

**BANKING FOR A
STRONGER SOUTH AFRICA**

November 2018

Executive summary

Studies show that South Africans continue to be big borrowers and poor savers. 53% of South Africans borrowed money in 2017, and despite tougher affordability requirements and efforts to increase consumer awareness, credit use is outpacing employment growth. A lack of propensity for savings leaves individuals significantly exposed in both the short and long term. Reducing indebtedness and creating a savings culture in South Africa are major socio-economic challenges facing both individuals and society as a whole.

Despite the complexity of these challenges, most of them can be addressed through simple behavioural changes at an individual level. In fact, the hurdles that need to be overcome to get individuals to make better financial decisions are not too dissimilar to those faced in encouraging healthier lifestyles or more responsible driving, and similar behavioural models apply.

This paper outlines that by changing five controllable behaviours – spending less than one earns, saving regularly, insuring for adverse events, paying off property, and investing for the long term – individuals can materially improve their financial position and reduce the risk of not being able to meet their financial obligations.

A shared value banking model provides an effective platform to initiate this change. By providing incentives for individuals to make better financial decisions, a shared value banking model generates higher savings levels, lower risk and increased wealth and prosperity for society as a whole. Importantly the model recognises that:

- 01 | Good financial decision making is largely agnostic to income level. Our research demonstrates that financial health is less about income level and more about how individuals manage their money.
- 02 | Financial awareness and education are critical components to effecting better decision making; South Africans under-index in this important area versus other countries.
- 03 | To initiate and sustain a change in behaviour requires an understanding of how individuals think about and interact with their finances. Our research shows that individuals are inherently optimistic about their financial health and prioritise immediate gratification over more important long term outcomes, leading to lower savings levels and under-estimating the probability of unforeseen life events or not being able to meet future financial obligations.

In response to these findings, Discovery is introducing Vitality Money in 2019, a behavioural change programme that encourages and rewards healthy financial behaviour.



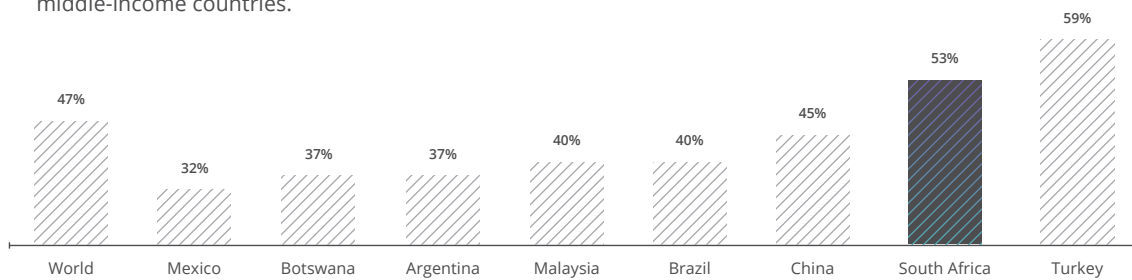
The opportunity to improve the financial health of South Africans

Reducing indebtedness, including the inappropriate use of short-term credit and creating a savings culture in South Africa, are major socio-economic challenges facing both individuals and society as a whole. Although these financial behaviours are fuelled by the current economic environment and rising living costs, it is low levels of awareness that entrenches them. These behaviours are modifiable, and small changes in behaviour can have a material impact on improving one's financial health.

01. South Africans **borrow more** than they should

South Africans are more likely to borrow

- Globally, 47% of adults borrowed money in 2017, including through the use of a credit card. In South Africa, the rate was higher at 53%. The proportion of South Africans borrowing is higher than many other upper-middle-income countries.

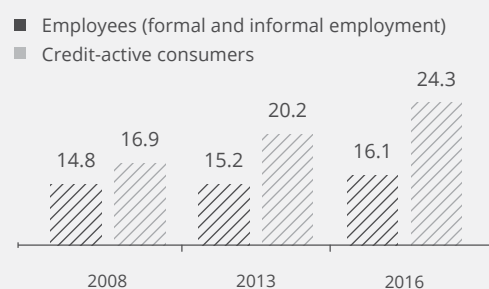


World Bank; Global Findex Report, 2017

Credit use is outpacing employment growth

- Despite tougher affordability requirements and efforts to educate consumers, credit use is outpacing employment growth, the over-indebted gap is widening, and there are now eight million more credit-active consumers than the total number of employed people in South Africa.
- In 2016, there were 24.3 million credit-active consumers, 40% of whom had an impaired credit record (at least three months overdue on repayments).¹

Employed individuals versus credit-active consumers (millions)



National Credit Regulator; Consumer Credit Market Report, 2017; StatsSA

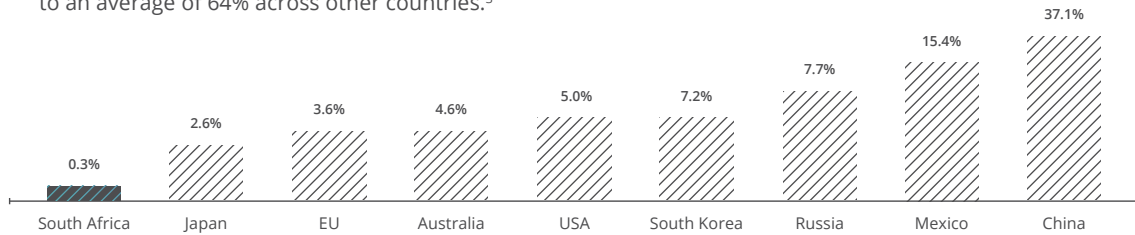
Credit facilities such as credit cards, overdrafts and store cards make up 65% of South Africans' credit accounts²

- These figures do not account for informal debt. Private loans and lending granted outside the formal system, such as loan sharks, are not captured, therefore the problem is likely to be much larger than official numbers indicate.

