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Hungarian Central Bank

The Increasing Importance of Financial Education

Remarks by Angel Gurría,
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OECD

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Prime Minister, Governor, distinguished guests;

It is my pleasure to be here with you today to speak about an issue of critical importance in today's world: financial literacy.

The global financial crisis has touched every country. Governments see that they need to bolster prudential regulation with other measures that can protect and strengthen the financial system. One of these measures is to provide better information to consumers of financial services. A well functioning financial system requires better consumer-oriented financial education.

Consumers must be able to make informed choices.. The current financial crisis is the result of many complex factors; but one of the sources of the problem is the misinformed US home buyer. If there is a consolation to be drawn from this crisis, it is that from now on, no one will ignore the importance of financial education and literacy.

Financial literacy helps consumers manage their income, save and invest wisely and avoid fraudulent practices. Today it is even more important. Financial products are increasingly diverse and complex. Between 2007 and 2012, over 700 million new credit cards will be issued world-wide. Here in Hungary and other Central European countries, many consumers have taken foreign currency mortgages and other loans without fully appreciating the risks. An increasing number of people have also assumed the control and responsibility of managing their own pensions.. Better financial understanding is an urgent and essential tool to help our societies build a safer future..

The OECD has recognised this urgency. Last June at the OECD's Ministerial meeting, I assured governments that the OECD would strengthen its leadership on financial education by addressing new trends, developing guidelines and exchanging worldwide good practices. Around the world, national strategies are being deployed in Canada, the UK, the US, New Zealand, Australia and Mexico. I am happy to be here to help launch Hungary's national financial education strategy.

Later today, André Laboul will speak about the OECD Financial Education programme which includes the goal of issuing, by early 2009, a set of financial education principles based on good practices in the area of credit.

I would now like to focus on two issues -- pensions and insurance and financial literacy for a very important segment of the population -- youth.

I think there is wide-spread uneasiness about pensions. Your Central Bank confirmed in 2006 that the average Hungarian knows very little about his or her pension. Hungarians don't plan for the future. But Hungarians are not unique in this. People across OECD countries are not aware of the importance to save for their retirement and are not saving enough to ensure an adequate retirement income. And often, they are not saving wisely.

Most OECD countries are also wrestling with how to maintain a sustainable public pension system in the face of aging populations. Many countries have undertaken pension reforms – which frequently involve new policies that require individuals to take more responsibility for funding their retirement income -- for example, lower levels of retirement income for a given number of years of work.

Companies and governments are also switching from defined benefit to defined contribution pension plans. Under defined contribution plans, individuals face a number of financial risks:

investment risk during the accumulation phase; and longevity and inflation risk during the decumulation phase.

With the increase in life expectancy, individuals will need to ensure that they have adequate savings for the longer period they can expect to spend in retirement. Individuals also face a high risk of volatility with the adequacy of retirement income dependent upon financial conditions in the year of retirement.

Private pensions are growing as a source of retirement income. Private pensions are complex – and probably frightening to the average consumer. They involve tax issues, assumptions about future salaries, longevity and interest rates.

Another vehicle for retirement savings is insurance products. Hungary, like many countries, has seen strong development of unit-linked insurance products. In 2007, these products represented more than two-thirds of life insurance premiums in Hungary and most of their annual growth. These products require that individuals bear most of the investment risk and responsibility for the definition of asset allocation. Only financially literate consumers -- with the knowledge and skills to make informed choices – can make the most of these tools.

Governments can learn from one another about how to raise financial awareness. Many governments have launched successful campaigns to raise public awareness and explain the need for pensions reform, and the increased responsibilities of individuals, and how to manage the choices that must now be made. The next challenge (for the OECD) is to develop the tools to measure the extent to which this awareness is translating into a concrete change in behavior.

The countries of Central and Eastern Europe launched campaigns for the introduction of their individual account-based pension systems in the late 1990s. They used a wide range of media vehicles — like advertising campaigns, brochures, call centres, information packages — and diverse partners — like journalists, politicians, NGOs, unions. By and large, these countries are viewed as having been successful in equipping consumers with the information they needed to make the right decisions.

