



Getting it right on the money

A global crusade is under way to teach personal finance to the masses

EVERYBODY wants it. Nobody understands it. Money is the great taboo. People just won't talk about it. And that is what leads you to subprime. Take the greed and the financial misrepresentation out of it, and the root of this crisis is massive levels of financial illiteracy.

For years John Bryant has been telling anyone who will listen about the problems caused by widespread ignorance of finance. In 1992, in the aftermath of the Los Angeles riots, he founded Operation HOPE, a non-profit organisation, to give poor people in the worst-hit parts of the city "a hand-up, not a handout" through a mixture of financial education, advice and basic banking. Among other things, Operation HOPE offers mortgage advice to homebuyers and runs "Banking on Our Future", a national personal-finance course of five hour-long sessions that has already been taken by hundreds of thousands of young people, most of them high-school students.

That many poor people do not have a bank account—and that few of them understand why this puts them at a disadvantage (let alone other essentials of personal finance)—is at the heart of "the

civil-rights issue of the 21st century", says Mr Bryant. He calls the attempt to help people help themselves out of poverty through financial literacy and economic opportunity the "silver-rights movement".

In January George Bush appointed Mr Bryant vice-chairman of his new President's Council on Financial Literacy. This was launched as part of his administration's increasingly frenetic response to the financial crisis that followed the meltdown in subprime mortgages, many of them given to borrowers who may not have understood the risks. Often borrowers did not even realise that their monthly payment would rise if interest rates went up, says Mr Bryant. Subprime borrowers on adjustable interest rates, whose mortgages make up just 7% of the total, accounted for more than 40% of the foreclosures begun in the fourth quarter of last year (see chart on the next page).

The council is not short of expertise. It is chaired by Charles Schwab, eponymous boss of a broking firm. Its other members include the head of Junior Achievement, which has been teaching children about money since 1919, and a co-author of "Rich Dad, Poor Dad", a self-help bestseller. Al-

ready, it has approved a new curriculum for middle-school students, "MoneyMath: Lessons for Life". (Lesson one: the secret to becoming a millionaire. Answer: save, save, save.) It is starting a pilot programme to work out how to connect the "unbanked" to financial institutions. And it is supporting what, echoing the Peace Corps, is called the Financial Literacy Corps: a group of people with knowledge of finance who will volunteer to advise those in financial difficulties.

April has been declared Financial Literacy Month by Congress. The need to make this more than a slogan is especially apparent this year. But America is not the only country where doing something about the widespread ignorance of personal finance is on the agenda. Governments from Britain to Russia are declaring their commitment to financial education. This month the World Savings Banks Institute, which represents retail and savings banks from 92 countries, will hold a summit in Brussels about financial education in the light of the subprime crisis.

Meanwhile, on March 14th a new campaign to promote financial literacy in the developing world was launched at a conference in Amsterdam. Called Aflatoun ("Explorer"), after a cartoon character based on a Bollywood star, it is the brainchild of Jerroo Billimoria, a social entrepreneur who previously worked with street children in India. Among other things, she founded a successful emergency 24-hour telephone service, called Childline. She found that many of the children she helped were entrepreneurial (indeed, such »

spirits may have played a part in their decision to leave home) and became convinced that, given better education, they would have done well in life.

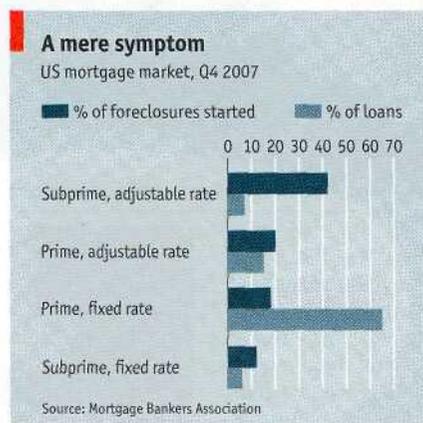
Ms Billimoria addresses herself to children aged between six and 14, whom most educators consider too young to understand money. Having begun with experiments in rural India, her non-profit organisation, Child Savings International, has piloted the Aflatoun course in 11 countries, including Argentina, South Africa, Vietnam and Zimbabwe, since 2005. It is now extending the course to 35 developing countries. Only recently, after suggestions from the Dutch central bank and the European Commission, has Ms Billimoria started to adapt Aflatoun for rich countries such as Britain, the Netherlands, Ireland and perhaps America. "My mistake. I never thought it would be needed in developed countries," she says. If only.

Fools and their money

It is a "well-established fact" that "a substantial proportion of the general public in the English-speaking world is ignorant of finance," writes Niall Ferguson, an historian at Harvard University, in his forthcoming book about the history of finance, "The Ascent of Money". He produces a long list of evidence to support this conclusion. According to one survey last year, four in ten American credit-card holders do not pay the full amount due every month on the credit card they use most often, despite the punitive interest rates charged by credit-card companies. Nearly one-third said they had no idea what the interest rate on their credit card was.