02. Many individuals are **exposed** to unexpected expenses or **loss of income**

South Africans save less than their peers

- South Africa's net household savings rate, at 0.3% of household disposable income, ranks well below many other Organisation for Economic Co-operation and Development (OECD) countries. In addition, only 40% of South African respondents to an OECD survey were classified as active savers, compared to an average of 64% across other countries.³

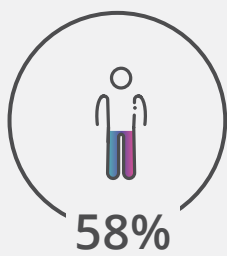


World Bank, Global Findex Database

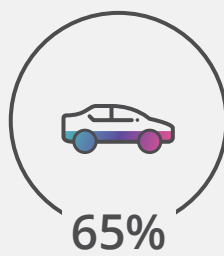
Few breadwinners save for emergencies

- If faced with an unexpected expense of R10 000, more than half of South Africans will be forced to take out a personal loan, rely on credit facilities or borrow from family or friends, while 30% are not certain how they would handle such an expense.⁴
- Less than 20% of breadwinners have enough of a financial buffer or an emergency fund to be able to cover a relatively modest unexpected expense. The rising cost of daily living expenses is squeezing disposable incomes and leading to a decline in savings.⁴

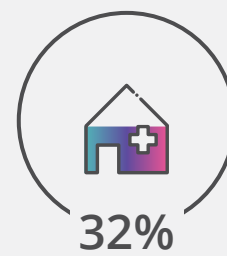
Lack of insurance exposes individuals to adverse events



Size of the insurance gap of middle- and upper-income South Africans that have a life insurance policy.⁵



Cars on the road that are not insured.⁶

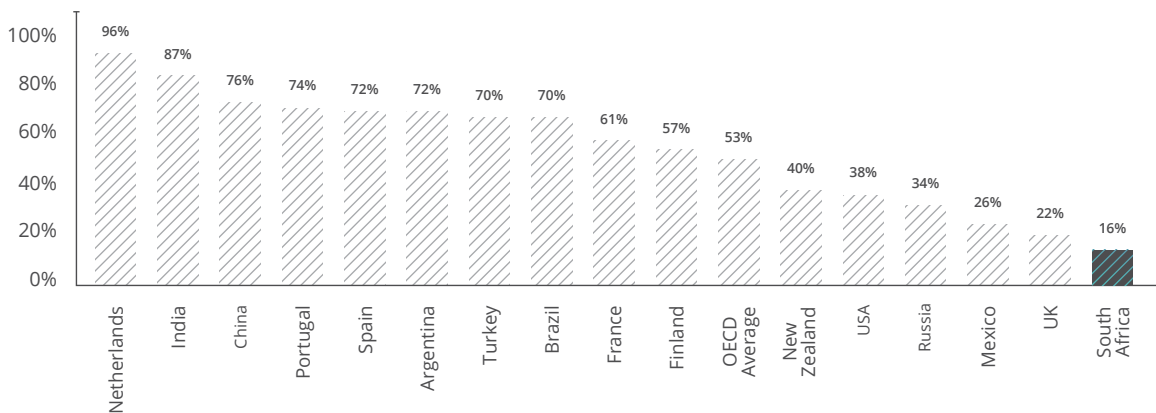


Middle- and upper-income South Africans that do not have medical scheme cover.⁷

03. Few South Africans have sufficient income in retirement

South African retirees do not have adequate savings for retirement

- South Africans significantly underestimate the proportion of income taken up by the cost of living at retirement. A person's retirement savings are deemed adequate if they can replace at least 75% of their final income, something only 8% of South African retirees achieve.⁹
- South Africa's replacement rate ranks well below many other countries.

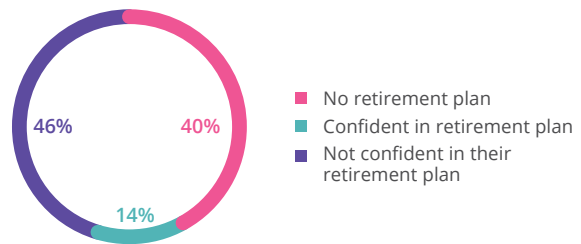


OECD and G20 indicators; 2016

South Africans do not plan for retirement



of South Africans either have no plan or are not confident in their plan for retirement



Financial Services Board; Financial Literacy in South Africa; 2016

Millennials spend more on coffee than on saving for retirement



A recent survey found that almost half of those aged between 18 and 34 today have spent more of their hard-earned money on coffee than on any form of retirement investing.⁸

South Africans do not reinvest their savings

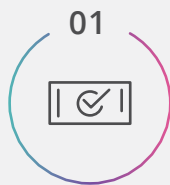
62% of individuals do not reinvest retirement savings at retrenchment or job changes.⁹

We need to change five behaviours

Behavioral theory shows that people are not inclined towards rational choices leading to many of the financial issues which they experience today. Changing five simple behaviours can have a massive impact on financial health.

