Financial literacy and its role in promoting a sound financial system

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This article discusses the importance of financial literacy. Financial literacy – the ability to make informed judgements and decisions regarding the use and management of money – is important for individual consumers of financial services, the financial system and the wider economy. It influences how people save, borrow, invest and manage their financial affairs. It therefore affects their capacity to grow their wealth and income, and has significant implications for people's lifestyle choices. Financial literacy also has a significant part to play in influencing how financial institutions – such as banks, non-bank deposit takers and insurers – manage their affairs and what products they provide. Because financial literacy influences people's investment decisions, including risk/return tradeoffs, it also affects how resources in the economy are allocated. In turn, this has implications for the potential growth rate and stability of the economy. Accordingly, the main theme of this article is that financial literacy matters – at many different levels. The focus of this article is on financial literacy at the household and individual level.

Research raises some concerns regarding financial literacy in New Zealand. The evidence suggests that many New Zealanders have limited financial literacy. The Retirement Commission and other government agencies are working to improve financial literacy levels. The private sector has also taken initiatives in this area. Work is under way to strengthen the regulation of financial advisers and to improve financial disclosure by issuers of securities to the public. However, there appears to be a need for further initiatives to raise the level of financial literacy in New Zealand. These initiatives should be accompanied by others to improve the delivery of user-friendly financial information to investors and consumers. This article explores the potential for further work in these areas.

1 What is financial literacy?

Financial literacy means different things to different people. For some it is a wide-ranging concept, incorporating an understanding of economics and how household decisions are affected by economic conditions and circumstances. For others, financial literacy means focusing quite narrowly on basic money management skills – budgets, savings, investments, insurance.

A consistent theme running through the various definitions of financial literacy involves an individual's ability to acquire essential knowledge and skills in order to make decisions with an awareness of the possible financial consequences. It encompasses being able to manage personal finances in changing circumstances.

The US Financial Literacy and Education Commission defines financial literacy as "the ability to make informed judgments and to take effective actions regarding the current and future use and management of money" (Basu, 2005:1). A similar definition of financial literacy has been adopted by Noctor, Stoney and Stradling (1992:4) in work undertaken on behalf of National Westminster Bank in the UK, where they define financial literacy as: 'The ability to make informed judgements and informed decisions regarding the use and management of money'.

Taking these broad definitions, financial literacy has a number of elements, including:

- basic numeracy skills, such as the ability to calculate rates of return on investments, the interest rate on debt, and basic arithmetic ability;
- an understanding of the benefits and risks associated with particular financial decisions, including spending, borrowing, leverage and investing;
- the ability to understand basic financial concepts, including the trade off between risk and return, the main attributes of different types of investments and other financial products, the benefits of diversification, and the time value of money; and

- the capacity to know when to seek professional advice and what to ask, and the ability to understand the advice given by professional advisers.

The focus of this article is on the financial literacy of non-expert consumers of financial services – that is, members of the general public in respect of their decisions involving budgeting, borrowing, investing and using financial risk protection services. In particular, we focus mainly on financial literacy as it affects the decision-making capacity of non-expert members of the public in their investment decisions. Although the focus is on the household sector, financial literacy is also important for other sectors in the economy, such as small businesses and the farming community, given that many of their business decisions require or would benefit from a reasonable level of financial literacy and capability.

2 Why does financial literacy matter?

Financial literacy is important at several levels. It has major implications for the welfare of individuals in the management of their financial affairs. It affects the behaviour of financial institutions and hence has implications for financial stability. And it influences the allocation of resources in the real economy and therefore the longer-term potential growth rate of the economy.

This section of the article discusses briefly each of the reasons why financial literacy matters.

Financial literacy's importance for individual consumers of financial services

Individuals make many financial decisions each year. These relate to a wide range of financial matters, including decisions on how to budget, how much to spend and to save, where to invest their money, how to manage their financial risks, how much debt they may need to fund their expenditure, and what form that debt should take. These decisions range in complexity, but all require at least a basic level of financial literacy.

In a world of escalating financial complexity, there is an increasing need for financial knowledge and at least basic financial skills (Morris 2001). Technological advances have dramatically transformed the provision of financial services in New Zealand and around the world. There is an ever-increasing diversity of financial products and services, including debt products and investment opportunities available to the public. While this provides increased benefits, it also entails more complex risks, including risks that are not always readily apparent to the unwary. Accordingly, the scope and complexity of the financial decisions an individual has to make in managing their financial affairs has grown significantly. Individuals must be able to differentiate between a wide range of financial products and services, and providers of those products and services.

