Zeti Akhtar Aziz: Enhancing financial literacy for sustained economic prosperity

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It is my great pleasure to be here tonight at this second Citigroup-INSEAD Financial Education Summit. Malaysia is particularly pleased to host this year's Summit here in Kuala Lumpur given that enhancing the levels of financial literacy is being accorded a high priority on our agenda.

Effective participation in the economy essentially needs to be an informed participation. This is more so now than ever before. We are now living in an environment of rapid change. The advances in technology, product innovation, the removal of regulatory restrictions, deregulation and greater competition have dramatically transformed the financial system and the economy. The environment is marked by increased access to financial services, broader range of products and services, a far more competitive financial services industry and more complex financial transactions. It is the demands of this new environment that has created a greater need for financial literacy to not only ensure the efficient functioning of the financial system but also enhance the potential for the economy to prosper and thrive.

This evening, I would like to focus on financial literacy from the perspective of the Central Bank, given that the function of the Central Bank has widespread implications on financial markets, businesses and the public as large. The main responsibilities of the Central Bank includes the formulation and implementation of monetary policy, ensuring the soundness and stability of the banking system, and finally ensuring the integrity and reliability of the payments systems. In all these areas, the actions of the Central Bank have direct implications on the business community and the public at large. The ultimate aim of the policies are to make the economy strong, and to ensure the health of the financial system that is vital to supporting the economic growth and development process. Knowledge of what the Central Bank does and the reasons for its actions are essential for the efficient functioning of the financial markets and the effectiveness of the policy initiatives. In all these areas, the behavior of businesses and consumers at large are important in determining the final outcome. Having the knowledge and understanding of the issues would better equip consumers to manage their financial matters and to make well informed decisions regarding their own finances. In addition, it would also contribute to the soundness of the banking system and the efficiency of the payments system.

In this current environment, the issue of financial literacy from these perspectives has become more urgent, particularly in the emerging market economies of Asia, where household consumption is becoming an important driver of growth. The expanding cumulative domestic market in Asia is becoming massive, a factor that has been important in facilitating intra-Asian trade and thus driving the economic integration of the Asian region. This trend has the potential to contribute to the rebalancing of global growth and thus to address the structural imbalances currently prevailing in the global economy. Households therefore need to be financially strong if this trend is to be sustainable. Financial literacy will allow households to have the increased confidence to make sound decisions regarding their consumption expenditure.

Of importance to Central Banks is that consumer credit remains within prudential limits and do not impose undue risk to the consumers that can often result in financial stress. Consumers not only need to be able to assess their capacity for expenditure, savings and debts but also have to be able to select from the array of financial products and delivery systems that will best meet their requirements. Households need also to be aware of and understand the financial risks associated with their transactions. Greater financial literacy can contribute to mitigating these financial risks.

The growth in household debt is an increasingly evident phenomenon in Asia. Over the period of 2000 to 2004, the volume of consumer loans across seven major Asia Pacific economies grew at an average annual rate of 9 percent, relative to total loan growth of 5.2 percent and corporate credit growth of 2.6 percent. The risk emerges when debt reaches a level where it cannot be sustained, and ultimately leads to increased financial stress. It is therefore important that borrowers are financially savvy to manage financial risks in a proactive and constructive manner.

The environment we are operating in is becoming increasingly challenging. Individuals may not know where to seek information or do comparative shopping. The aggressive marketing by financial institutions may lure naÃƒÂ¯ve borrowers into financial transactions that cannot be sustained in the longer term. A number of regional economies have seen aggressive marketing of credit cards, that have led to situations where financial institutions were eventually compelled to write-off many bad loans. The observation from surveys is that many consumers do not fully understand relatively simple financial calculations, and hence do not realise the risks involved.

For some countries, the cost of borrowing may increase substantially depending on the prevailing conditions. This may result in difficulties in servicing the debt. Also this would depend on the extent of the household gearing. For Asia Pacific economies, this ratio of debt servicing to total income ranges from a low of two percent for economies that do not have sophisticated financial systems, to 74 percent at the high-end, where consumerism is well entrenched. While there is no magic number to determine prudent gearing, this ratio can be used to assess whether the financial risk is increasing. Over time, it could provide an indication of the level of debt that is manageable. Basic financial literacy would be necessary for such self-assessment.

A further risk, which is linked closely to the high cost of borrowing, is the reliance for financing from the informal financial sector. Very often such type of predatory lending results in perpetual debt since the interest rate is prohibitively high, and the borrower does not have recourse to legal aid or proper financial advice given that the transaction takes place in the informal financial sector. Increased financial literacy would avoid recourse to such financing and would facilitate greater reliance on the formal financial service providers.