These behaviours, if left unmanaged, are linked to three risks that lead to 80% of the reasons why individuals do not meet their financial obligations.

5 controllable behaviours



01
Spend less than you earn



02
Save regularly



03
Insure for adverse events



04
Pay off your property



05
Invest for the long-term

3 risks



01
Unaffordable level of debt



02
Exposed to unexpected expenses or loss of income



03
Insufficient income in retirement

which leads to

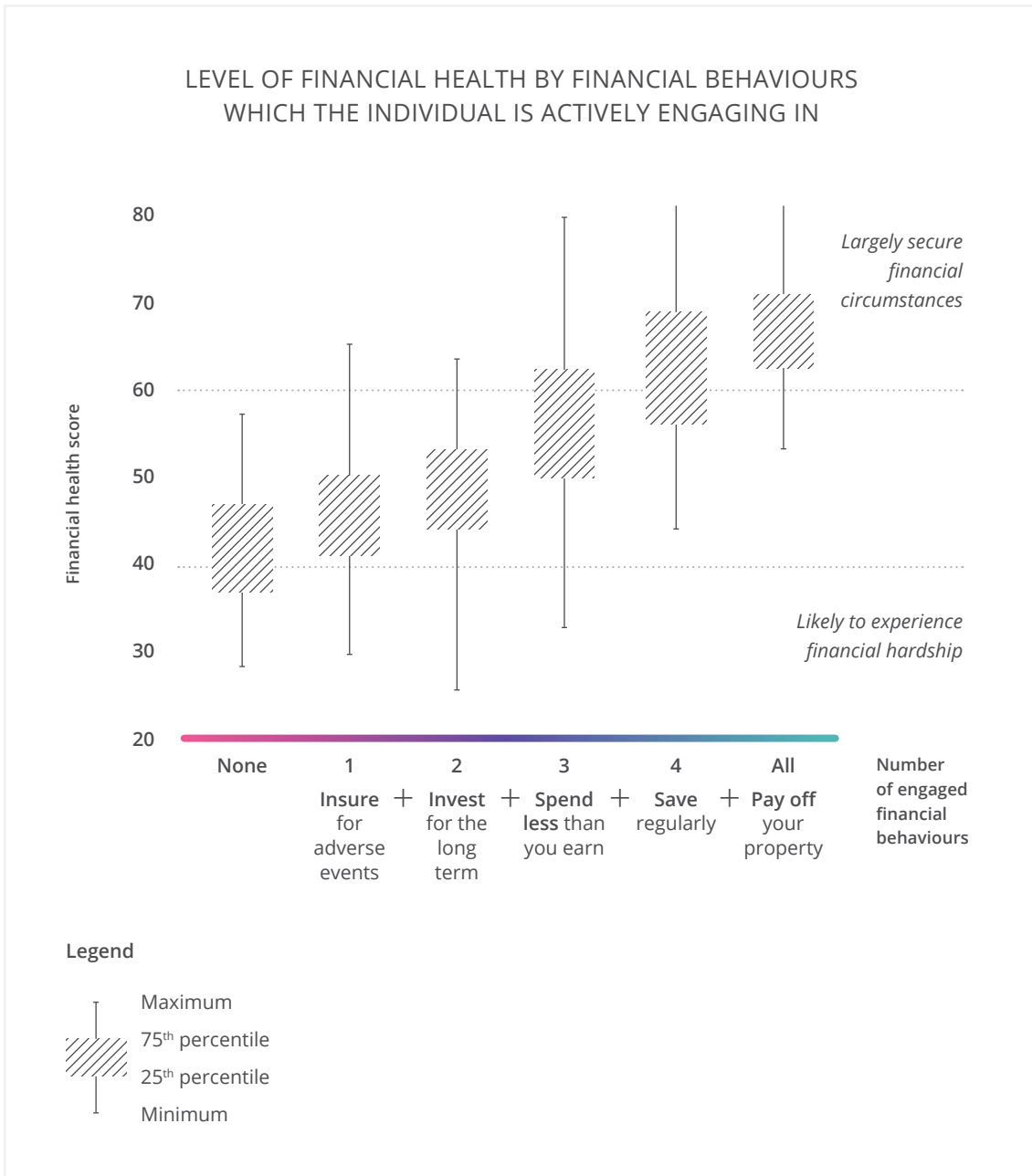
80%

of the reasons why individuals do not meet their financial obligations

Five steps to improving your financial health

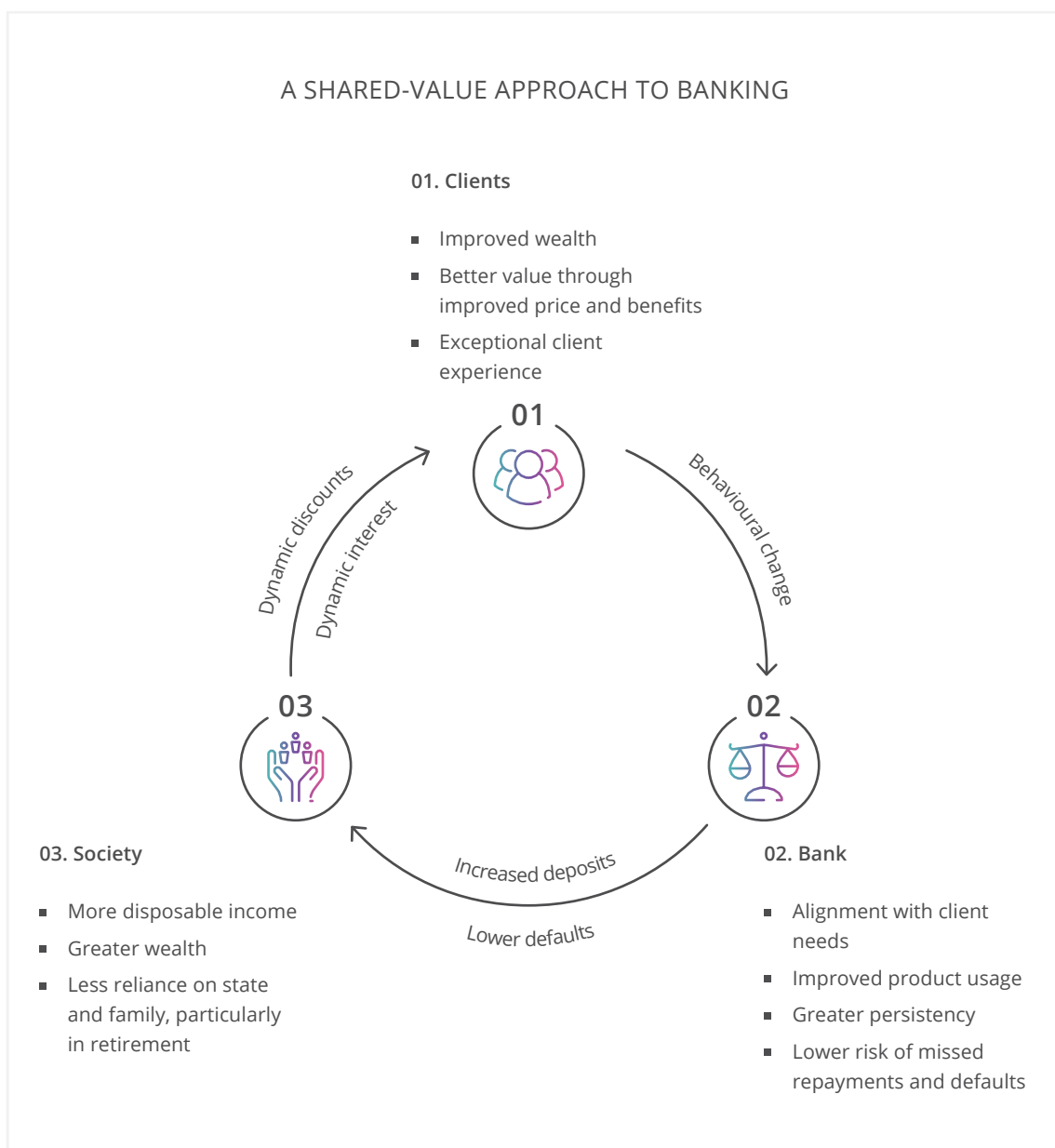
Individuals who engage across three or more controllable financial behaviours, including spending less than they earn, are typically of significantly better financial health.

Your financial health score describes the extent to which you can meet your current and future financial obligations. Your score can vary depending on how you manage your spending, and whether you save regularly, have insurance, pay off your property and save for retirement. The score indicates whether you may be experiencing material hardship or largely secure financial circumstances.



A shared-value banking model provides an effective platform to improve financial health

A shared-value business model links a company's success with individual client benefit and social progress. Such a model encourages people to objectively assess their financial situation, make the necessary changes using financial tools, and incentivises them to address behavioural biases using personalised goals and rewards. Better money management will lead to fewer defaults, a wealthier society and a lower reliance on the State.

