people are less likely to adopt, or switch between, providers/ products as their circumstances or the markets change.

We have already seen the introduction of opt-out pension schemes which will vastly increase the number of people saving into a pension. In the past, the financial services industry has been accused of profiting (and even profiteering) from poor default choices: people remaining on high mortgage SVRs or low savings rate products rather than switching to better rate offers, lack of take up of OMO in annuities, etc. Providers need to consider what default options to use and in what circumstances – and these defaults need to be considered during the life of the product or investment as well as at the point of sale.

To put this in the context of financial vulnerability, default bias makes the financially vulnerable particularly (more than the ‘average’ consumer) open to advice from someone who seems more knowledgeable and to marketing that appears to offer a simple or safe solution, as well as that which draws superficial (but perhaps inappropriate) parallels between products.
**Loss aversion and recency bias:** Generally people place more value on something they risk losing than on something they stand to gain. Equally, there is a tendency to use the recent past as a guide to the future (e.g. to assume that a market that has grown in the recent past will continue to do so in the foreseeable future). Taken together, this can result in people ‘sticking with’ an inappropriate product because they do not want to ‘realise’ a loss (even though by moving they could make a marked improvement to their situation), or becoming vulnerable to being sold an inappropriate product (e.g. one whose recent performance has the effect of reducing the perceived risk or where the short term benefit is emphasised).

Behavioural economists would describe both of these as relatively common phenomena among the population as a whole. Among the financially vulnerable, particularly those with poor education, they are even more likely, especially if (as is also likely) they are accompanied by a wariness and conservatism borne of feelings of inadequacy in dealing with financial services decision making. It may have the effect of reducing switching (between both products and providers) and make consumers more sensitive to increases in cost (and less appreciative of decreases).

People have a tendency towards social comparison and to conform, and to seek the approval of their peers. This can lead to consumers making decisions based on what is right for someone else. Those with poor understanding of the purchase they are making, or who are feeling pressure to make a decision, are more likely to default to this type of decision making, possibly selecting products and providers with large or growing customer bases as this is seen as implicit endorsement by others.

In order to make decisions, individuals construct preferences to help them select a product or option. This is a specific danger in financial services, where the products can be unfamiliar and complex, and preference constructions can be conjured from low or partial knowledge and assumptions. The result is that product features which in reality are peripheral can assume an inflated level of importance among customers. While the financially vulnerable may not be any more likely to behave like this than anyone else, the consequences of ‘getting it wrong’ may be greater because of their initially weaker starting position.
People tend to care more about their immediate wellbeing and immediate gratification than the future (which they optimistically assume will ‘be okay’ or can be dealt with later). This practice of what behavioural economists refer to as time discounting is a constant problem that all governments and providers face when trying to encourage planning, as is evidenced by the current savings and protection gaps.

Time discounting is a particular issue with the financially vulnerable, as, if they are struggling to make ends meet, they are likely to have a particularly strong focus on the present at the expense of the future (and may well feel they have no choice in this) and be unable to anticipate future change in usage or need. Those with poorer educations may also be more likely to prioritise immediacy and less able to predict and appreciate future benefits. Equally, those in retirement are more likely to place greater value on immediate benefits – we can see this in annuity selection preferences. In this context products which seem to help combat this tendency by ensuring a commitment (through ‘locking away’ money) or otherwise help people control themselves can be really attractive to consumers even if, in reality, they compare poorly to peer products. Therefore consumers, and the financially vulnerable in particular, risk getting caught between products which seem to meet their immediate needs and those which seem to address their future needs, when the reality could be that none of the choices they are being offered are as suitable as they seem (or as they want them to be). By the same token time discounting can lead vulnerable consumers to be more likely to respond to campaigns offering incentives or ‘teaser’ rates than other groups.

Most of these biases are likely to be stronger where consumers find it harder to assess the value of the options being presented – a need for a higher cognitive effort and difficulty in predicting value increase the impact of the bias on the decision. In taking account of behavioural economics and consumer biases, the important thing for providers is to guard against inadvertently disadvantageous vulnerable consumers by encouraging any of these biases inappropriately.
Implications

A key implication of the various types of financial vulnerability described above is that they can – and do – interlock.

Everybody, whether defined as financially vulnerable or not, is subject to the vagaries of behavioural economics. Equally anybody can fall ill or be suddenly bereaved, or suffer an injury leading to physical or mental impairment. In the current economic climate almost anybody can lose their job (over 5,000,000 people have claimed Jobseeker’s Allowance at least once since 2010), and, as mentioned above, being in employment is no guarantee against slipping into poverty.

This can make it hard for providers to identify the financially vulnerable, even among their existing customers, because it is possible to suddenly become vulnerable even for people who seem to be relatively well-off and comfortable with financial services.
Servicing vulnerable customers

For providers the key to servicing vulnerable customers is having accurate, up-to-date information. This is especially important as the vulnerability of customers is open to change. The problem with this is that it relies on the customers themselves to provide up-to-date information, and to do so when they are facing difficulties. Quite apart from the fact that informing their financial services providers of changed circumstances is likely to be fairly low on their list of priorities, there are issues of confidentiality and trust.

