

## **Investor Education: Opportunities and Challenges**

**(As Prepared – 7 November 2012)**

**Claude, thank you very much for your kind remarks and your warm introduction.**

**I am very honored to be here today. I thank you for allowing IOSCO to join you and these distinguished speakers and participants who will be discussing this most important and timely topic of investor education. David Wright, the Secretary General of IOSCO not only sends his regards, but also his regrets that he is unable to be here today.**

**At my first meeting with David he made clear to me the importance of investor education to IOSCO and to him personally. At an investor education conference that was co-hosted by IOSCO in Seoul, Korea, in May 2012, David said, “Investor education is ...in fact vital, not for a fleeting minute in history, but permanently investors need educating now more than ever to break down the information asymmetries, be able to deal with rapid changes in the market place, and to better balance the huge differences in lobbying power between consumers – dispersed and fragmented – and the financial industry who are at the apex of global lobbying spending.”<sup>1</sup>**

**IOSCO has just over 200 members - about 115 of them are regulators of different countries. These members regulate more than 95% of the world’s securities markets. IOSCO is the leading international policy forum for securities regulators and is recognized as the global standard setter for securities regulation. Consequently, IOSCO’s guiding principles of securities regulation addresses investor education. Specifically, key issue 6 of Principle 3<sup>2</sup>**

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<sup>1</sup> “Importance of Investor Education and Current Real Challenges,” Speech by David Wright, Secretary General of IOSCO to the IOSCO/IFIE Investor Education Conference, Seoul, Korea, 21 May 2012. Located at, <http://www.iosco.org/library/speeches/pdf/IOSCOSP01-12.pdf>.

<sup>2</sup> See, “Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation” (IOSCO Principles), September 2011, and located at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf>.

says: “Regulators should play an active role in the education of investors and other market participants.”

Investor education is a key component of investor protection. Investor education can alert investors to potential problems, provide understandable explanations of products and processes, and also provide questions to ask, as well as helpful tools to assess investments and financial services professionals. Regulators are clearly in a unique position to provide this unbiased and objective information to potential investors. Investor education can lead to market expansion and growth with confident and informed investors.

Indeed, in today’s complex and challenging world there seems to be almost unanimity in the stated benefits to be gained from investor education. Ben Bernanke, the U.S. Federal Reserve Chairman and a former Princeton University Professor said, “Financial education supports not only individual well-being, but also the economic health of our nation.” And, “consumers who make informed decision about financial products and services not only serve their own best interests, but, collectively, they also help promote broader economic stability.” “Financial education “can play a key role” in promoting financial planning such as budgeting and saving for emergencies and retirement, which can help households live better and be better positioned to handle financial shocks....”<sup>3</sup>

Well, if investor education is such a good thing, then:

1. how broad and how deep are the investor education literacy challenges, and
2. what are some of the challenges facing those of us who are committed to advancing investor education, and
3. what can be done about those challenges?

In the minutes I have remaining, let me just briefly discuss each of these three areas and provide what I hope you will find to be some insights and some topics we can consider in this one-day conference.

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<sup>3</sup> “Ben Bernanke: Financial education supports economic health of U.S.,” *The Washington Post*, August 7, 2012.

**1. How broad and how deep are the investor education literacy challenges?**

The short answer....very broad and very deep!!

A fairly recent article in the *Journal of Pension Economics and Finance* entitled, “Financial literacy around the world: an overview,” stated that “(n)ew international research demonstrates that financial illiteracy is widespread in both well-developed and rapidly changing markets.”<sup>4</sup> It also seems that the demographic groups that display the lowest level of literacy are the same across the countries studied. The authors found that “women are less financially literate than men, the young and the old are less financially literate than the middle-aged, and more educated people are more financially knowledgeable.”<sup>5</sup>

Based on this and other research, and what we have heard from some IOSCO members, global financial literacy levels seem to be low. In short, there seems to be a global crisis of financial illiteracy that must be addressed by responsible parties.

