

K C Chakrabarty: The what, why, who and how of financial literacy

Address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the stakeholders' workshop on "Financial literacy", organized jointly by the UNDP, NABARD and MicroSave, Mumbai, 4 February 2013.

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Dr. Prakash Bakshi, Chairman, NABARD; Ms. Caitlin Wiesen, Country Director, UNDP India; Mr. Manoj K. Sharma, Director, MicroSave; delegates at the Workshop, ladies and gentlemen. As you all know, financial literacy has emerged as a focus area for policy makers not just in India, but all across the globe, particularly in the aftermath of the global financial crisis. Success in dissemination of financial literacy has been identified as key to meeting the critical objectives of financial inclusion and consequently, financial stability. The workshop is extremely topical as it brings together key stakeholders and brainstorms on steps needed to provide impetus to the financial literacy mission going forward. I congratulate the organizers for today's initiative and hope that some meaningful and credible strategies emerge from the deliberations.

The United Nations Development Programme (UNDP) has had a significant impact on the social emancipation of people across the globe, ever since its inception in 1966. Over the years, it has focused on Poverty Reduction, Democratic Governance, Crisis Prevention and Recovery; and Environment and Sustainable Development. It is heartening to note that UNDP has partnered with the Government machinery and civil society in India, with a particular focus on seven of the less developed states, to work towards improvement in the quality of lives of the poorest of the poor. Achieving inclusive growth has been one of the predominant objectives of UNDP's programmes in India and across the world. NABARD, as you all know, was set up with a mandate of facilitating credit flow for promotion and development of agriculture, rural industries and services. It has evolved to occupy a pivotal position in the financial inclusion efforts, particularly in the rural hinterland of the country. Similarly, MicroSave has also made important contributions in the field of financial inclusion by successfully partnering with diverse stakeholders such as financial institutions, investors, donors, corporate and regulators for providing, what its corporate tagline claims, "Market-led solutions for financial services". I am happy to note that the three organizations have come together to host today's seminar and hope that the partnership yields fruitful results for our financial inclusion/ financial literacy initiatives.

I am happy to note that at the behest of UNDP and NABARD, MicroSave has conducted a Financial Literacy Assessment Survey to assess the current status of financial literacy in the UN focused states and to gather relevant inputs from other similar programs operating nationally/ internationally. It is, indeed, very important not only to work hard, but also to have periodic appraisals of the performance, as it helps one to refocus, reorient and undertake mid-course correction, which is so very vital to the achievement of the ultimate objective. I am sure the insight gained from this exercise would provide valuable guidance to UNDP and help them in further streamlining the existing programs and taking it further, both – in terms of its penetration across the targeted states and the impact it has on the financial behavior of the beneficiaries.

In my address today, I shall answer four basic questions about financial literacy:

- What is implied by the concept of financial literacy?
- Why is financial literacy necessary?
- Who all need to be made financially literate and in what aspects?

- And finally, how to spread financial literacy?

What is implied by the concept of Financial Literacy?

Let me begin by answering the first question. Financial literacy is not a new term to all of us present here. While we have heard a number of definitions of financial literacy, I would use the one given by OECD, which defines it as “a combination of financial awareness, knowledge, skills, attitude and behaviours necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.” Financial literacy is expected to impart the wherewithal to make ordinary individuals into informed and questioning users of financial services. It is not just about markets and investing, but also about saving, budgeting, financial planning, basics of banking and most importantly, about being “Financially Smart”.

Financial literacy is a complex concept, and it is important to understand its full import. In fact, as a society, we are yet to fully recognise the need and potential of financial literacy. As I would explain subsequently, financial illiteracy permeates across all levels of society and economic strata. The nature of illiteracy and its manifestations may vary, but it gets reflected in the everyday financial choices that many of us make. The lack of basic knowledge about financial products and services and their risk-return framework is one common instance of financial illiteracy that is widely observed. The greed for higher returns eventually culminates into a crisis involving larger number of retail investors. This basic lesson holds true not just for an individual investing his hard earned savings in financial products, but also for a bank or financial institution that manages public funds and channels them, either as investments or loans. Thus, appreciation of various aspects of financial literacy and how it impacts our lives holds the key to prudent financial planning and welfare maximisation, both- at the individual level and for the society as a whole.