Many of the events and circumstances that can lead to financial vulnerability are things which people regard as personal, and for financial services providers to ask about them as intrusive. Moreover the fundamental and on-going lack of trust in the financial services industry means that some people are likely to be wary of providers’ interest and unconvinced of providers’ motivations for wanting better information about their customers.

Given that the financially vulnerable are by definition less able to understand and manage financial products, they are arguably more in need than most of personalised service. However, for most financial services providers they are unlikely to be highly profitable customers, so it may be difficult to justify the costs of servicing them properly.

Nevertheless, we have highlighted below three key ‘moments of truth’ when providers need to be alive to the potential vulnerabilities of their customers. This point is broadly true of all customers, but the risk and consequences of ‘getting it wrong’ are greater with vulnerable customers than with the wider customer base.

Point of sale

One of the FCA’s key concerns is the suitability of products to the purchaser’s needs, so providers are already becoming more focused on this aspect of sales. However,
suitability is a particular concern with the financially vulnerable, and from a provider’s point of view there is a risk of failing to identify vulnerable customers – either because they are newly vulnerable or new customers to that provider, or because the customers try to mask their vulnerability.

The increasing reliance on remote channels makes this a potentially growing problem, as there is less interaction between customer and provider and more reliance on the customer to manage their end of the purchase process. As stated above, those with language, literacy or other (e.g. physical) form filling problems may struggle with this. From a provider’s perspective this may help identify vulnerable customers, but they need both to be able to offer alternative purchase routes for these customers and to be on guard as best they can that they are indeed offering these customers the most suitable products.

For customers whose vulnerability does not centre on physical or linguistic disability the suitability issue is equally important, but the vulnerability may be harder to detect, as identifying it may rely largely on the prospective customers themselves.

**On-going servicing and communication**

A certain amount is already being done by providers to cater for those with known physical disabilities such as impaired vision, and foreign language needs can be met through a degree of foresight and planning, but issues like literacy or basic product understanding may be harder for providers to identify (and may even be hidden by customers).

Another factor for providers to consider is that customers may have become financially vulnerable since taking out the product, either through illness/ injury or other factors affecting their wealth and income. There may be an imbalance between what the provider thinks it needs to know and what the customer wants to tell it about any such changes, or it may simply not be obvious to the customer what (and how) to tell the provider. And, as stated above, the customer will probably
have much higher priorities than keeping providers abreast of their changed circumstances.

These issues are exacerbated by the fact that on-going contact during the life of a financial product is likely to be more routine and remote than at the point of purchase or maturity/closure of the product. Providers can be aware of the potential for changing customer circumstances, but it is harder for them to keep track of such changes.

**Maturity/ claim**

With many products it is at the maturity or claim stage that there is the most contact between providers and their customers, and it is here that relatively personalised contact with the provider is most likely. This gives providers the greatest opportunity to discover and adapt to any financial vulnerabilities customers may have.

Depending on the product, the claim itself could be related to an event that will make the customer vulnerable (e.g. critical illness of the customer or a loved one, bereavement, etc.), and it is important that the provider is prepared for this and has procedures in place to help (or at least not unduly burden) the customer in this event, as well to try and prevent them from making unsuitable decisions because of their vulnerability.
Why would companies want to research the financially vulnerable?

There are a number of reasons why providers might wish to research the financially vulnerable with a view to improving the services they offer them. Chief among these are the need to protect vulnerable customers from purchasing or using unsuitable products, and the need to protect themselves from accusations of letting this type of customer down (accusations from the media which could lead to PR damage, or from the FCA which could lead to fines). In the current economic and political climate and there is increasing pressure on financial services providers to take ownership of, and to discharge, a moral duty of care towards customers, and this is particularly true with regard to the financially vulnerable. Failure to do so is likely to result in increased risk to providers from both a compliance and brand perspective.

This means that it is in the interests of the provider as much as the customer for the provider to protect vulnerable customers from buying or using financial products inappropriately. While providers may not always see themselves as responsible, for example if an independent adviser has made an inappropriate sale to a customer, the likelihood is if anything increasing that they will be held accountable. This is especially true if the adviser is no longer in business and able to be held accountable directly.

As well as moral duties and defence against charges of failing to meet them, there are practical and commercial reasons why providers can benefit from a better understanding of the needs of vulnerable customers. Customers who buy the wrong product, fail to manage it properly, or complete paperwork incorrectly all potentially create work for providers and cost them money in sorting out problems.
About Strictly Financial

Strictly Financial is a qualitative research agency specialising in the financial services sector. This is all we do - day in, day out. So we know the market context and are able to apply our expertise to our clients’ business issues, thereby adding value to the research output.

Run by Claire Labrum and Dave Skelsey, the company offers high quality, insightful and actionable research to a range of clients. We design custom made research programmes that take account of the business problem, market issues and research practicalities.

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