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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

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Governor Kwon (FSSK), Chairman Park (KOFIA), distinguished guests, Ladies and Gentlemen,

Thank you for inviting me to this prestigious conference, I am very honoured to be here. The last time I was here was in 2010 during Korea's presidency of the G20 and we held important meetings in this very hotel and in Busan on the coast. Unfortunately I barely saw the light of day because we had to work for many hours to agree communiques etc.

I have come from Beijing where last week we had a very successful IOSCO Conference where we had all our Members in attendance and hundreds more participating in the public part of the programme.

It was successful because:

- We agreed on the formation of IOSCO's new Board structure and its leadership (Masamichi Kono from Japan as Chair until March 2013, then Greg Medcraft from Australia until September 2014). Furthermore, we agreed on the Chairs, Vice-Chairs and members of all our 7 main policy committees;
- Secondly we moved forward with some of our important G20/FSB mandates particularly in the shadow banking, OTC Derivatives and commodities areas;
- We added 4 new signatories to the IOSCO MMOU process a unique arrangement which requires regulators to cooperate with each other and provide



information to each other on request for enforcement purposes. Today 86 countries have signed up; another 14 or so are in the pipeline and we hope to have many more firm signatures before the end of the 1.1.2013 deadline. Encouragingly those outside are feeling the pressure of not being inside – and most are making real efforts to comply. Today the MMOU covers 95% of the worlds' securities markets and over 2000 exchanges of information per year. No mean feat for a non-binding instrument;

- Fourth, The IOSCO Secretariat Generals' proposal to build an IOSCO FOUNDATION was universally welcomed. Structured around 3 pillars – technical assistance, education and training and research – the Foundation, once agreed by IOSCO's Membership will strengthen IOSCO's inclusivity and help ensure the implementation of IOSCO principles and standards. Consultation will be held until end-June and a final proposal should be made in the autumn. A strong governance and accountability model and avoidance of any conflicts of interest regarding funding are sine-qua-non. For the education and training part we need funds for investor education training modules all over the world; for training the trainers; for specific specialized training on securities markets issues; for arranging one year exchange programmes between regulators to gain experience; and to build up a sophisticated electronic library of top class teaching classes...

Throughout the Beijing Conference there was a recognition of the growing role of securities markets in the future financing of the world economy, as bank lending is constrained by the new Basle rules, as global financial leverage decreases and as public sector deficits remain under fierce supervision. There was a growing recognition as well that we must all work harder to identify emerging security market risks, and use this intelligence to shape our forward agendas. The global financial industry wants IOSCO to be positioned upstream of national and regional lawmaking in the regulatory cycle – identifying, anticipating and acting early. If we can do this IOSCO will be much enhanced as the global body for securities regulation.

Ladies and Gentlemen,

Financial markets remain very volatile across the world, including the effects being felt here in Korea. The crisis in the Eurozone, some widening sovereign debt spreads, low growth in the Western world, high unemployment...and evident worsening contagion are worrying. There is no solution to this profound financial crisis without strong international cooperation – not just fine diplomatic words – but decisive, commonly implemented action. That for example deals effectively with the resolution of failing large cross-border financial institutions without triggering panic and without resorting to hugely expensive tax payer bail outs.

But as global financial markets inevitably expand with deepening global trade links and interconnectivity – electronic and commercial – we have to make sure that the financial system is safe, sustainable and works for the economy, not the economy working for finance.



In short this is the mandate of the g20 and the FSB. This means defining good rules, implementing effective supervision and fully understanding all the capital flows and pitfalls in the market place. Unfortunately none of these 3 essential conditions were met in the biggest markets in the world leading up to this crisis.

Financial markets are composed of the demand and supply sides, retail, wholesale and infrastructure. In this matrix, the retail side is the least knowledgeable, the least prepared and often very vulnerable to a powerful incentivized supply side - an equation made worse by huge information asymmetries in favour of financial services suppliers.

And yet, given these disequilibria, given that many global populations are ageing and that they will have to take more responsibility for their future pensions etc., it is frankly rather astonishing that the governments and regulators of the world do not give the populace at large the tools to do the job – i.e. the ability to choose well the financial products they need from the tens of thousands on offer. Financial service suppliers face, in general, weak sanctions regimes if they mis-sell, insufficient product regulation to protect consumers and erratic supervision of the basic regulatory tool box – disclosure, transparency, conduct of business and suitability criteria. The cards, in short, are stacked one way.

So let me state the obvious (or maybe not so obvious):

Investor education is really important – 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.

IOSCO and I support and recognize fully the importance of investor education. I have always believed that financial literacy should form part of the core curricula in schools from Kindergarten to the end of secondary education. I am glad to note that INFE and the OECD agree.

Pertaining to Investor Education, let me ask you rhetorically:

- How do you evaluate what you do?
- How do you know if you are successful?