The Hungarian government is now developing a communication strategy on the continued need for pension reform in the country. I was especially impressed with two innovations: first, the use of a Pensions Roundtable of Experts to develop a national pension plan based on maximum consensus. And second, civic platforms involving internet based, deliberative discussions around the initiative have also been launched.

The OECD pays a lot of attention to such innovations. Through our country surveys and analytical work, we turn successful experiences into guidelines and principles that other others can use in developing their own strategies. To that effect, the OECD recently released its Recommendation on Good Practices for financial education relating to private pensions. This recommendation draws on Hungarian experience and may be useful to you as you launch further financial education initiatives in the pension area.

Another subject for financial education that often does not get enough attention is risk awareness and risk insurance. Once again, over the past ten years, responsibility has shifted to households to manage risks. This trend was driven by decreasing overall public support and the emergence of an increased variety of risks, such as health-risks or natural and man-made disasters and the uncertain consequences of climate change.

Private, market based insurance mechanisms and products are likely to play greater social and economic roles. They offer efficient customised tools to cover individuals' risk exposure and respond to their saving needs.

Once again, surveys reveal that households across OECD countries have a low level of awareness of the risks they face. And they lack knowledge about insurance products and issues. This is not surprising given the variety and complexity of insurance products, markets, providers and distributors.

We see a number of resulting negative side effects such as little or no insurance coverage for vulnerable groups in case of disasters or important illnesses; increased costs for governments linked to ex-post assistance and difficulty in undertaking policy reform in order to spread the burden of overall increasing risks.

Former socialist countries face an added burden, given that the notions of private insurance and individual responsibility for financial risks and protection are relatively new. Older generations cannot help the younger ones to take on these responsibilities and make the right choices to protect themselves.

A particular issue in Hungary illustrates this well. Hungary, like many parts of the globe, faces an increasing risk of dramatic flooding which could match or even exceed the magnitude of the 2002 catastrophic flooding in Central Europe. Large-scale flooding could even jeopardize the financial soundness of the public compensation scheme in place.

The Hungarian government has undertaken to reform the current scheme, to shift at least part of the risk to the private insurance market, and to develop and enforce more rigorous risk reduction measures.

However, in the absence of appropriate risk and insurance awareness, the reform has proven difficult to implement. Individuals are simply unaware of the potential risks they face, and the public is reluctant to accept the partial private financing of such risk. Consequently, few consumers are opting for flood insurance.

Many OECD countries now include risk and insurance awareness and education in their overall financial education programme. Another strategy is to tailor initiatives to particular challenges concerning specific risks and/or insurance products.

Finally, I would like to talk about a very important group: young people. You might think that young people – today's teens and twenties – who are so much more sophisticated than we were (with their computers and Internet and iPods, etc.) would be more sophisticated about money. Well, that's not the case.. Young people are not interested in financial issues. They don't access information on financial services; they don't know about banks – except for the most simple current accounts and credit cards. Surveys in OECD countries show that adults have limited financial ability; young people have much less. Fortunately, we already see a large number of financial education programmes being deployed in schools.

However, good statistics on financial literacy of students are hard to find. In order to have better indications on the progress of students' financial literacy levels, I would invite OECD countries to give some thought to expanding the OECD Programme for International Students Assessment (PISA) to include a financial literacy component.

Prime Minister, Governor, Ladies and Gentlemen:

The current financial crisis has put a spotlight on the importance of financial education. But even without this crisis, developments in financial markets, demographics, economic and policy changes are all pointing to the importance of financial education.

Financial markets are very complex. New products are being offered continuously. Consumers now have access to a greater variety of credit and savings instruments and are taking on more debt. Changes in pension arrangements mean an increasing number of workers will have to take more responsibility for saving for their retirement.

Surveys of financial literacy indicate consumers in many countries do not have adequate financial background or understanding and that they underestimate their needs for education. A well functioning financial system requires better consumer-oriented financial education.

The OECD will provide sound analysis based on reliable data and good practices to support policy development and measurement of effective financial literacy policies and programmes.

The OECD welcomes the recent initiatives of the Hungarian Government and Magyar Nemzeti Bank aimed at improving the financial literacy of Hungarians.

I wish you a successful conference.