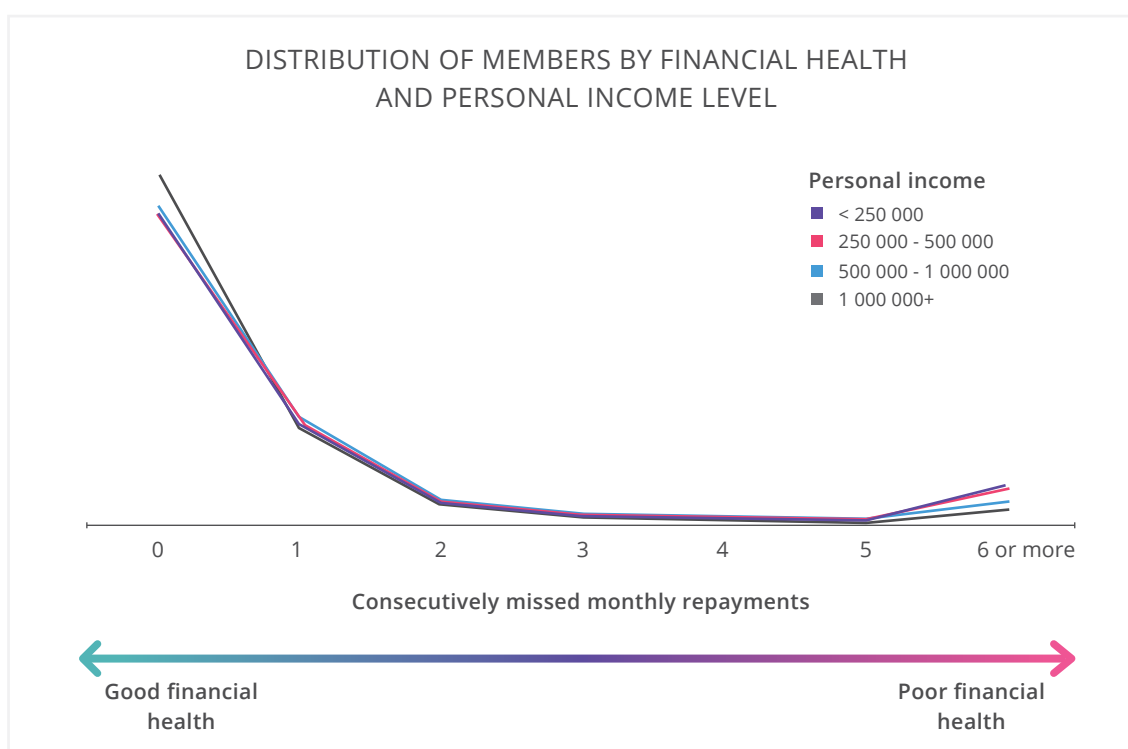


The shared-value model recognises the unique issues and challenges in improving people's financial health.



Financial health is less about how much you earn and more about **how you manage your money**

- Although there is a relationship between an individual’s financial health and socio-economic factors such as income, education and employment, individuals of similar socio-economic status can be in materially different financial health.
- Individuals with higher personal incomes have, on average, higher financial health scores (57.0 versus 53.8 for individuals with lower personal incomes). They are also less likely to be in arrears with debt repayments (34% have missed at least one repayment on an unsecured credit facility in the past 12 months, versus 38%).
- However, despite these differences, the distribution of measures of financial health by income groups are wide and overlap substantially, highlighting that a person’s financial health does not only depend on earnings.
 - For example, 35.9% of individuals with a personal income between R500 000 and R1 million per year, have missed repayments on their unsecured credit facilities in the past 12 months, including 9.1% who have missed three or more consecutive repayments. These figures are only marginally better than those of individuals earning less than R250 000 (37.7% and 13.1% respectively).
 - Similarly, 10.4% of individuals earning more than R1 million per year who were surveyed, achieved a financial health score of 40 or less – a level typically associated with experiencing material hardships and having difficulty in making ends meet – versus 13.3% of individuals earning less than R250 000.
 - Such findings are consistent with those of the Consumer Financial Protection Bureau in the United States and ANZ.^{10,11}
 - Consequently, individuals can be relatively financially healthy without necessarily having a high income.



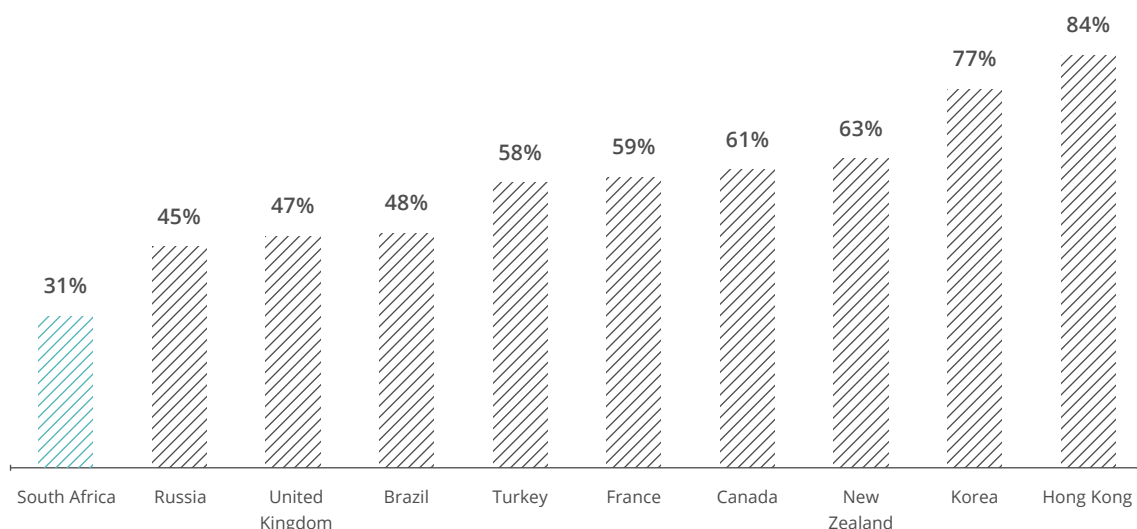


Financial awareness and education are critical to initiate change

- Financial education is key in equipping individuals to compare financial products and services and make appropriate, well-informed financial decisions.
 - In an OECD study¹³, South Africans ranked lowest out of 20 countries in terms of financial education, with limited understanding of financial concepts such as inflation and compound interest. For example, when asked how inflation levels impact purchasing power, one in four South Africans responded correctly.
- There is a strong link between financial knowledge and financial health. Research shows that higher levels of financial knowledge are correlated with better financial outcomes and financial behaviours such as participation in the stock market, adequate retirement planning and debt management.¹⁸

Financial knowledge score by country

Percentage of respondents scoring at least 70% on the financial knowledge assessment



