

Risk Transfer and the Growing Importance of Financial Education

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The IMF's Perspective

- Macroeconomic and financial stability
- Surveillance: multilateral and bilateral; policy recommendations
- Monetary and Capital Markets Department's *Global Financial Stability Report* ('risk transfer' series)

Key Points

- Risk transfer through the financial system— increasingly shifted to households
- Surveys show lack of household knowledge of even basic financial issues
- Financial education shortcomings are not new, but increasingly urgent to address
- Governments have a major role in raising awareness and financial literacy of individuals
- The private sector has a key role in providing targeted, quality advice and products

The Changing Risk Profile of Households

- Risk flow: banks, insurance companies, pension funds, households
- Changing risk profile—more *direct* risk exposures
- Prospective changes in healthcare benefits
- Bottom line:
 - Household sector more of a “shock absorber of last resort”?
 - Household risk management capacity part of financial stability

Households' Capacity to Manage New Risks

- Need for basic education about risks and alternatives. Households:
 - Often do not take a comprehensive approach
 - Are slow to adjust their asset allocation as needed
 - Underestimate required level of savings and risks
- Experience of previous generations not a good guide
- Some population segments most at risk? (data/identification issue)

Some Survey Results...

Surveys frequently show a substantial lack of knowledge of households' own arrangements for retirement savings:

- Netherlands: 65% of households are unable to provide an estimate of their pension income upon retirement
- U.K.: 44% of the population reported a basic knowledge of pensions in 2004, down from 53% in 2000
- U.S.: 47% of workers who have not saved at all are confident that they will have enough for retirement. Many count on employer-provided benefits that are increasingly unavailable
- France: a majority of households consider themselves ill-equipped to choose an investment strategy, and do not compare investment products

Government Communication on Priorities and Challenges

- Important for broad public awareness
- Necessary for political buy-in and success of pension (and health care) reforms
- Public debate and awareness of these implications is often still nascent—need for further initiatives

Raising Awareness—Examples

- U. K.: Pensions Commission Report
“Pensioners will become poorer relative to the rest of society” unless taxes or social security contributions devoted to pensions rise, individuals save more, or employees accept longer working lives
- Sweden—new public pension system
Following a broad information campaign, surveys have shown that the share of participants who say they do not understand the system has fallen from about 30% in 1998 to 13% in 2003

The U.S. National Retirement Risk Index

A good example of how complex risks associated with retirement saving can be presented relatively simply

- Measures share of working age households who are “at risk” of being unable to maintain their pre-retirement standard of living in retirement
- Assuming individuals retire at age 65 and annuitize all their wealth, 43% will be “at risk”
- Good news: changing retirement and savings behavior can substantially improve the outlook (e.g., retiring at 67 reduces share to 32%)

Percent of Households “At Risk”

(at Age 65, by Birth Cohort and Income Group)

Income group	All	Early Boomers 1946-1954	Late Boomers 1955-1964	Generation Xers 1965-1972
All	43%	35%	44%	49%
Top third	36	33	35	42
Middle third	40	28	44	46
Bottom third	53	45	54	60

Source: Munnell, Webb, and Delorme, *A New National Retirement Risk Index*, Center for Retirement Research, Boston College, June 2006

Information vs. Education

Information cannot substitute for greater household financial literacy

- Financial information may be accessible, but households often make limited use of it
- U.S.: increased financial information for consumers may not result in improved financial management in areas such as mortgages and investment (behavioral economics and finance)
- Disclosure vs transparency

A Key Role for Governments in Financial Education

- Governments may come under growing public pressure to intervene in support of the household sector, for example:
 - in the form of added public expenditure pressures
 - in the form of re-regulation of certain products or services
 - in order to deal with waves of litigation
- A key objective for governments may be to strengthen basic financial education programs at school and at the workplace—indeed, such efforts are underway in some countries

Financial Education and Long-Term Saving Challenges

- Saving for retirement: uncertainty over returns and costs of systematic errors
- Uncertainty/risks affecting ageing-related liabilities (e.g., longevity risk)
- Complexity/variety of products available (greater for savings/investment products)
- Purpose of financial education (not a single approach; equip individuals to ask informed questions and understand potential outcomes)

Challenges in Financial Education Program Design

*Define strategies to strengthen
financial education programs*

- Focus (e.g., home ownership; savings accumulation vs. debt reduction; etc.)
- Target audiences - need to reach different population groups and levels of sophistication:
 - Basic financial education in schools
 - Long-term planning for the middle aged
 - Consideration of payout strategies during later working life
 - Need to identify the most vulnerable population categories (requires detailed cohort data)

Challenges in Financial Education Program Design (cont.)

- Delivery channels (e.g., public/private, different media, new technologies)
- Coordinate efforts to strengthen financial education (e.g., U.K.'s FSA, U.S.' Office of Financial Education)
- Evaluate the effectiveness of existing efforts

OECD Financial Education Project

- Leading international efforts toward strengthening financial education programs
- Provides an inventory of education initiatives and a list of good practices for financial education programs
- Allows to build on cross-country experience in the design of financial education programs

Government Policies and Household Savings Strategies

- Governments can help households implement the new approaches to savings and investment that they increasingly need
- Savings
 - Taxation
 - Opt-in/opt-out schemes
 - Mandatory savings?
- Investment
 - Lifecycle products
 - Annuity products
 - Equity release products

Public/Private Complementarity

- Governments and private industry have comparative advantages in addressing household financial needs
- Employers and financial institutions are well positioned to deliver targeted financial education and advice
- Examples:
 - Japan: role of banks
 - U. S.: employer-supported seminars

Role of Financial Institutions

- The finance industry is well placed to provide tailored advice on saving and investment products, and financial management/strategies
- The provision of quality financial advice should progress with that of financial education
- A number of financial institutions have already started to improve the way they operate in relation to households

Incentives for Financial Advice

There may be a need to strengthen the incentives for financial advisers to better support the needs of households

- Availability and appropriateness of advice may be an issue
- Household reluctance to pay for advice
- Policy considerations:
 - Simple and stable tax and regulatory regime
 - Educational standards for advisers
 - More transparent commission/fee structures