Why is Financial Literacy necessary?

I, now, come to the second question: Why is financial literacy necessary? Together with Financial Inclusion and Consumer Protection, Financial Literacy forms a triad, which is necessary for ensuring financial stability. Not only do the three have a bearing on financial stability, they also have a strong interplay among each other, with each having a vital impact on the other. Thus, financial literacy has significant relevance for financial inclusion and consumer protection. Without financial literacy, we cannot expect to make major headway in either financial inclusion or consumer protection.

Financial inclusion, essentially, involves two elements, one of access and the other of awareness. It is a global issue, and the relative emphasis on the two elements varies from country to country. For developed countries with widespread financial infrastructure, the access to financial products/services is not a matter of concern. It is more of a financial literacy issue in that market players/consumers are required to be educated about the characteristics of the available financial products/services, including their risks and returns. In developing countries like India, however, the access to products itself is lacking. Therefore, here, both the elements, i.e. access and awareness need to be emphasized, with improving access assuming greater priority.

Financial Stability, as a policy objective, refers to the avoidance of financial crises as also to the ability of the financial system to limit, contain, and deal with the emergence of imbalances before they pose a threat to the economic processes.¹ The recent global financial crisis is a glaring example of how lack of financial literacy can impact financial stability. The genesis of the crisis was in the sale of inappropriate mortgage products to sub-prime borrowers, who did not understand the product characteristics. The crisis was also fanned by the creation of

¹ Schinasi, Garry (2004), “Defining Financial Stability”, IMF Working Paper, WP/04/187.

sophisticated financial products by seemingly expert market participants, without understanding the underlying risks involved. Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System, remarked “In light of the problems that have arisen in the subprime mortgage market, we are reminded of how critically important it is for individuals to become financially literate at an early age so that they are better prepared to make decisions and navigate an increasingly complex financial marketplace”.²

As already noted, financial literacy involves imparting knowledge about the risk and return of financial products to the users and providers of these products. It is this knowledge that helps in containing risks and maintaining stability in the financial system. I would like to argue that with knowledge, financial market players are expected to control their avarice for higher returns, keeping in view their inherent risk taking abilities.

Financial literacy is an essential pre-requisite for ensuring consumer protection. The low levels of transparency and the consequent inability of consumers in identifying and understanding the fine-print from a large volume of information leads to an information asymmetry between the financial intermediary and the consumer. In this context, financial education can greatly help the consumers to narrow this information divide. Besides, knowledge about the existence of an effective grievance redress mechanism is essential for gaining the confidence of the unbanked population and overcoming apprehensions they may have about joining, what would appear to be a complex and unfriendly financial marketplace. For the population group that would have newly entered into the formal financial system through our financial inclusion initiatives, awareness about the consumer protection mechanism is critical as any unsavory experience could result in them being permanently lost to the financial system.

Who needs to be financially literate and in what respect?

This brings me to the third question of who needs to be financially literate. I shall argue here that everyone associated with the financial system needs to be financially literate. This includes all users of financial services, be it the financially excluded resource-poor, the lower and middle income groups or the high net worth individuals; the providers of services; and even the policy makers and the regulators.

For the resource-poor population, which operates at the margin, vulnerability can be acute due to constant financial pressures. Household cash management can be daunting under difficult circumstances, with few resources to fall back upon. Financial literacy efforts, in case of such population groups, essentially, involves educating them about the benefits of being part of the formal financial system and managing short term volatility in incomes and meeting unexpected emergencies without getting trapped in unnecessary debt. To cite one example, a study by NCAER and Max New York Life has shown that in India, around 60 per cent of labourers surveyed stored cash at home, while borrowing from moneylenders at high interest rates; a pattern of saving money that is bound to aggravate financial vulnerability of these labourers.³ The process of educating these excluded sections would involve addressing deep entrenched behavioural and psychological factors that are major barriers to participating in the financial system.