An important objective of enhanced financial literacy is to achieve greater personal accountability for post-retirement financial, medical and social needs. Unlike in the developed economies, the financial burden of those who have retired with respect to health and retirement costs are usually borne by the individual. This requires understanding of the various insurance products and other health care plans. The most sustainable approach to mitigating this type of risk is to have informed participation in health and retirement funding schemes. Greater understanding and knowledge of these financial risks through improved financial literacy is the first step towards actively managing these risks.

Enhanced financial literacy can also contribute towards a more stable and sound banking system. A more discerning household sector can drive greater innovation, greater efficiency in terms of lower fees and charges and better quality of services. This combined with the monitoring by Central Banks to ensure that financial services are provided fairly and to ensure appropriate risk management and governance practices adopted by the industry increases the potential for enhanced stability and performance of the industry. This in turn enhances the potential for the industry to provide financing to households and enterprises thus contributing to the economic growth process.

Another instance where efficiency and potential of the industry can be enhanced is migration from paper-based payments to electronic payments. This would provide significant benefits to all parties as it provides a more efficient and reliable payment instrument and it attracts lower costs, increased convenience and a higher level of security.

In promoting financial literacy, several issues need to be addressed. One of the most critical issues is the apathy towards information. Irrational behavior, the inability to comprehend complex information, the perception that information is unreliable, or more often than not the reluctance to invest the time to study the information, are all reasons that increase such apathy.

In addressing financial literacy, the information provided to consumers needs to be simple, brief, contextualised to the needs of the consumer and delivered at the right time. An example is providing special, inclusive programmes for financially excluded groups that are at different levels of development and that face different challenges in managing their financial affairs.

The emerging best practices in enhancing financial literacy clearly suggest that an integrated and coordinated delivery of financial literacy initiatives is needed to address the issues highlighted above. This requires a comprehensive approach involving central banks, government ministries, NGOs and corporations to work collaboratively to promote financial literacy. Attention needs to be given to greater strategic focus on the outcomes to be achieved by the financial literacy programs. It will require concerted, deliberate and sustained efforts by all parties concerned. Finally, the progress made in advancing financial literacy needs to be tracked. This will allow for insights to assess the capacity of the financial system to handle greater levels of innovation and free market practices.

In Malaysia, a comprehensive approach has been adopted to enhance financial literacy in the country. The Financial Sector Master Plan, which was 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 Central Bank in partnership with the financial industry and other government agencies, has introduced the Financial Mediation Bureau, Deposit Insurance Scheme, Basic Banking Services Framework, Credit Counselling and Debt Management Agency, as well as created a new class of licensed Financial Advisers. These initiatives are also being reinforced by a higher level of transparency and disclosure.

A series of consumer education programs has been introduced, such as Bankinginfo and Insuranceinfo, both of which are delivered through various channels. These include road shows, pamphlets at the branches of financial service providers and dedicated Internet sites hosted by the central bank. Savings and education programs are also being promoted in schools.

More recently a one-stop centre was 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. This Centre was established to act as a centralised point of contact to facilitate a rapid and effective response for members of the public and small and medium enterprises (SMEs) in matters related to their requirements. Also a Credit Counselling and Debt Management Agency will be launched early next year. The Credit Counselling and Debt Management Agency is being established to undertake credit counselling and loan restructuring for individuals. This institutional arrangement will help consumers who encounter difficulties in meeting their financial commitments. Apart from being a source of information and advice on financial management, the arrangement would represent a more cost effective and prompt means of debt settlement through out-of-court procedures.

All these measures to enhance financial literacy involve all the parties concerned - the consumers, the financial service providers, the regulators and relevant Government ministries, the corporate and the NGOs. This collective approach reflects the importance of shared responsibility in helping consumers manage their financial risks more effectively. In this regard, the financial institutions who are the first line of contact with consumers, and who bear a major part of the financial risk in the event consumers suffer financial stress, need to play a greater role in helping create more informed participation in the financial system. The dividends in terms of lower non-performing loans and increased profitability makes this a win-win proposition. Financial institutions with their extensive branch networks, qualified financial management officers and extensive experience in assessing the risks facing consumers are best positioned to increase the level of institutional capacity that can enhance financial literacy.

We need to recognise our shared responsibility to equip the communities in our countries with the necessary skills and confidence in managing their personal financial matters. Collective efforts to develop institutional capacity to share information and knowledge about financial literacy across the region can also bring about mutually reinforcing results. Financial literacy needs to be elevated to a more important level on the national and international agenda for a greater shared economic prosperity.

On that note, thank you for your attention.