The ability to make well-informed financial decisions plays an important part in the ability of individuals to manage their financial affairs. The outcomes of financial decisions have significant implications for an individual's financial security and standard of living. A person with a good level of financial literacy is likely to be better placed than someone without those skills and knowledge to manage their financial affairs prudently; all else being equal, they are more likely to budget effectively, invest wisely and manage their debt level in a sustainable manner. By contrast, poor financial choices, possibly based on a lack of understanding of financial matters, can result in a number of negative outcomes, including a lower level of financial wealth and imprudent debt levels.

Financial literacy has a clear relevance for the ability of households to manage debt. Deregulation of New Zealand's financial environment has led to access to a much broader range of financial products and services. In particular, debt has become easier to obtain. However, growth in debt has outstripped growth in household income. Over the decade to December 2006, household debt has increased almost three times. This is mostly housing debt, which has tripled, while consumer debt has more than doubled. Total household debt is now more than $150 billion, and around 155 percent of household disposable income.[1]

[1] Reserve Bank Data

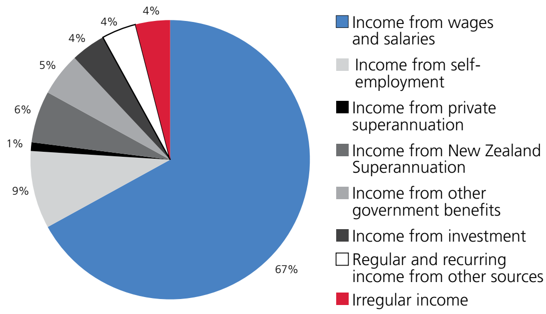
Around $13 billion of total household debt is consumer debt. Credit and store card debt accounts for more than $5 billion of this, with the balance mostly in short-term instalment credit – much of which used to be called hire purchase debt. There are few limits to how many sources of credit the average consumer can have at any time (eg, credit cards, department store cards, bank loans, overdraft facilities), and there is evidence that multiple sources of credit are commonly a factor in reported cases of unmanageable debt.

At the same time as debt has risen, measured household savings have continued to decline. Low savings rates, and the predominance of mortgage lending, have meant that New Zealand household assets are concentrated in housing assets, with relatively low levels of financial assets and a lack of diversification in investments. Most household income is derived from wages and salaries; survey data suggest that less than five percent of total New Zealand household income is derived from sources such as private pension schemes and investments (figure 1). The decision by households to invest mainly in housing and to have relatively few other forms of investment may reflect a range of factors, including expectations of capital growth on housing, lifestyle preferences and other considerations. However, it is certainly arguable that a lack of financial literacy may have contributed to a lack of investment diversification by the household sector, particularly in terms of understanding the relative performance of different forms of investment, the risks associated with holding a large proportion of wealth in housing, and the principle of asset diversification as a means of lowering portfolio risk.

This growth in household debt levels and the concentration of household assets in housing indicates a need for increased financial literacy. Greater financial literacy would allow the householder to choose better options for managing their debt, better understanding risk and return tradeoffs and better understand the risks associated with concentration in particular asset categories.

Figure 1

Sources of Household Income

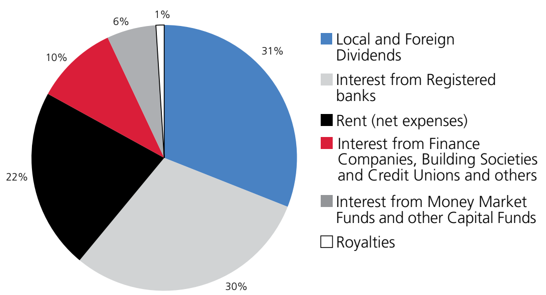


Source: Statistics New Zealand, Household Expenditure Survey.

This focus on household property assets and lack of sophistication of the New Zealand market is also reflected in the composition of investment income. Just over 71 percent of that investment income is provided by way of simple interest returns and dividends. In contrast to the 22 percent of investment income provided by net rental returns on property, less than 6 percent of investment income in New Zealand is derived from capital markets, and other sources of financial capital in New Zealand. See figure 2

Figure 2

Sources of investment income



Source: Statistics New Zealand, Household Expenditure Survey.

