*Building Financial Capability**

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Introduction

Professor Njuguna Ndungú, Governor, Central Bank of Kenya, representatives from the Capital Market Authority, the Insurance Regulatory Authority and the Retirement Benefits Authority of Kenya, my colleagues from the OECD/INFE, World Bank, distinguished guests, ladies and gentlemen! It gives me immense pleasure to be here amidst you in the beautiful city of Nairobi, the safari capital of the world, to deliver the opening remarks in this OECD-World Bank Regional Dissemination Conference on building financial capability.

2. This is the second in the series of dissemination events of the output of the Russia/World Bank/OECD Financial Literacy and Education Trust Fund following the event in Cartagena, Colombia; with the next event planned in India during the month of March 2013. It is, indeed, heartening to note that the efforts made by the OECD/INFE for promoting and facilitating international co-operation between policy makers and other stakeholders on financial education issues have found massive acceptance, with over 200 public institutions from more than 90 countries having joined the network. The endorsement of the OECD/INFE High-level Principles on National Strategies for Financial Education by the G20 leaders in their meeting in Los Cabos, Mexico not only identifies these principles as the global standard, the rule book, for the financial education initiatives, it also demonstrably proves that promoting financial education and literacy has become a long-term policy priority in most countries across the globe.

* Opening Remarks by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India at the OECD – World Bank Regional Dissemination Conference on Building Financial Capability at Nairobi, Kenya on January 30, 2013. Assistance provided by Shri Ajay Kumar Misra and Shri Bipin Nair in preparation of this address is gratefully acknowledged.

3. Building financial capability through financial literacy is a key component of the Financial Inclusion process. While every country has to tread its own path to financial inclusion and literacy depending upon the local factors/indicators like literacy levels, per capita income, poverty levels, levels of financialisation of the economy, *etc.*, expert bodies like INFE, facilitate a cross-country sharing of experiences, thereby helping individual jurisdictions to save time and crucial resources and to avoid mistakes that other countries might have committed. They also provide standard tools/benchmarks for framing national strategies for financial education and provide the framework for policy interventions relating to roll out of these national strategies. The conferences like these also provide a great platform to all of us to meet, exchange notes on what is happening in our respective countries and learn from each other's experiences. For example, I am sure all of us have drawn our lessons from the pioneering effort undertaken by Kenya for Financial Inclusion through the M-PESA model.

Why do we need Financial Literacy?

4. With this brief background, today I would share my perspective on the necessity for promoting financial literacy as a policy tool, its centrality to ensuring inclusive growth and the initiatives we have taken in India for promoting financial literacy. But before I venture any further, let me quickly state what is meant by 'Financial Literacy'. I quite like the definition given by the INFE researchers, Atkinson and Messy, who describe it as 'a combination of financial awareness, knowledge, skills, attitude and behaviours necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.' Thus, an absence of financial literacy can lead individuals to make poor financial decisions that can have adverse effects on their financial well being.

5. A venerable section of commentators analysing the causes of the global financial crisis have identified widespread financial illiteracy as one of the fundamental reasons for its build up. The mortgage market of the USA, wherein lay the genesis of the

crisis, was largely built around rampant mis-selling of home loans to a vastly gullible customer group, who had virtually no inkling of what an adjustable rate mortgage meant and how it could hit them once the rate cycle turned around. The extent of financial illiteracy ran really deep, whereby, even the sophisticated investment bankers and bond dealers took huge bets by investing in the safe and the so called 'Triple A' super-senior tranches of CDOs, CDO -squared and CDO-cubed. The customers entering into financial contracts, without understanding the risk import of such transactions, ultimately bore the brunt of unforeseen volatility in financial markets, which quickly spread to the real economy resulting in massive job losses and other long-term ill-effects, which the world economy is still grappling with.

6. Two things emerge very clearly from the above developments – first, financial illiteracy is not limited to only the poor and vulnerable sections of the society and second, it is a problem that is equally endemic in both, the developing as well as the developed nations. To put things in perspective, I would quote the results of a recent study conducted in the US by the Securities and Exchange Commission (SEC) to identify the existing level of financial literacy among retail investors (a study mandated by the Dodd-Frank Act): 'The studies demonstrate that investors have a weak grasp of elementary financial concepts and lack critical knowledge of ways to avoid investment fraud'. In the aftermath of the financial crisis, imparting financial education and creating a financially literate population has been receiving increasing attention of the policy makers in a majority of economies. This has become much more necessary today due to the growing complexity of financial products and services, variety of product and service delivery channels, rising consumer activism and the limited ability of regulation alone to efficiently protect consumers.

