Y V Reddy: The role of financial education – the Indian case

Inaugural address by Dr Y V Reddy, Governor of the Reserve Bank of India, at the International Conference on Financial Education, organised by the OECD and co-hosted by the Pension Fund Regulatory and Development Authority, New Delhi, 21 September 2006.

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Distinguished Ladies and Gentlemen,

I am thankful to Shri Swarup for inviting me to this august gathering. The Conference represents an important step by the Pension Fund Regulatory and Development Authority (PFRDA) to distil from the experiences of other countries in its quest for enhancing the levels of financial education in our country. The collaboration with Organisation for Economic Co-operation and Development (OECD) which has been playing a pivotal role in this respect is a laudable idea which will certainly contribute to furthering the cause of financial education. The eminence of several speakers adds great value to the discussions. We in the Reserve Bank are also keen on this subject and look forward to benefit from the deliberations of this Conference.

My remarks on this occasion will be structured along the following lines. I will provide some introduction on the importance of this topic in modern day societies, followed by an overview of the global practice in this area. Any discussion on financial education in India would need to acknowledge the Indian realities as well. The concluding thoughts are in the nature of possible approaches towards expanding the outreach of financial education in India.

Background

Financial education can broadly be defined as the capacity to have familiarity with and understanding of financial market products, especially rewards and risks in order to make informed choices. Viewed from this standpoint, financial education primarily relates to personal financial education to enable individuals to take effective actions to improve overall well-being and avoid distress in matters that are financial.

The focus of any discussion on financial education is primarily on the individual, who usually has limited resources and skills to appreciate the complexities of financial dealings with financial intermediaries on matters relating to personal finance on a day-to-day basis. The process of economic reforms, which includes deregulation and marketisation, should have educating and empowering the common person to participate in the financial marketplace with knowledge and confidence, as a critical component of public policy.

The need for financial education is felt in the developed and the developing countries alike. In the developed countries, the increasing number and complexity of financial products, the continuing shift in responsibility for providing social security from governments and financial institutions to individuals, and the growing importance of individual retirement planning make it imperative that financial education be provided to all.

In the developing countries also, the increasing participation of a growing number of consumers in newly developing financial markets will necessitate the provision of financial education – if these markets are to expand and operate efficiently. In addition, the substantial growth of international transactions during the last decade, resulting from new technologies and the growing international mobility of individuals, makes the improvement in financial education, increasingly, an international concern.

From a regulatory perspective, financial education empowers the common person and thus reduces the burden of protecting the common person from the elements of market failure, attributable to, *de facto,* information asymmetries. For example, the emphasis on market discipline, as one of the three pillars of banking regulation, especially under Basel II, is best served by participation of financially literate bank customers in the financial marketplace.

Financial education can make a difference not only in the quality of life that individuals can afford, but also the integrity and quality of markets. It can provide individuals with basic tools for budgeting, help them to acquire the discipline to save and thus, ensure that they can enjoy a dignified life after retirement. Financially educated consumers, in turn, can benefit the economy by encouraging genuine competition, forcing the service providers to innovate and improve their levels of efficiency.

Global practices

It has been said, particularly in the context of the developed economies that while the young do not save enough and do not fully understand the need for investments for future, many of the elderly tend to feel the pinch of poverty. In this background, priority need to be accorded to financial education.

For example, in the UK, the Financial Services Authority has launched the biggest ever campaign to improve the financial skills of the population and imparting education to enable a better appreciation of the risks and rewards inherent in financial instruments.

The US Treasury established its Office of Financial Education in 2002. The Office works to promote access to the financial education tools that can help all US citizens make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The Financial Literacy and Education Commission (FLEC), established by the Congress in 2003 through the passage of the Financial Literacy and Education Improvement Act, was created with the purpose of improving the financial literacy and education of persons in the United States through development of a national strategy to promote financial literacy and education. The Federal Reserve, along with numerous other federal government agencies, is a member of this commission, which is supported by the Office of Financial Education.