Importance of financial literacy for financial system soundness and efficiency

Financial literacy can be a significant influence on the soundness and efficiency of the financial system. A financially literate, well-informed public could be expected to have beneficial effects on the soundness and efficiency of the financial system. This can occur in a number of ways:

- To the extent financial literacy facilitates a more prudent management of household balance sheets, it could reduce lending risks for banks and other providers of credit.
- Improved financial literacy could result in more discerning choice of investment and other financial products by consumers. In turn, this is likely to strengthen the incentives for financial institutions to respond innovatively to consumer demand, leading to a more dynamically efficient financial system.
- A more financially literate society could be expected to exert stronger market disciplines on financial service providers by exercising greater scrutiny over the risks of particular financial institutions and their products, and through a greater awareness of risk-return trade offs. In turn, stronger market disciplines are likely to encourage more prudent management of risks by financial institutions and a higher standard of financial service delivery.
- Well-informed investment decisions, based on a high level of financial literacy, could be expected to result in a more productive allocation of resources through time, reflecting a more discerning approach to the balancing of risk and return. In turn, this should contribute to a higher potential growth rate, and possibly a less cyclically volatile economy, with longer-term flow-on benefits for financial stability.

Reliance on market disciplines plays an important role in the regulation of banks and some other financial institutions in New Zealand. In the case of banking, the Reserve Bank, New Zealand's supervisor of registered banks, has adopted a regulatory stance that encourages self and market discipline to supplement (and substitute for) the use of regulatory discipline. The key tools that the Reserve Bank uses to facilitate market discipline are quarterly financial disclosures and mandatory credit ratings. Although a significant source of market discipline on banks comes from corporate investors and the money markets, the non-expert depositor should nonetheless be an important channel for market discipline. In this case, disclosures and credit ratings are effective only if people understand what they mean and incorporate them into their decision making – which requires at least a basic level of financial literacy.

Similarly, the regulation of non-bank deposit takers and insurers relies quite heavily on market discipline – including through non-expert depositors and insurance policyholders, via disclosure and (in the case of property and disaster insurance) mandatory credit ratings. Proposals for enhancements to the regulation of these parts of the financial sector also place emphasis on the role of market disciplines – and therefore implicitly rely on a reasonable degree of financial literacy among depositors and insurance policyholders. The same can be said for some other parts of the financial sector, such as superannuation and managed funds.

Accordingly, the stronger the level of financial literacy among consumers of financial services, the more effective the market discipline channels on financial institutions will be, and the more sound and efficient the financial system is likely to become. By underpinning stronger market disciplines, financial literacy enables a somewhat less intensive approach to the regulation and supervision of financial institutions. It therefore plays a part in reducing the compliance costs and regulatory distortions that can arise under a more intensive form of financial sector regulation and supervision.

Financial literacy also has implications for the efficiency of the financial system. The efficiency of the financial system relates to its role in allocating risk and resources throughout the economy (allocative efficiency), the economic costs of performing its financial service functions (productive efficiency), and its ability to innovate in response to or in anticipation of consumer demand (dynamic efficiency) (Hunter, Orr and White 2005). Financial efficiency can be eroded by factors that make it difficult for consumers to search and compare products and services. It can be eroded by product complexity, or by complexity in disclosures or performance assessments – or by insufficient levels of financial literacy.

The result can be sub-optimal and can lead to poor decision making. People can fail to understand risks they take on and may buy inappropriate financial services – for example buying either too much or too little insurance. Or they may simply fail to purchase financial services where it would be beneficial to do so. While financial advice is available, it can be expensive or tied to a particular financial product provider.

Competition may be hindered if people are unable to effectively shop around. More capable consumers are better placed to contribute towards competition and hence stronger and deeper retail markets. John Tiner, CEO of the UK Financial Services Authority and Financial Capability Steering Group Chair, has stated: "If people know what they want, and how to get it, the market for financial services becomes less one-sided and a lot more efficient. Consumers will demand better, cheaper and more appropriate products and services" (Financial Services Authority 2004:1).

The importance of financial literacy for the wider economy

In addition to being important for individuals and the financial system, financial literacy also has important implications for the wider economy. As noted earlier, the potential growth rate of the economy over the longer term is influenced by the allocation of resources within the economy. All else being equal, the higher the risk-adjusted rate of return on resources is, the higher the longer-term growth in the economy could be expected to be.