Let me give some specific examples of this global crisis of financial illiteracy from a country that I am familiar with - The United States. On August 30, 2012, the U.S. SEC released the results of a financial literacy study that was mandated by the Dodd-Frank Act. Included within that extensive report was research that was conducted by the Library of Congress, titled “Financial Literacy Among Retail Investors in the United States.” The essence of that report was probably best captured by an article in *The Wall Street Journal* that was titled “Good News for Fraudsters, Financial Illiteracy is Widespread.”<sup>6</sup> The first paragraph of the article said, “Good news for those intent on committing fraud. Bad news for everyone else. American investors apparently don’t know much about anything financial.”

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<sup>4</sup> Annamaria Lusardi and Olivia Mitchell, *Journal of Pension Economics and Finance*, Vol. 10, Issue 4, October 2011, pp. 509 -525. This issue had articles that specifically examine financial literacy in Germany, Italy, Japan, the Netherlands, New Zealand, Russia, Sweden, and the United States. It also included an article on “Assessing financial literacy in 12 countries: An OECD/INFE international pilot exercise.”

<sup>5</sup> Id.

<sup>6</sup> *The Wall Street Journal*, August 30, 2012.

Rather than try and provide you with compelling statistical data from the report, let me provide you with one key and rather astonishing quote:

**“These studies have found that American’s do not understand the most basic financial concepts, such as the time value of money, compound interest and inflation. Investors also lack essential knowledge about more sophisticated concepts, such as the meaning of stocks and bonds; the role of interest rate in the pricing of securities; the function of the stock market; and the value of portfolio diversion (spreading investments across asset classes to reduce risk). Surveys also demonstrate that investors lack essential knowledge about investment fraud and the importance of investment costs and expenses.”<sup>7</sup>**

And before we say, “that is all in America,” please keep in mind the research I cited that financial illiteracy is globally widespread in both well-developed and rapidly changing markets.

Clearly there is much work that should and that must be done!

## **2. *What are some of the challenges facing those of us committed to investor education?***

Someone once said “Difficult problems have simple answers.....and they are usually wrong.” That certainly applies to investor education.

Let me pose rhetorically just some of the questions we have raised at various IOSCO Seminar Training Programs (STPs) where we have addressed the multitude of issues relating to investor education. Might I also suggest these questions could provide a basis for further discussions – including discussions at this conference?

### **1. What do you do with respect to investor education?**

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<sup>7</sup> “Financial Literacy Among Retail Investors in the United States,” at page 5-6, December 30, 2011. Located at <http://www.sec.gov/news/studies/2012/917-financial-literacy-study-part2.pdf>.

- 2. Are there topics and products that you do not cover? How do you make that decision and why? It is interesting to note that some IOSCO members cover basic financial terms and concepts, while other members discuss much more complex problems and concepts.**
- 3. How do you define “complex products” and what investor education do you offer to investors with respect to complex products – if any?<sup>8</sup> Incidentally, IOSCO has a work stream examining all of the regulatory ramifications of retail structured products.**
- 4. Why do you do what you do? That is, what mandate and goals do you have with respect to your investor education program?**
- 5. How do you evaluate what you do?**
- 6. How do you determine/evaluate/measure objectively the success of any investor education program? Do you see how well an investor performs on a test or do you see if the investor made money or did not lose money in the market place, etc.?**
- 7. Do you have statistical data that rigorously evaluates and validates and verifies the success of the program? The key here is to use statistically derived random sampling procedures. That will ensure that survey results can be defended as statistically representative of the population. Surveys that do not follow these procedures can produce results that lead to misguided market research, strategic or policy decisions. It is a well know statistical principal that any so called “survey” in which no attempt is made to randomly select respondents, such as call-in readers’ or viewer “polls,” is likely to produce results that in no way reflects overall public opinion – even if many thousands of individuals participant.<sup>9</sup> Unfortunately, there are investor education surveys that clearly fall within that category.**
- 8. What are some characteristics of a successful and robust investor education program that can be replicated by others?**

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<sup>8</sup> “Complex Products - Heightened Supervision of Complex Products” FINRA Regulatory Notice 12-03, January 2012. Located at <http://www.finra.org/Industry/Regulation/Notices/2012/P125398>.