For the middle and lower-middle income groups that are participating in financial markets as either savers or borrowers or both, i.e. the financially included, financial literacy efforts should aim at enhancing their knowledge about the market and new products/services. For instance,

² “The Importance of Financial Education and the National JumpStart Coalition Survey”, Remarks by Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System, at the JumpStart Coalition for Personal Financial Literacy and Federal Reserve Board joint news conference, on April 9, 2008 at Washington D.C.

³ “How India Earns, Spends and Saves”, A Max New York Life-NCAER Study, 2008.

there is a large section of our population that has a bank account but refrains from participating in the capital market on account of lack of knowledge. Financial literacy, in such cases, would focus on creating awareness about the way the capital market functions and also about the fact that the equity market provides relatively higher returns as compared to other investments, over a longer time horizon.

Similarly for high net worth individuals, better knowledge about the financial markets, new and innovative products and instruments is important as it helps them in making better use of the available avenues in the financial markets. This knowledge is also useful for fetching greater returns from their investments in the market and to avail credit at relatively cheaper rates. However, whether saving or investing, the basic lesson that “higher return implies higher risks” should not be lost sight of.

While the need for financial literacy for the users of financial products/ services is a well accepted fact, I would like to emphasize that even banks, financial institutions and other market players need to be financially literate and be fully aware of the risk and return framework. Financial literacy for the providers of financial services would involve understanding the risks involved in their businesses and in the products that they offer to their customers. As market players, they need to understand risks inherent in complex financial products and choose wisely while committing funds. For service providers, financial literacy also involves understanding the needs of existing and potential customers and creating products and services suited to those needs.

Finally, I would argue that financial literacy is also relevant for opinion makers and policy makers. Literacy is a must to gauge the needs of the population and financial institutions; to understand the risks inherent in products and markets; and to create a policy environment conducive to attainment of the national goals. Only such an approach would ensure that physical and financial resources are put to their optimum use to generate higher economic growth, while minimizing the financial stability risks.

Some basic concepts are not fully appreciated even by seemingly literate groups, resulting in assumption of excessive risks. One example that I often quote about the widespread financial illiteracy is the theory being floated around by the so called “financial advisers” about investment in gold being a “hedge against inflation” and a “safe asset”. The steep rise in gold prices over the past few years only indicates that the risk involved in investment in gold has heightened, a fact which is not recognized by people.

How to spread Financial Literacy

Let me now turn to my final question about how to promote financial literacy and who should spearhead the process. As I have already argued, financial literacy is required for each player in the economy, albeit in different degrees, forms and modules.

World over, countries have targeted programmes for schoolchildren, teachers, research institutions, among others. Further, they have also launched mass media campaigns/websites providing simplified information, often in vernacular mediums, which can be used by the public to learn about the monetary and banking system. A global problem requires a global approach. Realizing this, the Organisation for Economic Cooperation and Development (OECD) created the International Network on Financial Education (INFE) in 2008 to promote and facilitate international co-operation between policy makers and other stakeholders on financial education issues worldwide. Currently, more than 200 institutions from 90 countries have joined the OECD/INFE.

In view of the sheer magnitude of the task at hand, it is beneficial to have a strong institutional architecture guiding and coordinating the efforts of various stakeholders towards spreading financial literacy. In India, we have that advantage through the Financial Stability and Development Council (FSDC), which is chaired by the Union Finance Minister with heads of all financial sector regulatory authorities as members. FSDC is mandated, *inter alia*

to focus on spread of financial inclusion and financial literacy. The Reserve Bank, besides its role as a member of the FSDC, has also taken numerous initiatives for spreading financial inclusion and financial literacy, both in terms of creating an enabling policy environment and providing institutional support.