The Federal Reserve System’s recently redesigned financial education website, FederalReserveEducation.org, is dovetailed to increase the use of Federal Reserve educational materials and promote financial education in the classroom. The website has material intended for the general public, as well as materials specifically geared toward teachers and high school and college students. It provides easy access to free educational materials, a resource search engine for teachers, and games for various ages and knowledge levels. The other regional Feds also have various interactive on-line programmes on their website designed to generate awareness about better financial management and assessment of one's own financial position.

In Australia, the Government established a National Consumer and Financial Literacy Taskforce in 2002, which recommended the institution of the Financial Literacy Foundation in 2005. Working closely with states and territories, the Foundation has produced a National Curriculum Framework for Financial Literacy to provide benchmarks for teaching the school children the importance of managing their money.

In Malaysia, the Financial Sector Master Plan, launched in 2001, includes a 10-year consumer education program. This agenda includes infrastructure and institutional capacity development in the areas of financial education, advisory services, distress management and rehabilitation. For this purpose, the Bank Negara Malaysia in partnership with the financial industry and other government agencies, has introduced the Financial Mediation Bureau, Deposit Insurance Scheme, Basic Banking Services Framework as well as created a new class of licensed Financial Advisers. Savings and education programs are also being promoted in schools. A one-stop centre has recently been established within the central bank for the public to obtain information about financial services in Malaysia and to provide face-to-face customer service on general enquiries and complaints. These initiatives have been reinforced by high levels of transparency and disclosure.

In collaboration with the government agencies, Monetary Authority of Singapore launched a national financial education programme (MoneySENSE) to enhance financial literacy and self-reliance of consumers. The programme covers three tiers of financial literacy: basic money management covers skills in budgeting and saving as also tips on responsible use of credit (tier I); equipping citizens with the skills and knowledge to plan for their long-term financial needs (tier II); and imparting knowledge about different investment products and skills for investing (tier III).

Above all, the OECD has been taking a pro-active initiative in generating awareness about financial education. It has recently released a major international study on financial education titled 'Improving Financial Literacy' encompassing practical guidelines on good practices in financial education and awareness. These guidelines, in the form of a non-binding recommendation, are designed to help countries devise and implement effective financial education programmes, drawing from the best practices in this area in OECD countries. They promote the role of all the main stakeholders in financial education: governments, financial institutions, employers, trade unions and consumer groups.

In addition, they also draw a clear distinction between public information provided by the government and regulatory authorities, and that supplied by the financial analysts.

It is also important to devise ways to ascertain whether financial education has achieved its objective, such as generating increased consumer awareness or a changed behaviour, a point I will return to a little later. The balance of evidence, however, suggests that such programmes tend to be effective. For instance, in the United States, it has been observed that workers increase their participation in retirement savings plans funded by employee and employer contributions when the latter offers financial education programmes, whether in the form of brochures or seminars. Consumers who attend one-on-one counselling sessions on their personal finances have fewer delinquencies.

Indian realities

Prior to the initiation of financial sector reforms in the early 1990s, the Indian financial system essentially catered to the needs of planned development. Customers had little choice in financial instruments. The segmented and underdeveloped financial markets meant that their exposure to risk was also limited. In such a situation, customers could employ their basic skills to invest in simple financial products with assured returns, unconcerned about their risks. The relevance of financial education was, at best, limited.

Pursuant to the process of globalisation, the economic and financial landscape in India is undergoing a significant transformation. In the process, the economy has become more diversified with new sources of growth. In tandem with these changes, we have seen the modernisation of the financial sector that has also become increasingly more diversified to meet the new requirements of the economy. The financial sector has also increasingly leveraged on advances in technology which has significantly changed the way financial business is being conducted. As market advances continue to expand the range of financial products and services, consumers are being faced with increasingly multifaceted choices and options in the management of their personal finances and exposure to a gamut of risks. In this complex financial landscape, it becomes important for consumers to have improved access to information.