Linkages between Financial Inclusion and Financial Literacy

7. We, in India, consider Financial Literacy as an important adjunct for promoting financial inclusion, consumer protection and ultimately, financial stability. We firmly believe that financial inclusion and Financial Literacy need to go hand in hand to enable the common man to understand the needs and benefits of the products and services offered by the formal financial institutions. We have defined financial inclusion as '*ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups, such as weaker sections and low income groups in particular, at an affordable cost, in a fair and transparent manner, by regulated mainstream institutional players.*' So, from the financial inclusion perspective, it essentially involves two elements, one of access and the other of literacy. Financial Literacy helps in creating demand for the financial products that are offered under the financial inclusion initiatives. Our experience with the rollout of a formal financial inclusion programme by commercial banks over the last few years is that while the reach of the formal financial system has significantly expanded, it has not yet had a major impact on the financial behavior of the intended population. The level of transactions in the newly opened bank accounts continue to be very low and this has impacted the viability and scalability of our financial inclusion initiatives. This lack of transactions is, in part, attributable to lack of financial literacy and awareness about the benefits of getting linked to the banking system.

8. The financial well being of individuals is linked inextricably to a nation's economic progress. The economy and our financial institutions would be stronger when more people have jobs, rising incomes and a buildup of wealth. Pointing to the weakening of the economic policy making process in the absence of financial literacy to the citizens, Mr. Alan Blinder, the noted Princeton economist and former vice chairman of the Federal Reserve's Board of Governors, has said that an uneducated citizenry can lead to simplistic policy solutions, and those solutions are usually suboptimal.' The fact that the basic level of economic literacy in the country, indeed in the world, is so low,

is one of the things that leaves the political process so vulnerable to this malady.'

9. Financially strong households tend to have higher levels of confidence about consumption and are more willing to make the major purchases required to support growth in the economy. As more and more financially literate customers join the formal banking system, start saving, start making use of entrepreneurial credit to set up small businesses and begin to use a wider array of financial services, the system benefits overall in the form of greater efficiency, lower fees, better services, and a safer, sounder banking system.

Improved financial literacy results in a higher standard of living for households

10. The most fundamental reason why people should strive to become financially literate is to help them reach their personal financial goals. Whatever the specific goal, the payoff from financial literacy is an improved standard of living and a sense of confidence about the future. Financially literate individuals are more likely to engage in sound financial planning early in their lives. This enables them to plan for retirement, fund the education of their children, and accumulate more assets. From a national perspective, the payoff is large.

Who are the target groups and what messages to deliver?

11. Everyone in the system, be it the users or the providers of financial products/services, need to be financially literate. In the Indian context, the users are broadly categorised as the financially excluded resource-poor, the lower and middle income groups and the high net worth individuals. For the resource-poor population, financial literacy would invariably involve addressing deep entrenched behavioural and psychological factors that are major barriers to participating in the financial system. For the purpose, our financial literacy efforts are primarily directed towards dissemination of simple messages of financial prudence, in vernacular languages, through large awareness campaigns across the country combined with vigorous roll out of financial inclusion plans by banks, insurance and pension funds, and others. However, it is important to note that being literate is not a necessary prerequisite for attaining financial literacy as the basic financial messages can be conveyed through various alternate means without relying on written inputs. Some of the basic messages we seek to deliver through our financial literacy drives are:

- Why save?
- Why save regularly and consistently?
- Why save with banks?
- Why borrow within limits?
- Why borrow from banks?
- Why borrow for income generating purposes?
- Why repay loans?
- Why repay loans in time?
- Why do you need insurance?
- Why you will need regular stream of income post working life –pension?
- Why you should keep money aside regularly and consistently during your earning life for pension in old age?
- What is interest? How moneylenders charge very high interest rates?
- What is the difference between money and credit?

12. One of the primary challenges in improving the effectiveness of financial literacy efforts, is to ensure the standardisation of the basic messages being conveyed to people, especially the illiterate population. This will help in ensuring consistency in messages reaching the target audience from various sources and making it more focused and purposeful.