OECD; OECD/INFE International survey of adult financial literacy competencies



A few simple changes in behaviour can have a big impact

- Various studies^{10,11,12} have shown that behaviours such as spending less than you earn and actively saving, provide the greatest differentiation between people with different levels of financial health.
- Discovery's research confirms these findings. Members who display these behaviours have, on average, significantly higher financial health scores and are less likely to have missed debt repayments.
- Individuals who save regularly and have emergency savings of at least three months' income, have a financial health score of 63 – 15 points higher than individuals who do not save. Similar results are seen when comparing individuals who manage their spending (a score of 55 versus 43 for those who do not).
- Discovery's research highlights that people who engage in healthy financial habits such as saving at the start of the month, and using a budget on a regular basis, generally achieve better financial outcomes.
 - People who are in the habit of saving regularly at the start of every month tend to have larger emergency savings balances; are better able to cope with the financial challenges of unforeseen life events; and have a higher financial health score than individuals who save what is left over at the end of every month.
 - Similarly, people who are in the habit of budgeting tend to have more money left at the end of the month; are more in control of their finances and have a better understanding of financial services and products.
 - When asked why individuals do not budget, many of the reasons were around lack of time or motivation as well as a lack of knowledge, highlighting the absence of incentives for creating and following a budget.

When comparing savers, those that save regularly at the start of the month, achieve better outcomes

	% respondents with three or more months' savings
People who save regularly at the beginning of each month	56%
People who save what is left over	25%

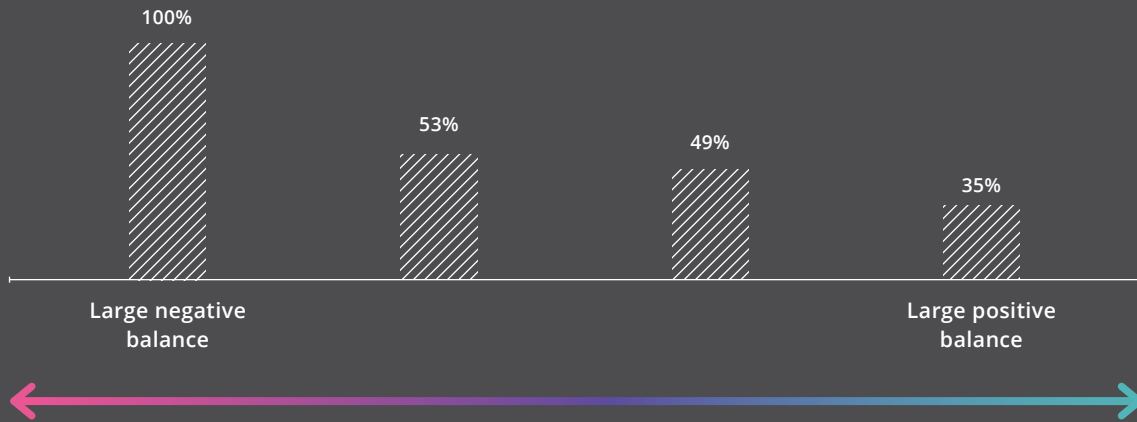
People who are in the habit of budgeting are more likely to have money left over at the end of the month

	% respondents with money left over at the end of the month
People who regularly budget	44%
People who do not budget	29%

Note: Poor financial health is classified as individuals who have missed repayments for three or more consecutive months.

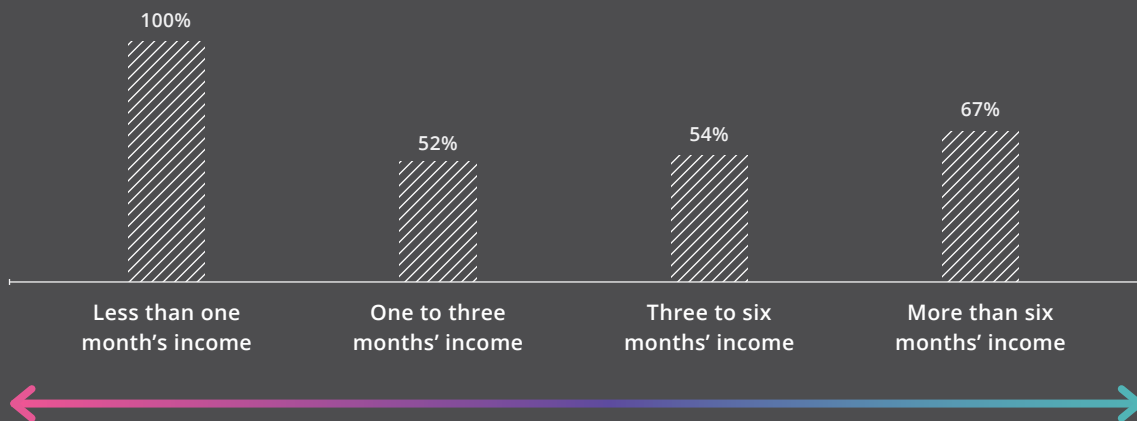
Spend less than you earn:

Proportion of members of poor financial health by average balance in bank account, rebased to 100



