Speech

Speech by SFST at IEC Financial Literacy Forum 2014 (English only)

Monday, November 10, 2014

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Investor Education Centre Financial Literacy Forum 2014 today (November 10):

Leonard (Professor Leonard Cheng), distinguished guests, ladies and gentlemen,

Good morning.

I'm very pleased to join you today at the inaugural Financial Literacy Forum. And my thanks to the organiser, the Investor Education Centre of Hong Kong. I know that some of you are here from overseas. A warm welcome to you all.

The Financial Literacy Forum is the first of its kind in Hong Kong. Some might ask why it took so long. Well, being Hong Kong, I guess we just assumed that our babies were born financially literate. Of course, that's not true. At least, not always true. Indeed, Alan Greenspan has said that, "The number-one problem in today's generation and economy is the lack of financial literacy." If anyone should know, it's Mr Greenspan, the former Chairman of the US Federal Reserve.

Six years after the outbreak of the financial crisis, it's time - past time - to identify ways to prevent future crises and better protect consumers. Time, in short, that we became financially literate.

The outbreak of the mortgage crisis in the United States was likely the first time that terms such as "subprime" and "MBS" entered the public domain. Indeed, I would say many in the financial community were coming across these terms for the first time as well. For users of subprime mortgages and asset-backed securities, it was time to face some hard truths. In retrospect, it was shocking that we knew so little about these products until, for many, it was too late.

Financial literacy is hardly a new concept. As early as 2005, the OECD released the "Recommendation of the Council on Principles and Good Practices on Financial Education and Awareness." That same year, the OECD published its first major study on financial education at the international level.

Over the past decade, the ability to make informed financial decisions has increasingly been seen as an essential life skill. This is because financial decisions made by individuals are having a greater impact on their financial conditions today than in previous decades. In high-income countries, individuals need to accept a greater role in saving - for education, healthcare and old age. In lower-income countries, the lack of social safety nets and the erosion of traditional support networks have put individuals squarely in charge of their own financial well-being.

In market economies, individuals are ultimately responsible for choosing financial products that best meet their saving, borrowing and investing needs. The outcome of these decisions has a direct impact on the financial resources available to them later in life. Existing programmes in educational institutions, however, are not designed to equip individuals with the skills needed for these tasks. Programmes to promote financial literacy have been introduced to fill this gap.

These offerings generally aim to help individuals develop the will and the capacity to manage their own financial needs, from budgeting to retirement planning. They also seek to enhance their ability to use common financial services, from credit cards to insurance, in a way that best suits their needs and the prevailing social and economic conditions.

So financial literacy, more than a means to promote consumer welfare, is emerging as an important pillar, supporting sustainable retirement systems, stable markets and vigorous economies. In short, it has become a key component of the policy response after the financial crisis. Why? Because the lack of financial education was both the cause of the crisis and the catalyst for its rapid spread.

The global financial crisis was triggered by the excessive use of subprime mortgages and the lax credit environment in the US in the run-up to 2008. Many households who took out mortgages to purchase homes were counting on continuously rising home prices. When home prices crashed they were left with a debt higher than the worth of their homes.

The playing out of the crisis exposed other systemic deficiencies that could well have been alleviated through enhanced financial literacy. The collapse of Lehman Brothers and near-collapse of many financial institutions across the Atlantic caused widespread market panic. In interdependent markets, this panic became highly contagious.

A financial crisis often starts with the failure of one or more financial institutions. The financial health of individual consumers, or the household balance sheets, is also a factor in determining the severity of a financial crisis and spread of the market panic. Households taking on excessive debt, for example, is a contributing factor to systemic risk.

When the financial crisis spreads, it often leads to drastic changes in asset prices and many complex, highly leveraged financial products sold to the public could very well end up suffering big losses. This in turn causes more market panic and a general loss of confidence in the financial system.

The naive understanding of market behaviour may also lead to a general and broader drop of confidence among financial institutions and market regulators. And this, in turn, leads to flight to safety, which only aggravates the financial crisis. Financial education clearly has a role to play in controlling fear and panic.

The financial crisis of 2008 also exposed the huge mismatch between the complexity of financial products on offer and the consumers' ability to understand them. As a result, many ended up assuming more financial risk than they could afford. When mis-selling occurs on a large scale, it becomes difficult for policymakers and regulators to evaluate the risks, which are increasingly supported by households at a macro level. The Lehman mini-bonds, sold widely to retail investors in Hong Kong, is a case in point.

The mini-bonds as we know were complex financial products structured in a way to expose investors to different sources of risks, and this complexity is disproportional to the return offered. Financial innovations drive the industry in designing complex financial structures that cater for different perceived market needs. If individuals or institutions involved do not possess the knowledge to properly understand the risk and benefit of the product, they run the risk of buying something that does not meet their expectations and needs. In the case of the mini-bonds, they were too complex for retail investors to understand and thus were simply unsuitable for retail investors.

Similarly, it is not easy for the average consumer to understand the risks behind the interest-only mortgages popular in the United Kingdom. Individuals without proper understanding of lending products, and their rights as borrowers, can easily fall victim to predatory lending practices. Enhanced financial literacy would help protect them from similar excesses and mitigate the risks.

In hopes of nipping future troubles in the bud, financial literacy has become an international priority. At their summit in June 2012, G20 Leaders endorsed the High-level Principles on National Strategies for Financial Education developed by the OECD. The Principles recognise the lack of a one-size-fits-all model. Instead, it calls for a nationally coordinated approach to financial education, one that involves all stakeholders under the leadership of a coordinating body. Good progress has been made on this. As of last year, 45 countries had implemented, or were designing, their own national strategy.

In Hong Kong, the Government is stepping up efforts on financial education to complement enhanced regulations. The promotion of financial literacy is not a means to shifting more responsibilities to the consumers. And sound regulations remain the backbone of our regime. As both regulation and education have limits on what they can achieve, however, we hope to employ both in a complementary approach to improve investor protection.

After the crisis, there has been a call for increased regulatory oversight as a way of addressing the information gap between financial institutions and consumers. There is also talk of the relative advantages of "merit-based" versus "disclosure-based" regulation. I do not believe in either a purely merit or disclosure-based regime. We should try to strengthen the point of sale regulation, with both disclosure and suitability assessment. We should also require financial products to be fair to the customers.

Regulation, however, is no substitute for a well-informed decision-maker, one who ultimately knows best about his own situation and needs. That's why we are taking steps to increase financial literacy across the financial industry in Hong Kong.

The Investor Education Centre (IEC) was founded in 2012, as a subsidiary of our securities regulator, the SFC.

The IEC's goal is to "improve the financial literacy and capability of the general public by influencing their fundamental financial attitudes and behaviour, so as to help them improve the quality of their financial decisions." Two years old this month, it is proving a valuable addition to our financial literacy efforts. Its strategic, three-year plan is in place, and an enhanced website was launched in February. It serves as a centralised resource for financial information and education.

Recent IEC research found that, while 82 per cent of Hong Kong people had financial goals they hoped to achieve, only about half that number were taking action to realise their goals. Unsettling as this may be, I see in it a long and useful future ahead for the IEC!

For that, my thanks to Professor Leonard Cheng, Founding Chairman of the IEC Executive Committee. I would also like to thank members of the Executive Committee, the IEC Advisory Committee and Advisory Group on the promising work they've done to date. To the rest of you, I encourage you to join us in supporting the work of the IEC. In helping to build financial literacy as both a right, and a responsibility, for all of us.

Thank you.

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