Under the aegis of the FSDC, the draft National Strategy for Financial Education (NSFE) for India has been prepared. The Strategy envisages ways of creating awareness and educating consumers on access to financial services; availability of various types of products and their features; changing attitudes to translate knowledge into responsible financial behaviour; and making consumers of financial services understand their rights and obligations. The Strategy calls for active involvement of individuals, financial sector regulators, educational institutions, NGOs, financial sector entities, multilateral international players and the Government at both Centre and State.

The Strategy envisages a time frame of five years for its massive financial education campaign. It envisages that financial education will be delivered to different target groups through trained users. Basic financial education is aimed to be included in school curricula up to senior secondary level. This is based upon the premise that the most effective way is to weave financial education into the normal content of curriculum. Accordingly, we are engaging with the curriculum setting bodies like the National Council of Educational Research and Training (NCERT), Education Boards like the Central Board for Secondary Education (CBSE), Central and State Governments to try and embed such concepts in the school curriculum.

Simultaneously, the Strategy aims at establishing initial contact with 500 million adults, educating them on key savings, protection and investment related products so that they are empowered to take prudent financial decisions. It also seeks to create awareness about consumer protection and grievances redressal machinery available in the country. All the above measures would be undertaken through various stakeholders including NGOs, civil society and by using all available channels of mass communication. As a first step towards increasing financial education, the NSFE envisages conducting a National Survey on Financial Education to provide a holistic assessment of the need for financial education in the country.

Since the challenge in India is to link large number of financially excluded people to the formal financial system, the focus of our strategy at the base level is to create awareness of basic financial products. Some of the steps that have been taken by the Reserve Bank and other stakeholders to promote financial literacy in India are as under:

- **Outreach visits** by Top Executives of Reserve Bank of India to remote villages: The objective of these visits is to understand the ground level position, spread awareness about benefits of being connected to the formal financial system and disseminate information about the functioning of RBI.
- **RBI website** – A link on Financial Education in the RBI website, containing material in English, Hindi and 11 vernacular languages, which includes comic books on money and banking for children, films, messages on financial planning, games on financial education and link for accessing the Banking Ombudsman Scheme.
- **Awareness** – distributing pamphlets, comic books, enacting plays and skits, arranging stalls in local fairs, exhibitions, participation in information / literacy programmes organized by Press. Books on financial planning for students and new professionals have also been released.
- **Financial Literacy Centres (FLCs)** have been opened by various banks with focus on the spread of Financial Literacy, to create awareness about financial products and provision of counseling facilities for customers of banks. There were 575 FLCs in the country as on September 30, 2012.

- Conducting Town Hall events across the country, including in Tier II and smaller cities, bringing together commercial banks and other stakeholders.
- Newsbition on Mint Road Milestones has become the focal point for financial literacy activities with all activities relating to financial literacy coalescing at a common forum at each centre
- Setting up of a monetary museum by RBI to create awareness about money and banking among general public and spread knowledge about the history of money.
- Use of mobile Financial Literacy vans by banks in the North Eastern States
- Awareness programmes on various Government Sponsored self employment schemes involving bank loans and subsidy by Government agencies like KVIC, DICs and SC/ST corporations.
- Mass media campaign tie ups with educational institutes, financial awareness workshops/ help lines, books, pamphlets and publications on financial literacy by NGOs, financial market players, etc.
- National and State level rural livelihood missions have large number of field functionaries for proper handholding support to large number of Self Help Groups.
- Large number of websites/portals of banks/ State Level Bankers Committees disseminating information on banking services
- Conduct of Financial Literacy programmes by ***Rural Self Employment Training Institutes***

In line with the “catch them young” strategy for our financial education initiatives, the Reserve Bank launched the RBIQ, an all India inter school quiz competition, in 2012. The quiz seeks to be an effective platform for disseminating financial education by creating awareness and sensitization about the history and role of the Reserve Bank, about banking and finance, economics, current affairs, etc., besides seeking to build a “connect” between the Reserve Bank and the young student community enrolled in schools across the country.

