FINANCIAL LITERACY AND THE TASKS AT HAND IN HUNGARY

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ABSTRACT

The economic crisis of 2008 once again drew attention to the importance of financial literacy and education. One explanation for the prolongation of the economic crisis can be found precisely in the deficit of financial knowledge within society at large. From young people to the most senior decision-makers, developing financial knowledge is required in order to ensure that the regulation of credit institutions occurs within a "necessary and adequate" framework, and that the functioning of bank processes and products is understood by consumers. It was in order to promote the growth of financial literacy that the European Banking Federation created the European Money Week programme, which Hungary has also joined (under the moniker Pénz7). The Pénz7 programmes both publicize and complement the activities of the government and credit institutions carried out in the service of developing financial literacy and education.

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FINANCIAL LITERACY AND THE ECONOMIC CRISIS

At the end of 2014, the number of mobile devices on Earth exceeded the number of people. Asked to think of two items we always carry on our person, for most people a mobile telephone and a wallet will surely spring to mind. The latter connects us to banknotes, coins and bank cards. And it is the sciences of economics and information technology that are most closely related to these two personal items now regarded as indispensable. Meanwhile, young people the world over today are brought up with almost no mention made of these sciences – and particularly not of economics – in elementary or secondary schools.

As a consequence of the economic crisis, the economic sciences – and within this the question of financial literacy, or more precisely the lack of it – has become the focus of attention. Let us not forget: "The concept of financial literacy is not new, as attempts were already being made in the United States at the beginning of this century to increase the public's knowledge of financial matters – albeit with the primary goal of creating and expanding the market for financial products. To put it simply, it was necessary to explain to people which financial products (e.g. bank deposits, credit, etc) might best be used and how. The time that has elapsed since the turn of the century, however, has yielded not only a significant degree of innovation in the area of individual commodities, but also with respect to products offered by the financial sector. Various research studies date the start of the major wave of innovation in the area of financial products to the 1980s. In all likelihood the financial products in use until then had reached the limits of their inherent possibilities and, shadowing processes in the real economy, it was at this time that sufficient pressure came to bear on the financial sector to renew its offering of financial products and services in response to demand. This process continues to this day in parallel with the acceleration and increasing sophistication of economic processes" (*Béres*, 2013).

"The financial crisis that unfolded in 2008 exercised numerous negative effects on the economy, and through this on society as a whole. The reason for the worldwide recession in this case cannot be primarily traced back to structural problems in the real economy, but can be connected instead to accelerated product innovation in the financial sector" (Survey in higher education, 2013[1]). The deficit in modern and up-to-date financial knowledge thus crucially contributed to exacerbating the economic crisis, burdening a broader section of society and dragging it on further in time.

As a method of approaching the problem, it is customary to list the following elements as aspects of financial literacy:

- financial knowledge, understanding of financial processes;
- ability to apply financial knowledge and acquired experiences;
- knowledge of financial interconnections and definitions;
- ability to reach well-founded financial decisions;
- knowledge of the most fundamental financial concepts;
- ability to reach simple (fundamental) financial decisions;
- ability to reach well-founded and conscious decisions;
- and knowledge of simple financial concepts (Béres, 2013[2]).

1 Further references: Borszéki, É. (2010): International finances (university lecture notes). Gödöllő: Szent István University; Botos, K. et al. (2012): Financial literacy and risk inclination in households in the Central Great Plain. *Pénzügyi Szemle*, pp. 291–309; Béres , D. & Huzdik, K. (2012): The appearance of financial literacy at the macroeconomic level. *Pénzügyi Szemle*, pp. 322–336; Biedermann, Z. (2012): The history of American financial regulation. *Pénzügyi Szemle*, pp. 337–354.

2 Further references: Hung, A. A., Parker, A. M. & Yoong, J. K. (2009): Defining and Measuring Financial Literacy: RAND Corporation.

In the event that difficulties and crisis situations arise, a partial or general deficit in financial knowledge can engender social discontent, a search for scapegoats in connection with financial institutions and a plunge in the moral reputation of these institutions. In 2008 and 2009, we witnessed examples of the above in almost every European country in the form of street protests and demonstrations.

