



NATIONAL BANK OF SERBIA

Project: Financial Education in Serbia

Belgrade, August 2008

Outline

Due to the development of financial markets over the past several years, as well as demographic and economic changes that have occurred worldwide, the significance of financial education has grown substantially. World financial markets have become more sophisticated and are now offering a wider range of new and complex financial products carrying different types of risks.

As appetite grows with eating, so does the financial services consumers' demand for the novel products on offer in financial markets. To manage their budgets successfully, financial services consumers need to be able to make adequate investments decisions in line with their own propensity to risk-taking.

In order to make right decisions, consumers must have access to full and precise information on financial products, and be aware of underlying risks. Financial services consumers can understand and compare different types of products, and hence make right decisions, only based on adequate information.

Given that numerous surveys conducted worldwide have shown that a significant percentage of world population (e.g. 71% in Japan) has insufficient understanding of even the simplest financial products, let alone complex ones, the OECD (Organization for Economic Co-operation and Development) embarked on defining the principles for improving understanding of the financial market and its products. Hence, in 2005, the OECD issued a publication titled "Improving Financial Literacy – analysis of issues and policies".

With a view to rising the level of understanding of basic financial terms, and aware of the necessity and importance of consumer education for further development, the National Bank of Serbia initiated various educational activities in 2005 aimed particularly at the youngest, as they are the future active participants in the economic life of our country.

A step further towards improving financial literacy was made in the course of the same year, by setting up the NBS Call Centre to serve the needs of the general public, where citizens, i.e. financial services consumers, may obtain information on advantages

and risks that need to be taken into account when making decisions on which financial products and services to use.

In the course of 2006, the NBS launched a project for protection of financial services consumers which resulted in setting up of the Centre for Financial Services Consumer Protection in January 2007. The Centre began its operations by initiating activities primarily in the area of financial education, and developing both a reactive and proactive approach.

Recent decision of the NBS to initiate even further activities with a view to providing precise and comprehensive information on financial products on offer in the Serbian financial market was prompted by the fact that the international supervisory authorities, central banks and international organizations such as OECD have stepped up their activities in the area of financial education. However, consumers' queries and, in particular their unfounded complaints which have shown insufficient understanding of certain financial products by the majority of the general public, also contributed to this decision of the NBS.

I FINANCIAL EDUCATION – Concept, Significance, International Practice

Concept and Definition of Financial Education

There is no such thing as a single definition of financial education, but it is important to note that financial education cannot be a substitute for classic education.

According to the OECD's definition "financial education is the process by which financial consumers/investors improve their understanding of financial products and concepts and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choice, to know where to go for help, and to take other effective actions to improve their financial well-being."

Thus, providing information means presenting facts, data and specific knowledge to financial services users, with a view to raising their awareness of choice possibilities and consequences of their actions in the financial market.

Hence, training and education of financial services consumers enables them to understand financial terms and concepts.

Finally, advising financial services consumers does not imply providing business advices, but rather advices on general financial matters and products. And the aim is to enable consumers to use financial information and instructions on their own.

Why is Financial Education Necessary

Financial education is not only significant for investors, it has also become a necessity for an average family which needs to find ways to manage its home budget successfully, to buy a house, save money for their children's education and to make provisions for old age.

However, development of the world's financial market and ever more complex financial products, has led to numerous innovations in financial markets. Namely, consumers today have access to a large number of credit instruments and different types of saving options by banking and non-banking institutions (insurance companies, pension funds, investment funds, etc.), of which they have insufficient or no knowledge at all. At the same time, consumers take the risks of their investments on themselves, which can

considerably affect their present and future lives, and particularly the period after their working life is over.

Given that the working life is extending, and that future pensioners will increasingly have to make personal pension plans, it is important that they are aware of the ways to provide for themselves in old age.

A survey carried out for the purpose of OECD's study on financial literacy indicates low level of knowledge on financial products in a large number of countries, including the developed ones. To illustrate, 71% of respondents in Japan are not familiar with investing into bonds. At the same time, though 67% of respondents in Australia claimed to understand the concept of interest rates, only 28% were able to solve given problems by applying this concept. An increased number of credit cards in OECD countries resulted in the increased number of personal bankruptcies – one of 10 families in the USA has undergone personal bankruptcy, while in Austria this number has risen by 11%.