Financial literacy can influence the allocation of resources in the economy. If investors are financially literate, they are more likely to adopt a discerning approach to their investment strategy, paying greater attention to the risks of alternative investment opportunities and the tradeoffs between risks and return. Financially literate investors are likely to be better placed to seek to maximise the risk-adjusted rates of return on their investments. In turn, this is likely to result in resources flowing to their most productive uses relative to risk, leading to a higher longer-term growth rate in the economy and, potentially, a lower risk of cyclical volatility in the economy.

It is arguable that New Zealand's economic growth may have been hindered to some extent as a result of a lack of financial awareness by investors. Specifically, the choices investors have made in allocating their investments and the effect this has had in reducing the size of the domestic savings pool and the operations of a capital market within the country could have had an impact on growth. The choice of investments also affects resource allocation in the economy and can have significant effects on potential economic growth. Of course, the growth rate in the economy is attributed to many factors that go beyond financial literacy. For example, the appetite for debt, the lack of a domestic savings pool and the relatively limited development of domestic capital markets can also be attributed to many other factors, including demographics, lifestyle choices, market size constraints and the lack of significant income growth in New Zealand. Equally, resource allocation in the economy reflects a wide range of factors, of which financial literacy is just one. Nonetheless, it can be persuasively argued that financial literacy does make a longer-term contribution to the growth and robustness of the economy.

3 What is known about financial literacy?

International research

There is a growing body of international research into financial literacy, both by academia and by government agencies. The Organisation for Economic Co-operation and Development (OECD) has researched best practice across its member countries, and Russia made financial literacy a theme of its G8 presidency in 2006. The G8 International Conference on Improving Financial Literacy agreed that the co-ordination of efforts by ministries of finance, economy and education, central banks, and special agencies were important for the establishment of an efficient national system of financial education. The role of governments in promoting financial literacy and providing consumer protection was seen as critical, and needed to be developed in close partnership with other stakeholders, especially with private sector and financial institutions. The conference concluded that the next step to be taken to improve financial literacy levels involved each country developing an individual strategy, based on best practices, at the government level.

Tempering this effort by governments, people may not recognise any need to raise their own financial literacy levels. An OECD survey carried out in 2005 found that individuals generally over-estimate their financial literacy. This is consistent with a 2003 German survey conducted by Commerzbank AG. In the Commerzbank AG survey, 80 percent of respondents reported that they were confident in their understanding of financial issues. However, when tested on their financial literacy, only 42 percent were able to answer half of the survey questions correctly (OECD, 2005). Similar results have occurred in the US, the UK and Australia.

Between 1957 and 1985, 29 states in the United States passed legislation mandating some form of consumer education in secondary schools. In 14 states, this enactment required the specific coverage of topics relevant to household decision making, from budgeting, credit management, and balancing cheque books to compound interest and other investment principles. Studying individuals between the ages of 30 and 49 years to determine if participation in a compulsory financial education class at school altered their financial habits as adults, Bernheim, Garrett and Maki (2001) found that before financial education was mandated, there was no difference in savings rates and net worth across states. However, once compulsory financial education classes were established in states, a regular and noteworthy divergence in financial behaviour took place. Those adults who had undertaken financial education classes at high school had higher savings rates (1.5 percentage points higher) and a higher net worth as a percentage of income (one full year's earnings) than those who did not receive financial education. Compared to the overall population, the rate of saving out of income for students exposed to the mandate was 4.75 percent higher; their net-worth-to-earnings ratio was 9 percent higher than that of students who were not exposed.

The Commonwealth Bank of Australia's 2004 survey on financial literacy looked at the link between financial literacy and outcomes for individuals and the Australian economy. The findings of this study, along with others conducted internationally, demonstrate that there is a definite lack of financial skills and knowledge among people with certain demographic characteristics. The results of the survey showed that younger people, males, students, people with lower levels of education, people with lower income, and the unemployed had poor financial literacy skills. People in older age groups also displayed lower financial literacy, suggesting that financial literacy is not merely a function of age or experience. Lower financial literacy was found to have an impact on an individual's general health, and lower scores significantly related to respondents being unable to pay their utility, telephone and credit card accounts. The survey also revealed that 85 percent of respondents primarily learn about managing their finances through 'trial and error' experiences (Commonwealth Bank Foundation 2004).