The spread of financial literacy

"An advanced level of financial literacy is in the common interests of every participant in the economy. At the micro level, households and enterprises with typically greater financial literacy are more likely to avoid detrimental financial decisions… the greater the financial literacy in a society, the greater the available savings in the country… the financial literacy of the population contributes to the stability of the financial system itself. Partly as a consequence of the above, it is in the fundamental interest of financial institutions to develop financial literacy since it contributes to growth in savings – and, through this, improving creditworthiness – in the private sector. At the same time, solvent customers represent a low-risk source of revenue for the sector. … Last but not least, developing financial literacy is also in the state's interest since with a higher level of financial literacy less emphasis needs to be placed on redistribution and stabilisation goals, which has a beneficial effect on every participant in the economy and the competitiveness of the country as a whole. (Survey in higher education, 2013.[3])

Evaluations of the financial literacy and knowledge of secondary school students have been carried out in Hungary for years by a joint research team of Econventio and the University of Szeged. The research survey, which reached one of the largest target groups in Europe (numbering close to 10,000), assessed knowledge of banking services, savings and investments, credit, pensions and insurance, the world of work and general economic knowledge (inflation, taxation, country risk). The average performance was 42.6%, although half of secondary school pupils failed to attain a mark of 40%. Those continuing their education having secured a secondary school-leaving certificate performed the best, which is attributable to the fact that education at this level generally incorporates economic and financial knowledge. (The financial literacy of secondary school students, 2014.) Accord-

3 Further references: IBRD, OECD, DFID, CGAP, 2009. The Case for Financial Literacy in Developing Countries: Promoting Access to Finance by Empowering Consumers. Washington: The World Bank; Czakó, Á., Husz, I. & Szántó, Z. (2011): How far do we stretch ourselves? – Changes in the financial literacy of Hungarian households and enterprises during the period of crisis. Budapest: BCE Innovation Centre Nonprofit Kft.; Klapper, L., Lusardi, A. & Panos, G. A. (2012): Financial Literacy and the Financial Crisis: Netspar.

ing to the results of research carried out among students in higher education by the State Audit Office, the BKF University of Applied Sciences in Budapest, the Econventio Roundtable Nonprofit Association, the Hungarian Nonprofit Association of Financial and Economic Auditors and the University of Szeged: "The department to which a student belongs, as well as the course of study followed, are likewise the determining factors in terms of financial literacy… the more time someone spends in education, the better results they will achieve, while it is also noticeable that correspondence students perform better than those studying in full-time education. This is attributable to the fact that correspondence students generally study in tandem with employment, so that they have a steady income, incentivising them to be active in the area of finances – or to put it another way: their living circumstances are different" (Survey in higher education, 2013).

Comparing and interpreting the two sets of results, we can state that financial knowledge is acquired more enduringly when tuition is combined with everyday practice and experience. In teaching financial education and literacy, and in planning the syllabus for the future, it is desirable to place greater emphasis on practical roles and tasks.

Recognising the general observable shortfall in the area of financial literacy, the European banking sector – with the intention of creating a tradition – is organising European Money Week (Pénz7) from 9–13 March 2015 in countries of the European Union in order to expand financial knowledge. The Hungarian Banking Association is among those that have joined this international week of financial literacy and awareness, an initiative of the European Banking Federation. Events in Hungary are being organised by the Hungarian Banking Association in collaboration with the Pénziránytű (Money Compass) Foundation of the National Bank of Hungary, the Ministry of Human Capacities, the Ministry for National Economy and the State Audit Office. The elements of the Hungarian Pénz7 programme include an international scholarly conference on financial literacy; the development of a practically oriented syllabus promoting financial awareness and literacy in elementary and secondary schools; preparing teachers and volunteers to conduct classes on theoretical and practical financial knowledge in registered institutions; announcing and organising related tenders; and organising interactive events. The project in Hungary is headed by Éva Hegedűs, a member of the board of the Hungarian Banking Association.

Banking regulation in the shadow of financial knowledge

As a consequence of the economic crisis, regulation of the finance sector – as had happened before – once again came under the spotlight. It is generally believed that supervisory and regulatory deficiencies contributed to the evolution and deepening of the crisis. We now provide a brief summary of the regulatory environment.[4]

The strengthening of prudent regulations is embodied in the Basel III framework. Basel III primarily targets the strengthening and improvement of capital requirements and, as a new element, stipulates liquidity requirements in order to avoid the negative phenomena experienced during the economic crisis.