For the above reasons, the OECD's Directorate for Financial and Enterprise Affairs has issued the following three recommendations:

- 1) Recommendation on Principles and Good Practices for Financial Education and Awareness (2005),
- 2) Recommendation on Good Practices for Enhanced Risk Awareness and Education on Insurance Issues(2008), and
- 3) Recommendation on Good Practices for Financial Education Relating to Private Pensions (2008) (www.oecd.org/findDocument).

These recommendations were translated into Serbian and, with the OECD's permission, published on the NBS website (www.tvojinovac.nbs.rs).

These recommendations are aimed at encouraging financial education of people in all social spheres, beginning from the elementary school, in both non-member and member OECD countries. Financial education programs should be directed towards important aspects in life, i.e. saving, insurance, pensions, and debt. These recommendations also promote the national campaign on financial education, web pages dedicated to this area, and citizens' right to receiving clear, intelligible, and full information before deciding on taking out a loan or on the ways of investing money. A significant role in financial education process is played by financial institutions which

should be encouraged to clarify the terms and conditions for buying products and ensure that clients understand them.

Some OECD countries (USA, Australia, Canada, Poland, New Zealand) have already developed the National Strategy for Financial Education, whose implementation has been entrusted to both financial institutions and relevant public institutions, i.e. central banks, financial supervision authorities, ministries of finance and education, and professional financial institution associations.

A developed, secure and stable financial sector which satisfies the needs of its consumers is of paramount importance for the development of every country. Wide range of financial products is in the interest of both professional investors and individual clients. In the market economy environment, the priority of any individual is home budgeting and making investment and borrowing decisions, while at the same time assuming the inherent risks. By obtaining information and improving understanding of financial products, financial services consumers develop their sense of risk as well as the skills for managing them. However, to make adequate decisions on investment according to their own risk profiles, consumers must have access to full and clear information, based on which they can compare different products in the market, and choose the most appropriate one. Financially literate consumers make notable contribution to strengthening public confidence in the financial sector by actively participating in the financial market. By searching for products to fit their needs, consumers challenge financial institutions to develop new ones, and thus encourage competition and innovations, and improve the quality of the financial market. As illustrated by Allan Greenspan, former president of the FED, “Financially educated consumers are less prone to fraud and misuse.”

Financial Education vs. Consumer Protection

The functions of financial education and consumer protection are complementary, and their overlapping is evident, as they both provide information on financial products. Except for providing information on financial products, financial education involves general financial assistance, but not business assistance. Consumer protection implies provision of regulations, prescription of minimal standards for financial institutions' operations, and setting up terms and conditions for disclosing information on financial products of such financial institutions.

To conclude, the role of financial education is to assist individuals in making decisions in accordance with their propensity to risk, and to raise their awareness of the risks undertaken. This is particularly significant in the event of new and more complex products emerging in the market, as well as in countries where clients did not have the opportunity to use financial services, or financial services were limited due to the underdeveloped financial market, while the country was a guarantor of clients' funds (e.g. Serbia). Financial education also has an important role in countries in which a sense prevailed that financial institutions existed only to serve the needs of "specific, privileged groups of people", and not to service the needs of their clients in general. On the other hand, the role of consumer protection is to provide regulations which will ensure that financial institutions' operations are transparent and conducted in compliance with the principles of good business practices. Professional and fair dealing standards help secure the consumer-financial institution base, thus strengthening trust and encouraging healthy competition and development of the financial sector as a whole.

Means for Conducting Financial Education

One of the most commonly used means for conducting financial education are publications: brochures, leaflets, newspapers, newspaper articles, magazines, annual publications, etc.). Such publications may be conveyed to end-users in different ways. Other means include the Internet and web pages, portals, advisory bodies, call centre, public campaigns involving presentations, roundtables, conferences, seminars, etc.

Even though the above publications are easily distributed to financial services consumers, it is impossible to get a feedback on whether they have understood the material. This is why it is important to organize interactive seminars and lectures and to examine the level of understanding of financial services before and after the lectures.

The OECD suggests the possibility of including financial education into the country's Social Protection Programme.

Improvement of financial education requires tighter international cooperation and exchange of experiences in this area, as well as participation of OECD as an international forum. Financial education has been entrusted to the International Network on Financial Education, of which the NBS is also a member. The web page International Gateway for Financial Education (IGFE) at www.financial-education.org was created with an aim to spreading international experience in the area of financial education, promoting access to information and improving awareness of the necessity of financial education.

