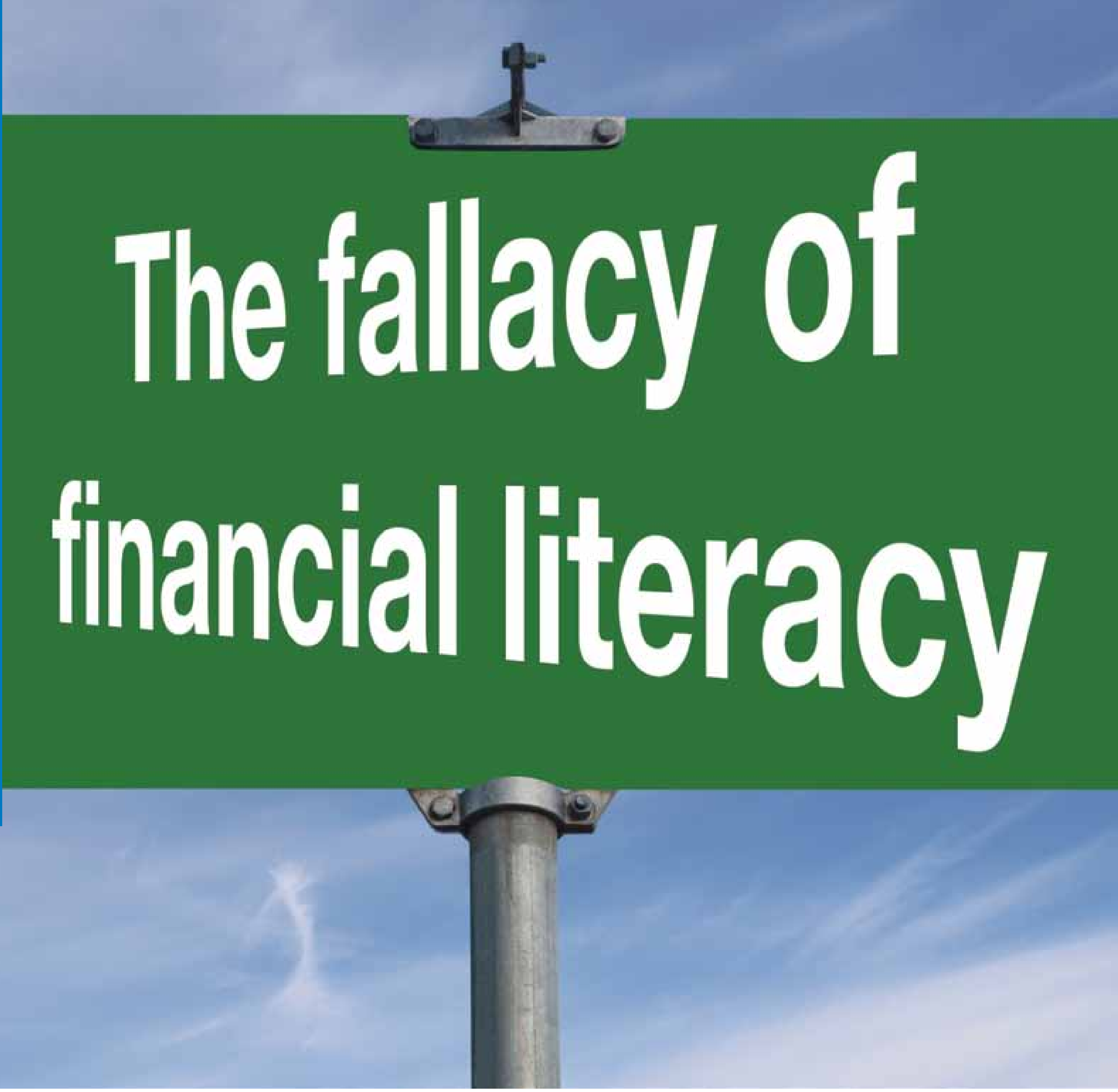

With the advent of financial tools such as credit, debt, insurance and the diversity of investment vehicles available, the average consumer now needs a basic knowledge of finance and economics, simply to navigate daily life. In addition, the complex nature of the global economy with influencing factors such as inflation, foreign exchange rates etc., serve to complicate matters further for the public.