The capital requirements of banks were enhanced with the introduction of new "capital buffers" (capital conservation, counter-cyclical and systemic risk buffers), while using a leverage ratio to set a further, non risk-sensitive limit with respect to minimum capital. The new regulations increased capital requirements for market risks, particularly for re-securitised positions. Beyond all the above, they tightened requirements pertaining to risk management and corporate governance, with particular regard to risk-adjusted remuneration policies. The regulations also included prescriptions relating to the improvement of supervisory activity, strengthening of cooperation between supervisory authorities and consideration of macroprudential aspects.

In the wake of the crisis, global regulators devoted special attention to handling the problem of large institutions considered "too big to fail," to the supplementary regulation of systemically important banks, and to the formation of crisis prevention, crisis management and resolution mechanisms. A radical new element in this area – in contrast to the state rescues implemented earlier – is the bail-in, which entails the obligatory involvement of banks' shareholders and creditors in settling losses. In several countries, the "too big to fail" problem was also managed by stipulating the separation of trading activities above a certain order of magnitude.

The Basel Accords and other global regulations initially apply only to major systemically important banks with cross-border activities. At the same time, it follows from the requirements of the single European market that internationally adopted regulations should be implemented across the European Union and applied to all institutions irrespective of size. The Basel III Accord has been made a part of the EU's legal framework by the CRR/CRD IV capital requirements regulation and directive, while crisis management rules were laid down in the Bank Recovery and Resolution Directive (BRRD). The most important development of the present decade is the establishment of the banking union aimed at managing the eurozone crisis, by which the creators intended to break the vicious circle between the indebtedness of individual member states and banking crises by creating a European "single rulebook," Single Supervisory Mechanism, Single Resolution Mechanism and uniform deposit insurance. Numerous elements of banking

4 Based on the expert summary of *Mária Móra* (Hungarian Banking Association).

union have already become a reality today: from November 2014, the European Central Bank took over supervision of significant banks in the eurozone, while the Single Resolution Mechanism has also been launched and a Single Resolution Fund established. Elaborating the details of the single rulebook (regulatory and implementing standards and guidelines) is the task of the European Banking Authority (EBA).

The regulatory framework has again been created with hindsight, according to the financial knowledge and concepts of the prevailing political players. Instead of a system of rules with consequences and effects that have been well thought through, an overregulated and inscrutable situation has been created which carries uncharted market risks. And in this form, it cannot provide a reassuring solution for shaping the economic role, future prospects and essential present challenges of the European banking system, and thus neither to the problem of the banks that are "too small to survive."

Financial knowledge very soon becomes obsolete due to rapid changes and evolution, so that knowledge acquired in this field in the past must be continually developed. For this reason, financial knowledge must be kept continually up to date at all levels of society, even among top management. An individual's opinion of their own level of knowledge, however, often differs from reality: "According to the results of calculations carried out based on the index, more than half of the examined 18–25 age group have a realistic assessment of themselves (59%); however, the proportion of those who overestimate (30%) or underestimate (11%) their own knowledge is great." (Survey in higher education, 2013.) Overestimation of one's own knowledge obviously also occurs on a similarly large scale among upper management and decision-makers. The European Banking Federation was therefore clearly justified in preparing a manual for members of the European Parliament (the EBF Handbook, 2014) which reviews current questions and challenges in banking regulation. As an EU summary document, it is worthwhile reviewing its main themes:

- *Bank structures.* In 2014 the European Commission introduced new rules which would prohibit the biggest EU-based banks from proprietary trading on their own account, as well as ownership of – or investment in – certain alternative investments funds. The Commission would grant supervisory bodies the power to compel affected banks to transfer their most risky trading activities to separate entities with the bank group, unless they can verify to the satisfaction of the authorities that they have adopted other measures to substantially mitigate the risks.

  According to representatives of the banking sector, regulations on capital requirements and rules on bank recovery and resolution already reduce by more than 90% the impact of potential bank failures on public finances. In contrast, they argue, the structural requirements bring a general increase in the cost of funds, impair banks' market-making activities related to important financial instruments, and significantly narrow the range of hedging instruments available to non-financial entities for the management of risk.

- *Money market funds.* Money market funds represent one of the important means of providing liquidity and refinancing for the banking sector. In 2013 the European Commission presented its proposed regulatory framework for the operation of money market funds, one element being a 3% capital buffer, intended to be introduced during periods characterised by falling asset value to ensure that the drawdown of funds can be safely completed. Another element of the regulation is a restriction on investments that funds may make, for example in repo transactions or asset-backed securities subscriptions.