Significant changes have also occurred in the social sphere. While on the one hand, costs of education have increased substantially, the longevity levels have also risen, on the other. Taken together, this implies that the elderly are now required to achieve a constant rebalancing of their consumption and investment portfolios. The increased life expectancy has also compelled employers to move away from ad hoc funded superannuation schemes to defined contribution schemes. At the same time, the advances in information technology have lowered the costs of information acquisition and processing as also of searching a job. This, in turn, has significantly raised job mobility with attendant implications for family size and expenditure patterns.

Financial education assumes importance in this changed financial environment. In considering means to improve the financial status of families, financial education can play a critical role by equipping consumers with the knowledge required to choose from a myriad of financial products and providers. In addition, financial education can help provide individuals with the knowledge necessary to create household budgets, initiate savings plans, manage debt, and make strategic investment decisions for their retirement or for their children's education. Being educated financially also enables individuals to better appreciate the possible contingencies and save for a rainy day, in an appropriate manner. It can empower consumers to become better shoppers, allowing them to procure goods and services at lower cost. This process, in turn, raises consumers' real purchasing power and multiplies the opportunities for them to consume, save, or invest. Having these basic financial planning skills can help families to meet their near-term obligations and maximise their longer-term financial well-being.

Financial education is also an integral component of customer protection. Despite concerted efforts, the current state of transparency coupled with the difficulty of consumers in identifying and understanding the fine print from the large volume of convoluted information, leads to an information asymmetry between the financial intermediary and the customer. For example, customers are often penalised for minor violations in repayments, although they have limited redressal mechanisms to rectify deficiencies in service by banks, rendering the banker-customer relationship one of unequals. In this relationship, it is the principal, that is, the depositor, who is actually far less powerful than the agent, that is, the bank. The representations received in regard to levying of unreasonably high service or user charges and enhancement of user charges without proper and prior intimation, and the growing number of customer complaints against the banks, also testify to this fact. In this context, financial education may help to prevent vulnerable consumers from falling prey to financially disquieting credit arrangements.

There are however, issues that would need to be addressed upfront in the Indian context. First, the regional profile in our country is diversified, with people across different regions being typically conversant in their vernacular languages. Second, there exists a wide divergence in literacy levels across States. Thus, for instance, in several States and union territories, the literacy rates in 2001 were well above the national average of 65.4 per cent; in contrast, there were also regions where literacy levels have remained perennially low. Third, the dependency ratio varies markedly across states. Fourth, within a State, there are marked differences between rural and urban areas. Fifth, there is also a perceptible variation in the penetration of banking across regions. Taken together, these unique conditions in our country create a role for the public policy to devise enabling mechanisms to improve the levels of financial education, reckoning the regional differences. To the extent the common person is better able to understand and appreciate the need for financial education, the task of the financial regulators is greatly simplified, lowering the overall costs of regulation.

Possible approaches

It is an imperative of increasing globalisation that the difference in the pace of growth of the financial sector and financial education be minimized. There are several ways to go about this process. For purposes of illustration, these can be classified as institutional mechanisms, delivery mechanisms and decentralisation of efforts.

Institutional mechanisms

As regards the institutional mechanism, there is near consensus on the fact that any attempt at expanding the outreach of financial education needs to start at the grass-roots. Present day school pass-outs need to be a lot more financially literate than their parents were, if they are to manage their personal finances successfully through life. In addition, universities and business schools have an important role in training financial specialists able to provide the public with high quality advice on financial matters.

Yet another channel for imparting financial education could be the workplace where it can reach most of the working adults. It would, therefore, be a potent mechanism for providing information about a number of financial services such as retirement schemes and insurance.

The role of financial institutions in providing financial education, not only to the clients but also to their own staff, needs to be better defined and further promoted. More information is needed at both international and national levels on good programmes and practices and on the ways to promote access to financial services by harnessing the role of non-government organisations (NGOs).