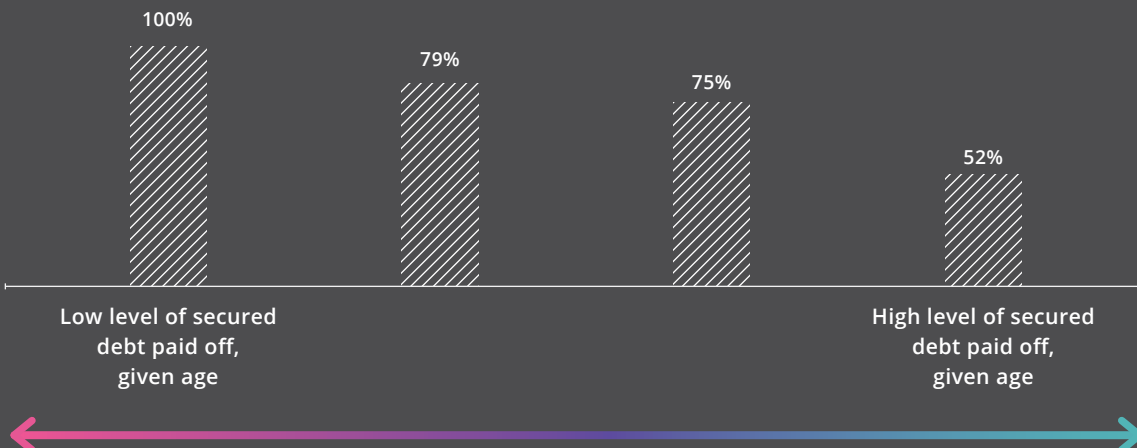
Save regularly:

Proportion of members of poor financial health by level of emergency savings, rebased to 100



Pay off your property:

Proportion of members of poor financial health by level of secured debt paid off, given age, rebased to 100



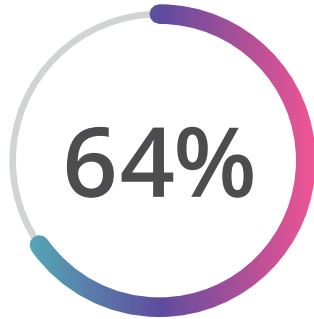
Human biases impact how people understand and engage with their finances

People are over-optimistic about their financial health

- Many individuals are over-optimistic about their prospects, including their financial health, with a significant difference between perception and reality. Such optimism can negatively affect decision making with individuals more likely to delay saving money, as well as under-estimating the probability of negative incidents such as unforeseen life events (for example car accidents or serious injuries) or not being able to meet a financial obligation.
 - Discovery's research highlights that one in 10 individuals surveyed are of poor financial health however the majority of such individuals (64%) are over-optimistic about their financial position, commenting that their financial health is good, very good or excellent.
 - Males are more likely to exhibit optimism bias, with 79% of males in poor financial health classifying their status as good, very good or excellent versus only 45% of females. Similar levels of over-optimism can be seen with regard to control of their finances (70% of males in poor financial health feel that they are on top of their day-to-day finances versus 56% of females). Various studies have previously highlighted such a gender bias with regard to optimism.
- Individuals may also be overly-optimistic or even unaware of their true financial position, including the extent of their unsecured debt. Only 16% of individuals surveyed who own three or more credit cards did not underestimate the number of cards that they use.
 - This awareness issue is compounded by the relationship between the number of credit facilities and the individual's relative level of debt: the greater the number of credit cards, the more likely the individual is to have a significant outstanding balance across their cards. 1% of individuals with only one credit card have an outstanding balance of 20% or more of their annual income, which increases to 58% of individuals who have five or more credit cards.

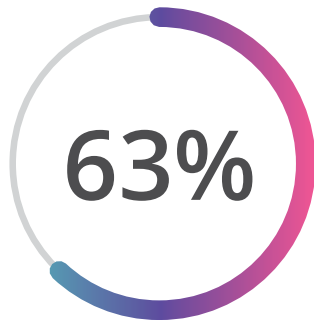
Note: Individuals with poor financial health are those who have missed repayments for three or more consecutive months. Individuals who have high levels of unsecured debt are spending at least 20% of their gross monthly income on debt repayments.

EXAMPLES OF OVERCONFIDENCE AND OPTIMISM WITH REGARDS TO FINANCIAL HEALTH AND KEY BEHAVIOURS



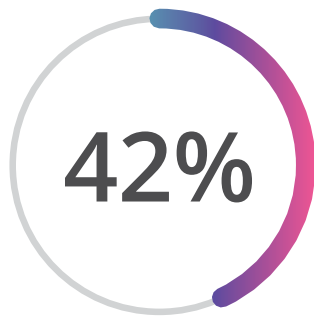
Financial health

Proportion of members with poor financial health who view their financial health as good, very good or excellent.



Control of day-to-day finances

Proportion of members with poor financial health who either agree or strongly agree with the statement 'I feel on top of my day-to-day finances'.