Let me focus on the last two critical points that I hope you can dwell on in this conference: How do you define success when it comes to investor education?

- Where is the statistical data that has been rigorously evaluated?
- There are questions and there seems to be a lack of consensus as to:
 - What is to be measured? (Score on a test, made money in the market, did not lose money, etc.)
 - How it should be measured? (Self-report, made money, how much money, a high score on a test? etc.)



- Are people making rational financial decisions or are they driven by passion?
- Do people make better decisions after they have followed financial literacy courses and been so called financially "educated"?

The key is to use statistically derived random sampling procedures. These 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.

Any so-called "survey" in which no attempt is made to randomly select respondents, such as call-in readers' or viewers' "polls", is likely to produce results that in no way reflect overall public opinion - even if many thousands of individuals participate.

Let me quote an interesting passage from the work of Professor Lauren E. Willis...She wrote in 2008 in the IOWA LAW REVIEW the following:

"The dominant model of regulation in the United States (and for that matter in most countries) for consumer credit, insurance, and investment products is disclosure and unfettered choice. As these products have become more complex, consumers' inability to understand them has become increasingly apparent, and the consequences of this inability more dire. In response, policymakers have embraced financial-literacy education as a necessary corollary to the disclosure model of regulation.

This education is widely believed to turn consumers into "responsible" and "empowered" market players, motivated and competent to make financial decisions that increase their own welfare. The vision created is of educated consumers handling their own credit, insurance, and retirement planning matters by confidently navigating the bountiful unrestricted marketplace.

Although this vision is seductive, promising both a free market and increased consumer welfare, the predicate belief in the effectiveness of financial-literacy education lacks empirical support. Moreover, the belief is implausible, given the velocity of change in the financial marketplace, the gulf between current consumer skills and those needed to understand today's complex non-standardized financial products, the persistence of biases in financial decision making, and the disparity between educators and financial-services in resources with which to reach consumers.

Harboring this belief may be innocent, but it is not harmless; the pursuit of financial literacy poses costs that almost certainly swamp any benefits. For some consumers, financial education appears to increase confidence without improving ability, leading to worse decisions.

When consumers find themselves in dismal financial straits, the regulation-through-education model blames them for their plight, shaming them and deflecting calls for effective market regulation. Consumers generally do not serve as their own doctors and lawyers and for reasons of efficient division of labor alone, generally should not serve as their own financial experts. The search for effective financial-literacy education should be replaced by a search for policies more conducive to good consumer financial outcomes."



HERE IS HOW INVESTOR EDUCATION SHOULD WORK:

Financial Education \rightarrow Financial Literacy \rightarrow Good Financial Decisions and Behavior Please demonstrate and provide <u>statistically reliable data</u> of programs that meet the above and that are proven "winners" so that we can determine best practice and advocate those programs around the world!

Finally here are some of provocative statements to debate:

- 1. Investor education is an impossible undertaking given the complexity of today's financial products. Consumers, en masse, will never be able to catch up and fully cope with the rapidly changing market place. Disclosure and transparency are totally insufficient as a policy instruments. Caveat emptor is dead and the swathe of recent mis-selling scandals proves it (subprime, PSI, split caps....). Only very strict product regulation, strict conduct of business rules and deterrent sanctions regimes for mis-selling have a chance of working.
- 2. Financial literacy is not the only element for good financial decision making. Strong sanctions, effective supervision and product regulation are essential requirements....
- 3. **Most investor education programmes are inefficient**. See new behavioural economics; generally they are too small and underfunded; and usually have the symptoms of lack of sustainability and staying power...
- 4. For some, personal finance classes increase confidence without improving ability potentially leading to worse decisions. Research shows that only long term, individually tailored programmes in small class rooms can work...
- 5. The Regulation through education model might end up blaming investors for their plight, shaming them and deflecting calls for effective regulation. That is, regulation MUST NEVER relieve regulators of their jobs. Investor education is there to compliment regulation...it is not a substitute for solid regulation.
- 6. Investor education tests should extend also to professional investors and eligible counterparties. Those wanting to take on major leadership roles in major systemic firms should prove to the regulators that they are competent, professional and knowledgeable. In short that they are fit-for-purpose. Unfortunately this crisis has shown that many were not.

Thank you and I you all a fascinating conference on this important subject.



Source Materials for the above:

Evidence and Ideology in Assessing the Effectiveness of Financial Literacy Education, 46 SAN DIEGO L. REV. 415 (2009), available at <u>http://ssrn.com/abstract=1098270</u>

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://srn.com/abstract=1869313

The Financial Education Fallacy, 101 AMERICAN ECON. REV.: PAPERS PROCEEDINGS 2011, available at http://srn.com/abstract=1869323

Against Financial Literacy Education, 94 IOWA L. REV. 197 (2008), available at <u>http://ssrn.com/abstract=1105384</u>