International organisations are well-positioned to coordinate international surveys and studies on the various aspects of financial education, to evaluate the comparative efficiency of various financial education programmes, and to develop guidelines and good practices for policymakers for implementation. International agencies can also provide a forum where countries can compare and discuss strategies to educate consumers about financial issues.

Several governments and central banks, either directly or indirectly, are actively involved in the provision of financial education about consumer credit, investment, and other financial issues, often as part of a public policy campaign to improve the protection of individual borrowers and investors, for instance, as part of the ongoing pension reform efforts. Exchange of experiences amongst central banks would thus be productive.

Delivery mechanisms

The delivery mechanisms for imparting financial education can be manifold. However, the content and delivery of financial education should correspond to the needs of specific sub-groups of consumers that is, the young or elderly, less or better educated, well- or ill-informed. Presentations, lectures, conferences, symposia, training courses and seminars can be actively utilised for this purpose.

Second, publications in diverse forms, including books, brochures, magazines, booklets/pamphlets, direct mail documents, can also be useful in this regard.

Third, leveraging information technology through concerted media campaigns using all possible avenues of mass communication can be expected to impart greater efficacy to the process. Other methods include advisory services from institutions, including the fast growing telecommunication services.

Not only the supply of financial education, but also the demand is very important. Most delivery channels are good for those who are already interested in particular topics. An important challenge is to create demand for financial information and education.

Decentralisation of efforts

Given the unique conditions in our country, any attempt at expanding the outreach of financial education should take cognisance of the role of regional differences in language, workforce and penetration of finance. Thus, banks with strong presence across different regions could explore the possibility of introducing a local-language based web-site providing details of facilities for customers.

Second, in recent times, the explosion of the internet has altered the relationship between financial organisations and its clientele. Organisations can examine ways to better communicate with both the prospective and existing clients by enriching the information content of their website on the lines of those practiced in the mature markets.

Third, credit counselling can be a potent tool for financial entities to expand the reach of financial education.

Fourth, it might be of interest for reputed organisations like the National Council of Applied Economic Research (NCAER) to conduct surveys at periodic intervals to ascertain the degree of consumer awareness about financial products and services. The findings emanating from such studies could be shared with financial entities to enable them to address the gaps in their service delivery and promote informed decision-making.

Fifth, several bodies, such as the Financial Planning Standards Board of India (FPSBI), a professional standards setting body constituted with public-private enterprise, are reportedly making proactive efforts to uniformly regulate personal financial planning practitioners. Much more of such efforts will be required to guide the development and promotion of standards for financial planning professionals to benefit and protect the public in the country.

Role of the RBI

The RBI, on its part, wishes to advance the cause of financial education in our country as part of an overall strategy. The strategy pursued in this regard can be elucidated as follows. Concerted efforts are underway to expand the reach of formal finance in view of recent emphasis on financial inclusion. This needs to be buttressed with financial education to generate greater customer awareness and understanding of financial products and services. Concurrently, a process of credit counselling is being encouraged to help all borrowers, but particularly those in distress to overcome current financial problems and gain access to the structured financial system. The Banking Codes and Standards Board of India (BCSBI) has also been instituted which is expected to ensure that the banks formulate and adhere to their own comprehensive code of conduct for minimum standards of banking services, which individual customers can legitimately expect. And finally, a Banking Ombudsman Scheme has been instituted for redressal of grievances against deficient banking services, covering all the States and Union Territories.

The RBI has also been exploring the possibility of instituting a Depositor Protection Fund (DPF). The Fund can be utilised towards generating greater awareness for the common man on issues relating to financial education and counselling. This could be complemented with providing greater role to our Regional Offices to promote financial education in their respective jurisdictions.

Conclusion

The international co-operation of the kind which OECD and PFRDA have embarked upon is a welcome development. I would like to congratulate them for undertaking this useful initiative and thank them for giving me an opportunity to be a part of this process.

I have no doubt that this Conference will prove to be an important milestone in the area of financial education for our country.

We, at the RBI, too look forward to benefiting from the deliberations.

Thank you.