Who Provides Financial Education?

Participants in the financial education process may be public and private institutions, i.e. the Central Bank, the Ministry of Finance, the Stock Exchange, the Securities Commission and professional associations (Bank Association, Association of Insurance Providers, Pension Funds Association ...).

The leading role in financial education in many countries (Poland, the USA, Mexico, Austria, Ireland, UK etc.) has been entrusted to their central banks or supervisory authorities.

II FINANCIAL EDUCATION IN SERBIA

In the course of 2005, the NBS devised a special, interactive programme and prepared didactic material involving presentations, tests and quizzes for groups of elementary school students visiting the exhibitions of the NBS Visitors Centre. At the same time, the NBS apprentices gave presentations on various economy-related topics to high schools students, prepared a list of basic economic terminology and a comic book on saving. An on-line lottery for high-school students and a video game about saving for elementary-school students were organized within the "Win by Saving" campaign.

In 2006, for the needs of the NBS, a survey was conducted on public confidence in the Serbian banking sector. The results show that 24% of respondents do not hold any bank account. Although 81% of loans to households in Serbia are foreign currency indexed, 48% of credit beneficiaries do not know what the foreign currency clause means, and 58% are not familiar with the consequences such foreign currency clause-indexed loans (CHF, EUR, and USD) may eventually have.

The main objective of supervision is to provide a financially sound and stable financial sector for the purpose of protection of the interests of financial service consumers and taking care of public confidence. Given that the level of development and public confidence in some segments of the financial sector was inadequate, and that there was no appropriate system for protection of financial services consumers, the NBS embarked on a programme of consumer protection by setting up the Centre for Financial Services Consumer Protection in January 2007. The Centre takes two approaches in carrying out its activities:

⇒ ***REACTIVE APPROACH***

- complaints
- mediations

⇒ ***PROACTIVE APPROACH***

- transparency of financial institutions
- informing the public
- educating the public

The results of the analysis of financial services consumers' complaints obtained from the Centre show that 59% of all complaints were baseless, which indicates that consumers did not properly understand the contracts signed with different financial institutions. Hence, the NBS embarked on a programme to strengthen public confidence in the financial sector, and, within educational activities, begun issuing brochures and leaflets (Guide on Credits, What to Pay Attention to when Borrowing, Your First Private Pension Plan, Insurance Products, Variable Interest Rate, Currency Clause...).

The NBS gave its contribution to keeping the public informed by publishing numerous newspaper articles and coming out in the public to discuss current topics on financial products and terms for their purchase. With a view to developing a modern and efficient financial sector capable of providing high-quality financial services, as well as to protect depositors, insureds and other users of financial services, being a supervisory authority the NBS has already issued numerous regulations, recommendations and guidelines.

The main goal of supervision is achievable only when financial services consumers are satisfied. This not only means that they must have access to adequate information on financial services, but must also understand them (expenses, yields, risks). Therefore, the NBS is willing to take the leading role in financial education as a means of prevention in the process of protecting financial services consumers.

A client who understands a particular financial product and all its underlying pros and cons, will also be able to compare it to other products in order to make adequate decision, while at the same time assuming all of the appertaining risks.

A satisfied client who understands financial products tends to use financial services more frequently, hence benefiting not only himself, but also the development of the financial sector and the country's economy as a whole.

The Role of Other Institutions in Financial Education

In cooperation with the NBS, Ministry of Finance and professional associations, Ministry of Education could contribute to financial education by introducing certain innovations (e.g. in mathematics or civic education) or organizing occasional interactive work-shops for elementary school students and lectures for high school and university students.

Professional associations can also take active part in financial education, even though they do not have an educational role in the true sense of the word. Their role is to provide clear, adequate and full information on specific financial products and terms under which they are purchased. Professional associations do not advertise the products of financial institutions they represent, nor are they allowed to use misleading information and terminology in their promotional materials. Professional associations

play a part in raising awareness of individuals and thus contribute to strengthening the role of financial education.

The major role of financial institutions in financial education is broadening the horizons of members of the financial sales network, which, in turn, plays a significant part when it comes to contacts with end-users of financial products.