There is similar evidence elsewhere. For instance, a survey in 2004 by Cambridge University and Prudential, a big insurer, found that some 9m Britons are "financially phobic", meaning that "they shy away from anything to do with financial information, from bank statements to savings accounts to life assurance." Research by the British regulator, the Financial Services Authority, found that one-quarter of adults did not realise that their pensions were invested in the stockmarket.

Financial illiteracy is not limited to subprime mortgage borrowers, then; it is pervasive in all age groups, income brackets and countries. "Subprime is a mere symptom," says Mr Ferguson, noting that many of the students he has taught in the "best universities in the world, including MBA programmes, don't even know the difference between the nominal and real interest rate." This problem is more pressing than ever, he adds, because governments and businesses have pushed more of the responsibility for financial well-being onto individuals, whether by encouraging homeownership or by promoting personally-managed retirement accounts rather than defined-benefit pensions.



The education system deserves much of the blame, says Mr Ferguson, who recalls having learnt nothing about personal finance at school in Scotland. In the 2007 survey of American credit-card holders, over half of the respondents said they had learnt "not too much" or "nothing at all" about finance at school.

Americans still leave school not knowing much about money. A sample of high-school pupils aged 17 or 18 gave correct answers to barely half of a set of questions about personal finance and economics posed in 2006 by researchers at the State University of New York, Buffalo. Less than one-quarter knew that income tax could be levied on interest earned in a savings account. Three-fifths did not know the difference between a company pension, Social Security and a 401(k) savings account.

The same survey, undertaken every two years for Jump\$tart, a coalition of 180 organisations in America that promote financial literacy, found that one in six had taken part in a course dedicated to personal finance. A further one-third said they had learnt a bit from studying other subjects, such as business or economics. Laura Levine, the head of Jump\$tart and a member of Mr Bush's financial-literacy council, says things are moving in the right direction, but that progress is slow. The results of the 2008 survey, which are unlikely to show much change, are due to be published on April 9th.

At present only three American states require that students take a course in personal finance. Another 15 insist that it be incorporated in other courses. Beyond that, it is a case of persuading schools one at a time. "Personal-finance education is not a hard sell conceptually," says Ms Levine, "but only when it comes to getting it prioritised." School principals will usually agree that financial literacy is worth teaching, but they are reluctant to give it time and resources.

Even when personal finance is taught, the right lessons are not necessarily learnt. "Wherever you look in America or the OECD, classes in financial literacy don't do much good," says Lewis Mandell, an econ-

omist at Buffalo. "As an educator, I'd like to believe you can teach people to do anything right, but clearly the way we are going about teaching personal finance needs to be improved."

To Mr Mandell's frustration, the only classroom method that seems consistently to raise financial literacy among high-school pupils is playing a stockmarket-investing game-which rewards taking high-risk bets. Most other approaches tend to show only short-term increases in financial literacy, he says.

According to Mr Mandell, one problem is that if financial literacy is taught, it tends to be before a student's final year-before she has faced any important financial decisions, such as buying a car or taking out a credit card. Another is that teachers are often financially illiterate, too. Financial literacy may be less about acquiring knowledge than forming good habits, something that is arguably better done before high school, let alone adulthood.

This is where Aflatoun comes in. Ms Billimoria encountered a great deal of scepticism when she developed her financial-literacy programme for six- to 14-year-olds. Yet she was convinced that starting with youngsters would be more effective, because that is "when their concept of themselves is developing and by 14 most of their habits have formed."

An important part of the teaching is getting the children to start saving, ideally by opening bank accounts. Typically, they have only tiny amounts, but this is enough to get them used to handling money properly. At first this faced a lot of resistance, as people asked, "How can young children handle money?" recalls Ms Billimoria, but "it soon caught on and parents started giving children money to save." To demonstrate its broad applicability, Aflatoun was piloted in economies beset by different difficulties. Zimbabwe, for example, was selected for its astronomical inflation rate. The course was adapted to encourage children to save by buying assets such as pencils, which, unlike the country's money, could be a store of value.

A nudge in the right direction

"The depressing truth is that financial literacy is impossible, at least for many of the big financial decisions all of us have to take," says Richard Thaler, a behavioural economist at the University of Chicago. Aply for someone who has built his career on the study of irrational financial behaviour, Mr Thaler admits that even he finds it hard to know the right thing to do. "If these things are perplexing to people with PhDs in economics, financial literacy is not the right road to go down."

Instead, policymakers should "focus on making the world easier", he argues in a new book, "Nudge: Improving Decisions About Health, Wealth and Happiness",

written with Cass Sunstein, a law professor (and an adviser to Barack Obama). By this he means defining more carefully and simply the financial choices that people have to make, and building "sensible default options" into the design of financial products, so that the do-nothing option is "financially literate". Today, the best choice typically requires some working out and an active decision.