13. While financial literacy for the users of financial services/products is of paramount importance, literacy is also a must for financial service providers.

Banks, financial institutions and other market players too need to be literate about their risk and return framework. Every bank, in order to expand its customer base, needs to understand the requirements of its customers and the market, credit and operational risks involved in its operations. They need to understand that for their business to survive, their customers must survive and for that, they need to understand the appropriateness of the products themselves to be able to explain it to their customers. In a scenario, where illiteracy level about the financial products/services is very high even among educated elite and policy makers, following key ideas/concepts need to be widely disseminated:

- Differentiation between Money and Credit;
- Differentiation between Expenses and Investment;
- Need for credit to be utilised for productive purposes and not for consumption at the initial stage of financial inclusion;
- Higher the return, higher the risk assumed (Risk-return trade off);
- Transition path:
    - o Financial Exclusion
    - o Money (Subsidy, Charity, Wage, Employment, Savings)
    - o Productive Credit (Income Generation)
    - o Consumption Credit (Income Smoothening and Asset Acquisition)
    - o Speculative Credit
- Understanding the Risk-return trade off associated with each stage of the above transition path.

If we can develop adequate appreciation and education about the above issues across the entire cross-section of the society including policy makers and financial market players across the globe, the world financial markets and the people would be much less vulnerable to financial crisis, such as the one we are facing today. That is the ultimate goal for building financial capability in a society.

14. The providers of financial services have a vested interest in the spread of financial inclusion and financial literacy, as it will help them in expanding their business operations to newer segments of the population. Globally, it is observed that commerce for the poor is more viable than commerce for the rich. The commercial viability of financial inclusion efforts is essential for ensuring long-term sustainability and scaling up of this business. This is possible only if the entire suite of products including credit products, remittance services and deposit products are offered to customers. The failure of financial intermediaries in effective implementation of financial inclusion plans as a viable business model, indicates a lack of basic financial literacy on the part of these financial intermediaries.

Institutional framework in India

15. The institutional mechanism for promoting Financial Literacy efforts in India is in the form of the Financial Stability & Development Council (FSDC) headed by the Union Finance Minister which, *inter alia*, is mandated to look after Financial Inclusion and Literacy efforts. The FSDC has the heads of all financial sector regulatory authorities as its members. The FSDC has constituted a Sub-Committee to focus solely on Financial Inclusion and Financial Literacy.

16. One of the important tasks that the FSDC Sub-committee has taken up is to formulate the National Financial Literacy Strategy document with the following objectives:

i. Create awareness and educate consumers on access to financial services, availability of various types of products and their features

ii. Change attitudes to translate knowledge into behaviour

iii. Make consumers of financial services understand their rights and obligations

Financial Literacy – Ideally start early in Schools, but do not neglect adults

17. It is well recognised that to be effective, financial literacy initiatives should ideally commence at school level, although, adult education would also provide substantial benefits. Financial education at the school level would involve teaching the basic concepts for laying a strong foundation. The groundwork for this sort of conceptual understanding is best laid in a formal educational setting. The reason why it is important to teach financial education in schools is also due to its multiplier effect on the society as the financially literate students would be in the best position to act as ambassadors for the spread of financial education in their surrounding environment. In India, therefore, we are engaging with the curriculum setting bodies like National Council of Educational Research and Training (NCERT), Education Boards like Central Board for Secondary Education (CBSE), Central and State Governments to try and embed such concepts in the school curriculum.

18. Our National Strategy also aims at establishing initial contact with 500 million adults, educating them on key saving, protection and investment related products so that they are empowered to take prudent financial decisions. It also seeks to create awareness about the consumer protection and grievances redressal machinery available in the country.