New Zealand survey data

There have been relatively few surveys of financial literacy carried out in New Zealand. Two recent surveys are the 2006 *ANZ-Retirement Commission Financial Knowledge Survey*, and a poll commissioned by the Reserve Bank in 2007.

The ANZ-Retirement Commission survey found that, across the entire subject area examined, knowledge increased with age, income, education and net worth. Some highlights from this survey were that:

- New Zealanders generally felt positive about how well they managed their money, with 83 percent saying they felt confident about managing their financial affairs; and
- Over 50 percent of respondents stated that they saved regularly.

These positive findings are, however, tempered by the following:

- Only 8 percent of the respondents stated that they had financial goals.
- 26 percent said their greatest difficulty with managing money was that they did not have enough.

- 19 percent said controlling their own spending was their greatest difficulty.

The survey results also underlined a number of knowledge gaps regarding key financial concepts. For example:

- 53 percent of people did not understand compound interest.
- 70 percent of respondents did not believe that investments in the share market (held in a portfolio) would outperform any other form of wealth generation over the longer term.

The survey also highlighted the lack of understanding of the relationship between risk and return:

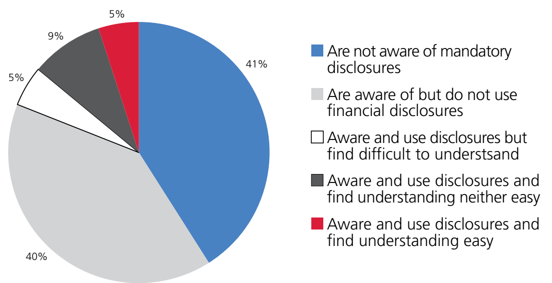
- In the 'advanced knowledge' group, which comprise dabout 15 percent of the population, there were still weaknesses in understanding risk and return for investments offering returns well above market rates.
- 50 percent of all respondents indicated that they would invest lightly in an investment offering above normal returns to determine if the offering was acceptable and that it was paid out, and if nothing adverse occurred within a short period of time they would commit themselves more fully without any further investigation of risk.
- 90 percent of respondents were of the opinion that if an offer greater than the market rate was made by an entity that was well known in the market, the offer would be safe, and they would not consider any further investigation of risk justifying the higher rate.

These weaknesses are supported by the Reserve Bank's survey on the understanding of financial information, the use of credit ratings, and perception of risk in the financial sector.

This poll indicated that nearly 60 percent of those surveyed expected the government or the Reserve Bank to bail out a collapsing bank – a further 13 percent were either unsure or felt that a bail-out would depend on specific circumstances. When linked to age demographics, this figure rises to 87 percent of under 30 year olds and falls to 67 percent in the over 60 year olds, indicating that this level of expectation of a bail out would worsen over time. While not a specific measure of financial illiteracy, this high level of expectation, contrary to the stated intentions of the Reserve Bank, indicates a pressing need to educate consumers about the regulation of financial institutions, and specifically to be aware of the fact that they may lose money when depositing in a bank, and therefore be more willing to read and understand financial disclosures and ratings and exercise market discipline.

The survey also revealed the relative use of financial disclosures issued by banks and non-bank deposit takers. Figure 3 demonstrates that even after many years of disclosure-based regulation in New Zealand, over 80 percent of those surveyed either are not aware of disclosures, or if aware of them, do not use them for decision making.

Figure 3
Reserve Bank Survey



Source: Reserve Bank Survey – Awareness and use of disclosures

The survey also sought to measure the understanding and use of credit ratings. The survey found that:

- Awareness of credit ratings was high, with 77 percent of those surveyed being aware that banks and some other financial institutions are required to have a credit rating. However, included in that number are 15 percent of those surveyed who claim to know very little about credit ratings. This level of total awareness compares positively to the level of awareness of disclosures which was reported at only 59 percent.
- Around 19 percent of those surveyed said they used credit ratings to decide where to put their money and around 6 percent claimed they knew a lot about credit ratings.

- The use of credit ratings in decisions to place funds increases with the level of knowledge of ratings, from 6 percent for very little knowledge, to 51 percent for a lot. This finding shows that knowledge of a simple metric such as ratings could be a significant influence on the decision process for the placing of funds – especially when linked to the higher level of awareness of ratings that already exists in comparison to disclosures.