As part of its efforts to gain from international perspectives on financial literacy initiatives, the Reserve Bank, in association with the World Bank and the OECD, is organizing a Regional Conference on Financial Education in New Delhi next month. The Conference is among the various events organized globally to disseminate the knowledge and products developed through the Financial Literacy and Education Trust Fund, managed by the World Bank and the OECD, for strengthening the capacity for planning and implementation of financial education programs.

One of the objectives of the NSFE is to standardize the messages that various stakeholders seek to disseminate through their financial education initiatives. The draft NSFE document identifies certain simple messages such as why save; why invest; why insure; why save with banks; why borrow within limits; why repay loans in time; why borrow for income generating purposes, what is interest and how moneylenders charge very high interest rates, etc. It is a well recognized fact that the standardization will help in ensuring consistency in the messages reaching the target audience from various sources and making them more focused and powerful.

The Reserve Bank has released on its website on January 31, 2013, a comprehensive Financial Literacy Guide, which, banks have been advised to use as a standard curriculum to impart basic conceptual understanding of financial products and services. The financial literacy guide consists of Guidance Note for trainers, Operational guidelines for conduct of financial literacy camps, and financial literacy material, including posters. The guide also contains a financial diary to be distributed to the target audience, so as to enable them to keep a record of their income and expenses, as a first step towards financial planning.

I am glad to note that the Assessment Survey conducted by MicroSave has highlighted that most of the UNDP programmes were liked by the targeted population and succeeded in creating a positive change in their knowledge, skills and financial behavior. I agree with the survey observation that there is a need for closer integration between the financial literacy and financial inclusion initiatives, as our experience shows that the two are complementary to each other and the absence of any one diminishes the effectiveness of the other. About the suggestion regarding introduction of chapters on financial literacy by UNDP in school curriculum through CBSE/ NCERT, our experience within the FSDC sub-committee, is that financial education needs to be embedded into the existing school curriculum. Significant work has already been done in this regard, under the aegis of the FSDC, in association with the CBSE/ NCERT. We would be happy to receive suggestions/ inputs from the UNDP on this.

Conclusion

While a number of measures have and are being taken across the country, given the enormity of the task, a lot of ground still needs to be covered. Apart from the Government and the regulatory bodies, there is a need for involving the civil society and all other stakeholders in spreading financial literacy. We need to evolve distinct strategies targeting the school children and the adult population. We are still evolving a formalized curriculum for schools, which teaches the schoolchildren the basic principles of money, credit, savings and investments and introduces them to the way our financial system operates. After all, while one-time, targeted programmes are useful, including financial education into school curriculum in an on-going manner would hold the key to making our future generations financially literate. I congratulate the UNDP, NABARD and MicroSave for their contributions to improving the quality of lives of the poor through their financial literacy initiatives. However, the widespread existence of financial illiteracy indicates that we need to do a lot more.

I once again thank the organizers of this Workshop for providing me the opportunity to present my thoughts on the important subject of financial literacy. Conferences such as these are important in generating new ideas and diffusing clarity of thought and purpose among the various stakeholders. By way of anecdotal evidence, I would like to share the feedback I received on the positive impact that a seminar on financial inclusion, that I addressed last December, had on the conference participants. I am informed that based on the awareness generated during the conference about recent relaxations in KYC norms for opening new bank accounts, there was a perceptible improvement in the willingness of banks to open accounts of the marginalized and migrant workers in the unorganized sector, thereby providing them access to various financial services. The message disseminated at the seminar galvanized the organizers to conduct several camps where sizeable number of bank accounts were opened. They plan to conduct several such camps in the coming days. I hope today's workshop will also have a similar impact on the participants present here.

Thank you.