<sup>9</sup> For a brief discussion of this and other basics of sampling, see, <http://www.marketdirectionsmr.com/wp-content/uploads/2011/02/samplesize.pdf>.

- 9. This is important....If there is evidence that effective investor education occurs at the point of sale (“POS”)<sup>10</sup>, then how do you provide that information in an objective unbiased fashion and avoid the clear conflict of interest? Some industry initiatives might better be described as “product education” or even “sales pitches” rather than a comprehensive objective investor education program?<sup>11</sup>**

**As David Wright noted in his investor education speech in Korea,<sup>12</sup> investor education should work as follows: Financial education leads to financial literacy which leads to good financial decisions and behavior. Please demonstrate and provide statistically reliable data of programs that meet these goals, and that are proven winners. We can advise our members of the programs and advocate those programs around the world.**

**Here are some additional challenges with respect to investor education as well as some additional “food for thought.”<sup>13</sup>**

- 1. Investor education is a difficult undertaking given the complexity of today’s products. How can consumers ever be expected to keep up with the new financial products and offerings?**
- 2. Financial literacy is not the only element for good financial decision making.**
- 3. Inefficiency. Limited resources.**
- 4. For some, personal finance classes increase confidence without improving ability – potentially leading to worse decisions.**

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<sup>10</sup> See discussion and PowerPoint presentations at SEBI – OECD International Conference on Investor Education, Goa, India, 3-4 February 2012. See especially the PowerPoint presentation of Professor Lewis Mandell.

<sup>11</sup> This concept was addressed by IOSCO C3 in their “Report on Investor Education Initiatives Relating to Investment Services,” July 2012 at page 23.

<sup>12</sup> See footnote 1.

<sup>13</sup> For a full discussion of these ideas please see: “Evidence and Ideology in Assessing the Effectiveness of Financial Literacy Education,” 46 SAN DIEGO L. REV. 415 (2009), available at <http://ssrn.com/abstract=1098270>. “Financial Education: Lessons Not Learned Lessons Learned,” Boston University School of Management Federal Reserve Bank of Boston Conference on Financial Education Consumer Financial Protection (May 2011), available at <http://ssrn.com/abstract=1869313>. “The Financial Education Fallacy,” 101 AMERICAN ECON. REV.: PAPERS PROCEEDINGS 2011, available at <http://ssrn.com/abstract=1869323>. “Against Financial Literacy Education,” 94 IOWA L. REV. 197 (2008), available at <http://ssrn.com/abstract=1105384>.

5. **Avoiding a regulation through education model that might blame investors for their plight, shaming them and deflecting calls for effective regulation. Of course, investor education must never relieve regulators of their jobs. Investor education should complement regulation. It is not a substitute for solid regulation that of course includes a robust sanctions regime.<sup>14</sup> Speaking of sanctions, and just to be very clear, investor education is NOT a substitute for meaningful sanctions. Given the huge asymmetries in the markets we do not need to just have investor education, but we also must have sanctions that are a meaningful deterrent so that mis-selling and any other market abuse activities are truly a costly experience and a real deterrent for any perpetrator.**
6. **Investor education should extend to all market participants and professionals.**

### **3. What can be done about those challenges?**

**Just as it has been a global standard setter with respect to securities regulation, IOSCO intends to not only advance, but also to “move to the front of the line” and have as a program priority the IOSCO education and training team work with respect to investor education. We will also work to enhance and to broaden the reach and scope of IOSCO Investor Alerts.<sup>15</sup>**