This does not mean that the same choice is right for everyone. The growing complexity of financial choices in part reflects remarkable innovation, much of which has benefited consumers. As Operation HOPE'S Mr Bryant points out, thanks to the availability of subprime mortgages, "homeownership has lifted many poor people out of poverty; the challenge is to make the product better."

Sweden's system of saving for old age contains an example of what Mr Thaler means. It offers Swedes a choice of funds to invest in, but includes a well-designed low-cost default option, which has become the choice of 90% of the people. The same approach might be taken to America's company 401(k) retirement plans, in which today's choices require a high degree of financial literacy. Employees might also be automatically enrolled in savings plans, with a right to opt out, instead of today's under-used opt-ins.

Mr Thaler deserves to be taken seriously, as one of his earlier attempts to apply behavioural economics to saving has had impressive results. Recognising that people find it harder to save money they already possess than to promise to put aside what they might have one day, he designed the Save More Tomorrow scheme, which gets people to commit themselves to saving a slice of any future pay increases. Where implemented, the plan has already brought about sharp increases in saving rates.

Another idea would make it easier for people to choose a suitable credit card, by obliging card companies to supply customers with two downloadable files, perhaps once a year. One would explain the issuer's charging rules; the other would list the charges the consumer has actually incurred. The consumer could then upload this to one of several websites that Mr Thaler believes would soon appear. With one click, the most suitable card would be recommended. A similar system could work for America's Medicare prescription programme, in which preliminary research suggests that matching the drugs a person needs with the right insurance plan would save on average \$700 a year, he says.

Better product design and financial education need not be alternatives, points out Mr Mandell. They can work in tandem. He is enthusiastic about schemes such as the Child Trust Funds introduced in Britain. These "baby bonds" give every child a

fund that matures at adulthood, letting everyone start out with a nest-egg. Mr Mandell is particularly excited by the curriculum being designed to be taught in conjunction with these funds, starting when children reach the age of seven. "Teachers will be able to talk about money realistically, because the kids will have ownership of wealth."

If you can make it there

One of the most interesting attempts to combine teaching and superior products is taking place in New York, championed by a mayor, Michael Bloomberg, who made his fortune selling financial information. He has created an Office of Financial Empowerment, which is trying to use the powers of government to promote both financial education and better design of financial products.

The city's regulatory powers mean that it can crack down on firms that exploit financial literacy, and educate the public at the same time, says Jonathan Mintz, New York's Commissioner of Consumer Affairs. It has found that many tax-preparation agencies are offering "rapid refunds" which, as many consumers do not realise, are in fact loans in anticipation of refunds. Its publicity blitz about these loans led to coverage on news programmes "in 22 states and Canada", allowing the city to promote the message that "anyone promising a tax refund within two days is selling a loan - don't do it."

Another initiative is to use the city's system of helping people to apply for the earned income-tax credit as a chance to encourage them to open a bank account. As well as explaining to applicants the importance of saving, the city is working with banks to offer carefully designed accounts, and has even persuaded some philanthropists to provide matching funds for the first \$250 someone saves. "You are not just educating me, you are allowing me to nod my head and say yes, and get a windfall," says

Mr Mintz. "Financial education is much more effective when it is connected to something real that is happening."

With Miami, San Antonio, San Francisco, Savannah and Seattle, New York has formed the Cities for Financial Empowerment Coalition, which met for the first time to share ideas on March 18th. There was general agreement that education and better product design should go hand in hand. Most big banks have started to sponsor financial-literacy efforts, if only to cover their backs. However, Mr Mandell remarks, by increasing the charges for bank accounts with only small balances they have in effect deprived children of what was traditionally the best practical educational tool, an account of their own.

Indeed, one of the biggest problems may be the illiteracy of financial-service firms, which often fail to provide the products that poor consumers most want. That, at least, seems to be the conclusion of a recent survey in two of New York's poorer neighbourhoods. Many people were using fringe financial products such as pay-day loans or money orders rather than the services of mainstream banks.

The mainstream financial providers are "missing genuine markets", says Mr Mintz. "One of the open secrets in this industry is that when people are engaged in behaviour that seems irrational, often it has a rational basis." Which only goes to show that consumers are sometimes only as literate as the products the financial-services industry chooses to sell them.

Mr Bryant makes the same point more colourfully, noting that some of the first people to be hit by the subprime-mortgage crisis were the very brokers who had sold people inappropriate mortgages. Having drunk their own Kool-Aid, they found themselves with enormous debts and no job. "It takes less credentials to be a mortgage broker than a pimp on a street corner in Harlem," he says. "Because a pimp needs references." ■