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Quality personal financial education is essential to give individuals the tools needed to manage money, budget appropriately, repay debt and use credit responsibly. However, the idea that greater financial-literacy education can equip the majority of consumers to navigate the complex world of insurance, investments and retirement planning is flawed.

As these products have become more complex, the inability of consumers to understand them has become increasingly apparent and the consequences of this inability, more dire. In response, policymakers around the world have embraced financial-literacy education as a necessary corollary to the disclosure model of regulation.

This education is widely believed to turn consumers into “responsible” and “empowered” market players who are motivated and competent to make financial decisions to increase their own welfare. The vision created is one of educated consumers handling their own credit, insurance and retirement planning matters by confidently navigating the unrestricted financial marketplace.

Unfortunately, the effectiveness of financial-literacy education lacks empirical support, particularly given the dynamism of the financial market place. The truth of the matter is that there is a gaping chasm which is not often discussed. This great gap exists between the skills and knowledge held by the most financially literate on the one hand and the proficiency required to understand and take full advantage of today’s complex financial products and markets, on the other.

More commonly known as the fallacy of financial literacy or education, the shortcomings of basic financial education have been highlighted in a growing body of research. The most notable of this research is that of Professor Lauren E Willis in her paper titled: “Against Financial Literacy Education”. In her study, Professer Willis was quoted as saying: “Financial education appears to increase confidence without improving ability, leading to worse decisions.”

These sentiments are echoed by Helaine Olen, in her recent book, “Pound Foolish”. She highlights the fact that available data indicates that fostering financial literacy simply doesn’t work. Financial literacy is ineffective in today’s complex, modern financial markets.

This trend is prevalent in developed nations such as the United States, where financial-literacy programmes are a mandatory part of basic scholastic education. It is therefore understandable that the gap between financial prosperity and financial literacy is even greater in developing nations.

This trend can be due to the heavy influence of sentiment, the lack of awareness of various financial instruments available or the financial markets in general. Whatever the reason, we have found a disturbing trend locally of underperformance in funds where members are provided with the option to make their own investment choices. This option is commonly termed ‘member choice’.

Yet financial education is still advocated over other methods of regulation, even though research has shown that unless it’s the investor’s professional focus, the average investor underperforms when managing their own funds. When it comes to investments such as retirement funds and insurance, this underperformance can be catastrophic.

The reasons for this underperformance are generally attributed to the fact that these decisions are often more heavily influenced by sentiment. Financial decisions which impact on the future financial security of an investor, their family and their dependents are often influenced by bias, emotions and the fear of uncertainty, rather than sound financial reasoning. It is for these reasons that Professor Willis states that when “left to their own devices, many consumers choose not to choose”.

Therefore, the intermediary market has and should continue to play a central role in guiding long-term financial and investment decisions. The debate around upfront cost implications and fees associated with this model persists. However the fact remains that poor financial decisions cost more in terms of lost earning potential and underperformance, in spite of a perceived degree of adequate financial literacy.

We are now in an age where defined-benefit pension plans are no longer the norm. These fund structures have been replaced by defined-contribution plans that require individuals to decide how much to save and how to invest. Thus the need for guidance, consultation and qualified advice has never been greater.

Financial product providers can also play an important role in helping to mitigate the deleterious effects of member choice. This can be achieved by keeping products as simple as possible. Whether the products are designed for individual or group risk business, they should help to manage risk and still deliver value, with minimal investor input. This will remove the opportunity for bias, sentiment and a lack of adequate knowledge to erode long-term investment returns. ❐

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