**While IOSCO will continue to advance its own investor education initiatives, IOSCO Secretary General David Wright has indicated that IOSCO is willing to partner with other organizations that not only share our passion for investor education, but we also seek to work with organizations that provide a strategic alliance and make sense (via economies of scale and offering unique expertise)**

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<sup>14</sup> For an interesting discussion on this concept, see “When Will retail Investors Call It Quits?,” *The Wall Street Journal*, August 2, 2012. Referencing the “flash crash” author Jason Zweig wrote, “If small investors needed any more reason to be disgusted with the stock market, they got it on Wednesday...” He went on to write, “Almost continuously since 2008, retail investors have been dumping mutual funds that invest in U.S. stock. More than \$129 billion gushed out of U.S. stock funds in the 12 months ending in June according to Morningstar. In July another \$7 billion leached away.”

<sup>15</sup> See, [http://www.iosco.org/investor\\_alerts/](http://www.iosco.org/investor_alerts/).

as we work to combat this global crisis of financial illiteracy. Consequently, we invite others to come and join us in our global effort.

At this stage let me tell you about the IOSCO Foundation and as well as some of the specific IOSCO activities that are on the horizon with respect to investor education.

### The IOSCO Foundation

The IOSCO Board at its meeting in October gave strong support to the establishment of the IOSCO Foundation. That foundation will seek funding to advance IOSCO's growing demands and work in three key areas: technical assistance, research, and education and training. A major component of education and training will be our work on investor education, as well as increased education and training programs, an on-line library of investor education and regulatory materials, a global certificate program, as well as an international exchange program for securities regulators.

Why is IOSCO proposing a foundation?

First, the world is rapidly moving to more market based financing. Second, many of our members, particularly in the emerging markets, need help in developing and growing the investor base of their market with informed and knowledgeable investors. And finally, our global market based economy presents monumental regulatory challenges before us that require a sustained and concerted global effort.

Given the importance of this foundation and its future implications it was also agreed that in the next few months we will also be seeking pre-commitment agreements from potential donors, in order to have a clear idea of what their level of engagement will be with the Foundation. Please contact David Wright if you are interested or if you want to be a part of this exciting global effort.

### What is on the IOSCO investor education horizon?

Additional IOSCO Foundation resources will allow us to fully expand each of the following initiatives:



**1. *Investor Education Workshops:*** Similar to IOSCO’s highly popular STPs and Mobile STPs, we will offer week long workshops that examine, from a very practical point of view, how to properly address the multitude of investor education issues IOSCO members face. We will all work together and we will all learn and listen because no one has a monopoly on good ideas. And IOSCO members in particular have lots of good ideas with respect to investor education and how to get the job done.<sup>16</sup>

**2. *Investor Education Website / Resources at IOSCO for IOSCO Members.***

**3. *Continue Member Research and Assessment:*** IOSCO Secretariat will ensure that the excellent work and insightful ideas exhibited in the July 2012 C3 report, will be used to “inform the broader based investor education work of IOSCO and E&T.”<sup>17</sup>

**4. *Forums to share “Best Practices” and “Good Ideas.”***

**5. *Research, Research, Research.***

**6. *IOSCO Publications as to what works and what does not work that is based on solid research and valuable experiences.***

I thank you again for inviting me and IOSCO to participate in this very important conference. I look forward listening and learning a lot that we can share with our IOSCO members.

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<sup>16</sup> Many of these good ideas were captured in a document prepared by the IOSCO Education and Training Team and titled, “Investor Education: An Analysis of IOSCO Member Websites and Web-Based Information.” This document is located on the member only section of the IOSCO website.

<sup>17</sup> “Report on Investor Education Initiatives Relating to Investment Services,” July 2012, page 4. Published on IOSCO member only website. Other valuable work has been done by IOSCO members to include: Technical Committee Report from March 2001, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD117.pdf>, and Emerging Market Committee Report from October 2002 <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD140.pdf>.