

## **International Keynote Session: Facing new realities – how important is individual financial capability in the global economy?**

### **Summary:**

The financial crisis has highlighted, among other issues, the damaging impact of inadequate consumer financial knowledge and skills. Distinguished speakers discussed the extent to which increasing financial literacy levels could affect economic recovery and resilience, and explored the roles and responsibilities of governments, the financial services sector, other financial educators, and members of the public in achieving a more financially capable society.

### **Key takeaways:**

- Informed consumers are essential but achieving financial literacy is actually very hard
- Ordinary people need to understand what they are being told. Product simplification and improved disclosure of financial products are necessary for consumers and regulators alike and understanding a product should be a pre-requisite for anyone marketing it
- Consumer financial capability is very important but should not be seen as a panacea for the world's current economic difficulties
- Financial education should be accompanied by the development of effective economic tools to manage financial and economic volatilities
- We need to adopt a multilateral approach where we recognise the importance of partnerships and the roles consumers, government, financial institutions and other key actors have to play. Within this financial capability is a vital ingredient.

### **Presentation synopsis:**

Moderated by: **Kishore Mahbubani, Dean, Lee Kuan Yew School of Public Policy**

The global financial crisis was caused by three major failures that should warrant further consideration:

- The failure of public guardians – particularly, the assumption that large financial institutions are carefully supervised and regulated;
- The failure of the private guardians – for example, the role of the rating agencies whose business model appears inherently conflicted given that they are paid by the very industry they are rating. In addition few agencies have been held accountable for their role in markets;
- The failure of financial institutions – there is a need for these institutions to examine what they did wrong and an inability to do so will lead to the disappearance of trust which will be difficult to regain

### **Martin Wolf, Associate Editor and Chief Economics Commentator, Financial Times**

Martin Wolf presented the following points for discussion:

1. We should have modest aims related to consumer understanding and not expect too much of consumers
2. The biggest mistakes were made by the financial services industry and consumers at the same time

3. Bubbles are very dangerous so there is a need to arrange the financial system and macro-economic management such that bubbles become less frequent
4. Providing that point 3 is achieved, then the provision of basic financial education will be immensely useful
5. However, achieving financial literacy is not an easy task. If financial sector professionals have limited understanding of what they are selling, then it is difficult to expect consumers to understand these products
6. If consumers were properly educated then a large part of the financial services industry would be likely to disappear
7. But if we had a smaller financial services industry the world would be a better place

### **Samuel Ochieng, President, Consumers International**

Samuel Ochieng agreed with the importance of financial capability in the global economy; however consumer education is not a panacea.

During the current crisis consumers have been maligned on the one hand for borrowing too much and on the other for not consuming enough. Consumers clearly need financial education - but they are not the only ones; financial professionals also fail to understand the products that they manufacture and sell.

In fact there is significant evidence that consumers – including those drawn from very poor social groups – are able to manage certain financial products responsibly with basic education. Mr Ochieng cited microfinance initiatives in various African countries that currently show loan default rates ranging between 1.2% and 3% as successful examples of positive consumer behaviour.

Financial product complexity poses a consumer hazard and creates significant regulatory challenges. Moreover, if the principle of 'caveat emptor' in relation to complex financial products is applied then the consumer will consistently be placed at a disadvantage. In order to restore consumers' trust in financial services the understandability of a financial product must become a pre-requisite for its sale.

### **Jonathan Larsen, Head of Consumer Banking & Global Cards, Asia Pacific, Citi**

Jonathan Larsen prefaced his comments by affirming Citi's belief that financial education is a force for good in developed and emerging markets.

From his perspective, Citi's presence in Asia needs to be constructive in serving customers with good products accompanied with good advice. But beyond the business element, financial education allows Citi -- at both the institutional and the individual employee level -- to give back to the societies in which it has been successful.

Mr Larsen went on to cite the Citi Fin-Q (Financial Quotient) Survey in Asia Pacific which was commissioned by Citi but conducted independently and which indicated inter alia that:

- Only 25% of those surveyed have a formal retirement plan;
- 29% would have an idea what to do if they suddenly inherited a lump sum;
- 66% agreed that they need to pay more attention to their financial welfare; and
- more than 50% have been directly affected by the financial crisis.

Survey findings suggest that some financial education would be of benefit to those that lack the most basic financial capabilities.

Mr Larsen agreed that financial education is not a panacea, and that many of the current problems are bigger problems than any one institution can solve. However, some progress could be made on the basis of a collective awareness of the issues. In addition a multilateral approach would be required in order to succeed.

#### **Session Q&A:**

##### ***What are the valuable things in financial services today?***

- Martin Wolf commented that the financial sector is an overhead cost for consumers as they seek to improve their welfare. Financial institutions are intermediaries, and as such the industry should be viewed as a means to an end rather than an end itself, and the extraordinary growth in the industry over the last 30 years is likely to be seen in the light of history as the result of an abnormal credit expansion. The industry would likely diminish in the next 10-15 years in places such as the UK and the USA, but he acknowledged a different dynamic in emerging countries and posited that basic financial needs on the part of consumers would always be required to be met
- Jonathan Larsen suggested that financial excesses in certain developed countries should not be viewed alongside the long-term trend in emerging economies in which the evolution of financial services needs to happen more responsibly

##### ***How should financial products be made simpler?***

- Martin Wolf commented that in general it was not in the interest of financial institutions to simplify their products as complexity generally supports profitability
- Jonathan Larsen provided some examples in which simplifying access and marketing materials (including product terms and conditions) had been undertaken within the industry

##### ***How important is individual capability?***

- Martin Wolf agreed that the world needs informed consumers and that they should not buy any product that they don't understand or any product that purports to make them a millionaire overnight. However, on this basis a lot of financial products would cease to be sold. The onus nevertheless is on the regulators to ensure product comprehensibility.
- Sam Ochieng agreed that individual capability is important but emphasised that good product information and accessibility of that information are key factors to consider.