Despite the limited use of both credit ratings and financial disclosures (both around the 20 percent mark), once respondents had heard the definition and an example of a credit rating, almost three quarters of them believed that the credit rating of a financial institution was a very important factor when considering where to put their money. A majority (61 percent) also declared any other financial information made available by a financial institution was important.

Compulsory disclosure of credit ratings from an approved rating agency for financial institutions was seen as helpful by four in five people. A similar majority (79 percent) believed that the disclosure of more financial information in a more user-friendly format would be helpful when deciding where to put their money.

The surveys have indicated that New Zealanders are aware of some of the financial issues that they face, but they are ill-equipped to make financial decisions. They do not effectively understand the basic financial terms or instruments or, more worryingly, the concept of risk and return. Furthermore, they do not use existing financial disclosures or credit ratings in a manner that would enhance their understanding of financial exposures. On the positive side, New Zealanders are aware of their need for financial independence, and when basic financial concepts and disclosures were explained to them, were able to understand the link between these concepts and their needs. The challenge is for the government and other agencies to direct education to enhance financial literacy needs.

4 Promotion of financial literacy

The implications of a lack of financial literacy for consumers and financial service markets are not unique to New Zealand. Many countries are developing strategies to raise levels of financial literacy. While governments and organisations internationally have approached financial literacy in different ways, there are a number of recurring themes. These include a move from general to more targeted programmes aimed at different groups in society; an increasing focus on young people, particularly school students; and the emergence of nationally coordinated approaches to developing and delivering programmes, often through a coordinating body.

In the UK, the government is committed to ensuring individuals play a more active role in the financial services market. Recognising that "regulation may protect consumers from making bad decisions, but it cannot empower them to make good ones", emphasis is being placed on the government's role in 'demand side' initiatives as well as in promoting 'supply side' reforms (HM Treasury 2007:19).

In 2005, the Australian Commonwealth Government established the Financial Literacy Foundation. The foundation works in partnership with government, industry and community organisations in providing a national focus for financial literacy issues. Its Advisory Board is responsible for contributing independent and strategic guidance on financial literacy issues.

Additionally, the Australian Government has mandated that school systems must deliver financial education to all students by 2008. In its 2007–08 Budget initiatives, the Australian Government provided funding of AUD 2 million for the provision of professional development for the 1,000 teachers who will be teaching financial literacy from 2008 onwards. As part of the Australian Government's commitment to lasting generational improvements in financial literacy, a further AUD 4 million was provided to the Department of the Treasury to extend the Understanding Money media campaign.

In the US, a range of federal government initiatives have been taken to promote financial literacy, supported by various private-sector measures. At federal government level, the Financial Literacy and Education Commission has played an active role in promoting financial literacy through a range of measures, including educational material and internet-based information. Initiatives have been taken at a range of levels, including financial education programmes for young students and adults.

Established in 1993, the Retirement Commission has the statutory role of promoting public understanding of financial issues in New Zealand. One of the Commission's principal functions is to improve levels of financial literacy within the population, so they can prepare financially for retirement. This involves concentrating on the development of a national approach for the provision of financial education, information and generic advice. Recognised internationally, the Retirement Commission's Sorted programme with its www.sorted.org.nz site provides a valuable resource promoting good money management tools and information. The Sorted brand is reportedly recognised by 60 percent of the population; 20 percent of New Zealanders have visited the Sorted site, and high proportions of visitors report taking action on their finances as a result. The Commission has embarked on a national initiative to highlight the importance of financial literacy and increase the visibility of financial education programmes.

In 2007, the Retirement Commissioner is leading the development of a national strategy for raising the level of New Zealanders' financial literacy. This will be conducted with the assistance of a widely-represented advisory committee. The Retirement Commission is also committed to embedding financial education in schools by 2009. To this end, the Retirement Commission has worked with a range of experts to develop a financial education curriculum covering all years of schooling. This curriculum seeks to enable schools to align their financial education teaching with a nationally recognised standard, and is structured to integrate into key learning areas and increase in depth and complexity as students progress through school. As part of this process, teaching resource needs and requirements for teacher professional development have also been identified.