Channels of Financial Literacy

19. Taking into consideration different cultures and market development needs, we are adopting a multi-channel approach to cover different financial and education levels in various age groups. We have a link on Financial Education on the RBI website for the common man, containing material in 13 regional languages, which includes comic books on money and banking for children, puzzles, competitions, *etc.* Top Executives of Reserve Bank of India undertake outreach visits to remote villages on a continuous basis to spread the message of financial awareness and literacy. A Young Scholars Scheme has been instituted wherein, around 150 graduate students are selected each year from across the country, who are provided summer internship in various offices of the Reserve Bank and are expected to submit small project reports relevant to the Bank's functioning. Moreover, these young scholars are required to visit some schools in their region and explain their project to school students, so as to create greater awareness among the school students regarding the functioning of the Reserve Bank. Besides, town hall meetings, participation in information/literacy programmes organised by Press, enacting plays and skits, arranging stalls in local fairs/exhibitions, *etc.* are some other initiatives towards this objective. In addition, to create awareness and interest about the history and role of the Reserve Bank, about banking and finance, other banking institutions, economics, current affairs, personalities and events that have contributed to the growth and progress of India over the years and to build a 'connect' between the Reserve Bank and the young student community enrolled in schools across the country, RBI has launched an all-India RBI Inter-School Quiz Competition for promoting financial literacy at the school level.

Who all are partnering in this initiative?

20. In India, a large number of stakeholders including the Central and State Governments, financial regulators and players, civil society, educationists and others are involved in spreading financial literacy. As we have adopted a bank – led model for financial inclusion, banks are actively contributing to our financial literacy initiatives by setting up Financial Literacy Centres (FLCs) with focus on educating people on availability of various deposit, credit and remittance products and create demand for the same and also for attaining Financial Inclusion. As on September 30, 2012, there were 575 such FLCs functioning in India.

Consumer Protection through Literacy

21. For all users of financial services, an important component of financial literacy is the provision of a grievance redressal mechanism, which they can access in case of complaints and frauds by/against

financial service providers. The availability of an effective grievance redressal mechanism is essential as its absence could lead to loss of confidence in the financial system, prompting people to move away from it. This could be a serious setback to the financial inclusion initiatives. For cost-effective, quick grievance redressal related to banking sector, the Reserve Bank has instituted Banking Ombudsmen in each of our Regional Offices. Other regulators have also set up ombudsman in their respective areas. However, banks/financial institutions should realise that improved customer awareness/service and effective grievance redressal mechanisms at the institution level can substantially reduce the number of complaints flowing to Ombudsmen.

22. In addition to the obvious benefits of financial literacy at the individual level, it has major macro-economic benefits as well. If we can bring the excluded population into the purview of banking services, we could raise household and overall domestic savings further, and can, thus, fulfill one of the necessary conditions for achieving double-digit growth.

Conclusion

23. I must compliment OECD/INFE, World Bank and the others for the plethora of publications, studies and research work they have undertaken in the field of financial education, for it gives us a ready and right amalgam of inputs needed to push financial education efforts in various countries. For example, in India, we have a mix of large sections of low income, less literate population living together with a large and upwardly mobile starry eyed middle class and a significant number of globally oriented professionals and businessmen. When we sat down to write our national strategy for financial education, we really had to plan for all the three broad groups. The standard guidelines of INFE were very useful, so were the national strategies of other similarly placed countries like Brazil, South Africa and others. The flavor of what we have prepared as our national strategy is Indian, but the content is in line with global standards. The INFE documents were also useful in one other way *i.e.* in making our strategy acceptable to a large number of stake holders.

24. I understand that the Central Bank of Kenya is developing Kenya's National Strategy for Financial Education, in partnership with various stakeholders including the Government Ministries, the Financial Sector Deepening (FSD) Trust, NGOs, financial institutions, and other private sector companies. I am also informed that other regulatory bodies/agencies are also involved in carrying out financial education campaigns and in development of financial literacy curriculum for schools. I wish them all the best in their endeavour.

25. While a number of measures have and are being taken for spreading financial education and promoting financial literacy, given the enormity of the task, we still have a lot of ground to cover. Here, I would like to emphasise the need for a collaborative partnership involving all stakeholders. However, like the proverbial 'horse and carriage', efforts to improve financial capacity and to promote financial literacy best go together; it makes for an easier and more successful journey.

26. In conclusion, I wish to thank the OECD, World Bank and other organisers of the Conference for their continued commitment and involvement in financial literacy. We in RBI believe that such programmes offer an opportunity to learn from mutual experience and help us in designing appropriate solutions best suited to our jurisdiction. I sincerely hope that with our collective efforts would financial literacy permeate to all and sundry, the common man would be empowered to take informed financial decisions and in the process, the global financial marketplace would become a more stable arena. With these words, I close my address and wish the Conference all success.

Thank you !