Levels of spending

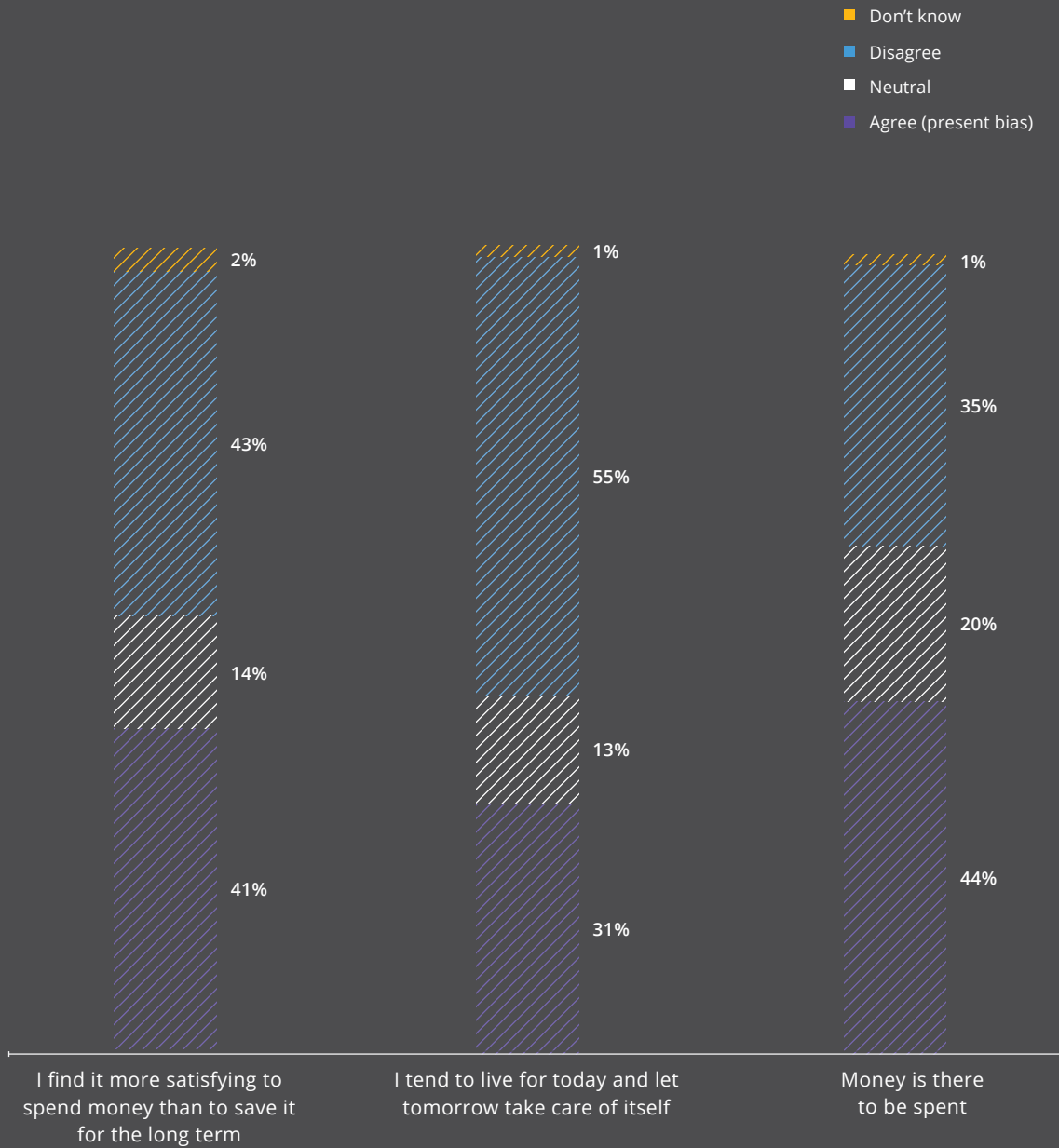
Proportion of members with high levels of unsecured debt who either agree or strongly agree with the statement 'I am comfortable with my current levels of spending in relation to the funds I have coming in'.



People are inherently present biased and prioritise immediate gratification over long term saving

- Present bias describes the tendency to make decisions that provide instant gratification over those that are in an individual's long-term interest. Several studies have found an inverse-relationship between being present-biased and savings behaviours, with the implications of this bias being overspending and not saving sufficiently for retirement.
- In 2015, the Human Science Research Council¹⁴ found that many South Africans are present biased, lacking financial self-control and prioritising instant gratification. Present bias was, however, lower among the following groups:
 - Household decision-makers: highlighting that those in charge are likely to be more responsible with regard to spending and saving behaviours.
 - More mature respondents: although the size of the degree of difference was not as large as what may have been expected.
 - Individuals in the upper LSM groups: however there was not a marked difference between low and middle LSM groups.
- In contrast to the above groups, present bias seems to be strongest among millennials. The preference for instant gratification marks millennials' behaviour as consumers. The result is that millennials' saving behaviour is driven by immediate essential needs, and not long-term financial provisions.
 - Despite an understanding of the importance of saving for retirement, where 25% of millennials said that they are worried about their ability to ever afford to retire, 37% indicated that retirement is simply too far off and that they have more immediate priorities.⁸

| Examples of present bias among surveyed South Africans



Human science research council; financial literacy in South Africa. 2016

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Two measures of financial health have been used throughout this paper:

01 | Missed consecutive repayments indicate the maximum number of missed consecutive repayments by an individual over the past 12 months across all of their unsecured credit facilities (for example credit cards, micro-loans). This metric has been calculated for all Discovery Card holders who have been clients since 1 January 2014.

02 | The Financial Wellbeing Scale has been developed by the Consumer Financial Protection Bureau in the United States to measure an individual's financial health. An individual's score can range from 0 to 100, with a score of 40 or less indicating that the individual may be experiencing material hardship or have difficulty in making ends meet. A score greater than 60 indicates the individual has largely secure financial circumstances. A sample of Discovery Card holders were surveyed in October 2018, with their responses used to calculate a Financial Health Score.

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