The Reserve Bank, in common with other central banks, has been an active provider of educational material to help students and the public better understand the economy and the role of the central bank.[2] The Reserve Bank supports this objective through its publications, a student challenge contest on monetary policy, and its support of the Enterprise New Zealand Trust – a non-profit organisation that operates programmes in New Zealand schools to promote financial literacy, enterprise education, and business understanding. The purpose of the Trust's financial education programmes is to raise awareness and provide innovative opportunities for students to participate in real life financial decision making, whilst developing money management, future investment and financial planning capability. In support of its financial education programmes, Enterprise New Zealand Trust has developed assessment material and a repository of resources for teacher use. Professional development is a core component of the support offered. The Trust has been working with the New Zealand Qualifications Authority to link financial education to unit standards and the achievement standards framework currently used in school curriculum subjects for the National Certificate of Educational Achievement.

Although these and other initiatives, including those promoted by many private-sector entities, are all helping to promote financial literacy in New Zealand, there is a widely-recognised need for further measures to strengthen financial literacy and capability among the general public. This theme emerged strongly in the government's Review of Financial Products and Providers (the RFPP), where numerous submissions reiterated the need for more initiatives to promote financial literacy and the adoption of more user-friendly forms of financial disclosure.

The RFPP does not involve financial literacy measures, but does entail complementary initiatives to enhance the ability of investors to access information on financial service providers. These initiatives include proposals to simplify and

[2] For example, the Bank of Spain has a customer portal to increase customer understanding of financial services and products; a Bundesbank campaign in Germany targets young people information them about money and monetary policy. In Switzerland, there is a package of materials about money and a monetary policy simulation game.

strengthen financial and risk-related disclosures by financial institutions and to implement a financial service registration framework that will make it easier for investors and others to access financial disclosure statements and other material relevant to their investment decisions. There are also proposals for some categories of financial institution – including non-bank deposit takers – to be required to obtain and disclose prominently a credit rating from a rating agency approved by a regulatory agency. Taken together, these measures could be expected to facilitate investor access to information on financial service providers and provide more user-friendly and relevant information to them.

In addition to these measures, the government is also promoting major reforms to the regulation of financial advisers to the public, including requiring financial advisers to be registered with and overseen by a professional body approved by the Minister of Commerce. These new requirements will strengthen the regulation of financial advisers and encourage the adoption of higher standards of financial advisory services in New Zealand.

In order for the benefits to be reaped from enhanced disclosures and credit ratings, and the strengthening of financial adviser regulation, there will be a need for further initiatives to enhance financial literacy. A number of initiatives can be considered, including:

- developing educational material to accompany financial and risk disclosures for financial institutions;
- encouraging rating agencies and the financial service industry to promote public understanding of financial and risk disclosures, including through their own educational material;
- working with the business news media to heighten their understanding of financial risks and disclosures, and encouraging them to convey financial risk and disclosure information in user-friendly formats to the public;
- working with consumer groups to heighten understanding of financial risk and other considerations relevant to making investment decisions, and to encourage investors to make greater use of them; and
- there is also significant scope to further integrate financial literacy programmes into the school curriculum and provide other forms of educational material via community programmes.

These kinds of initiatives are likely to be explored by government agencies, including the Reserve Bank, as part of the broader moves to promote financial literacy.

5 Conclusion

This article has argued that financial literacy is important at many levels. It is an essential element in enabling people to manage their financial affairs and can make an important contribution to the soundness and efficiency of the financial system, and to the performance of the economy.

The data on New Zealand's level of financial literacy raise some areas of concern. A low level of public financial knowledge can mean that inappropriate risk return decisions are being made, and that people are not necessarily aware of the risks they face in their day-to-day financial decisions.

Improved financial literacy can benefit individuals and families by giving them more control over their money and helping them make better financial decisions. Good financial literacy skills will build the capacity of New Zealanders to better understand and manage financial risk, and take advantage of increased competition and choice in New Zealand's finance sector.

Financial literacy needs to be embedded in the New Zealand culture in the same way that New Zealanders know how to 'Slip, Slop, Slap' before going out into the sun, or 'Buckle Up' their seatbelt before driving their vehicle. Financial literacy is in the interest of New Zealand as a whole, and the creation of a financially healthy New Zealand is the responsibility of all – government, the private sector and community-based organisations. It is too large a task for one group of stakeholders to achieve on their own.

The final result is not to create financial experts; it is more important to equip individuals with sufficient knowledge to make sense of financial activities, seek out appropriate information, feel able to ask relevant questions, and be able to understand and interpret the information that they subsequently acquire.

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