  The banking sector, although supporting regulation of the funds' operation, asserts that the introduction of the 3% capital buffer would make the utilisation of these funds as a means of ensuring liquidity too expensive, potentially reducing the market role of these instruments significantly in future.

- *Indices and benchmarks.* The existence of a number of benchmark interest rates is of key importance in pricing financial instruments, applicable in commercial and other contracts, as well as in risk management tools. In 2012 the integrity and accuracy of certain indices was called into question, and the European Commission consequently initiated regulation of this area in September 2013. The main aspects of this are strengthening governance and control of the benchmark process, minimising conflicts of interest among participants, and improving the quality of data input and calculation methods.

  The present draft regulatory framework covers an excessively broad range of indices, necessitating a narrowing of its scope in line with the actual importance and complexity of individual indices and the extent to which they are applied.

- *Review of the Payment Services Directive.* The Directive is the basic document regulating the creation of uniform payment services across the EU market. A review was initiated by the European Commission in July 2013. The main themes of the review were transparency and provision of information, access of so-called "third-party payment service providers" to bank accounts, review of the rules for refunds of payments, and increasing the responsibility of payment service providers.

  The most delicate problems arise from the access which the draft proposal grants third parties to personal customer identification data permitting disposal over bank accounts, while it does not require payment service providers to guarantee the expected level of IT security. In addition, there is inconsistency in placing responsibility on third parties for the burden of damages arising due to abuses connected with the actions or negligence of third parties.

- *Interchange fees.* The fees which merchants using terminals pay banks on card-based transactions have been maximised under EU regulations at 0.2% in the case of debit cards and 0.3% for credit cards.

  Although the setting of maximum interchange fee levels was aimed at providing an incentive for merchants to accept modern card-based payment and to reduce the eventual cost to consumers through fee reductions built into merchants' prices, neither of these goals is guaranteed to be fulfilled in the absence of other incentives targeting merchants.

- *Regulatory package to combat money laundering.* The EU has created a regulatory framework to protect against use of the financial system for purposes of money laundering and the financing of terrorism. The international professional basis for this is provided by recommendations published and regularly reviewed by the Financial Action Task Force (FATF). The draft of the 4th EU anti-money laundering directive was submitted by the European Commission in February 2013, and is designed to adopt the FATF's recommendations revised in 2012.

  In recent years the EU's banks have devoted extraordinary effort and significant investments to this area, becoming the most important players in the private economic sphere in the battle against money laundering and terrorism financing. By dint of this role, they have a sustained interest in the issue of maintaining and further developing high-level international requirements. At the same time, there is a need to create efficient tools – to be elaborated and maintained exclusively by the relevant authorities – to aid banks in their anti-money laundering activities; for example, official records of the actual owners of registered companies and of politically concerned individuals within the EU, as well as of countries with rules against money laundering and terrorism financing that are equivalent to those of the EU.

- *Automatic information exchange.* To ensure the efficient domestic taxation of private individuals, governments and tax authorities worldwide work out procedures to collect information from foreign financial intermediaries. From 2010, the US Foreign Account Tax Compliance Act (FATCA) generated new momentum for the automatic exchange of information on an international scale. From the autumn of 2014, leaders of the G20 countries approved the model of the OECD Common Reporting Standard (CRS), which the European Commission and Council aims to implement from 2016 through amendment of the Administrative Cooperation Directive, parallel with a review of regulations affecting savings tax.

Developments must be carried out consistently and proportionately on a global level as well. To achieve this necessitates the introduction of minimum threshold values tied to adoption of these rules, the application of uniform definitions and avoidance of multiplication in information provision.

Constant ad hoc regulatory changes or overregulation kill innovation. For this reason, precisely when the banking sector should be employing the greatest possible degree of innovation to eliminate the consequences of the crisis, it is increasingly hamstrung and barely able to manoeuvre. It must be accepted that procyclicality is a natural characteristic of the banking sector's operations, which can be temporarily assuaged, when necessary, only through regulatory and supervisory means. "These things did not happen for a long period prior to 2008. Since then, instead of recognising their responsibility, national and community regimes – particularly in the EU – have introduced a glut of shock regulations and made retroactive, punitive decisions. In this way, the competitiveness of the banking sector in the EU and its member countries is deteriorating at an accelerating rate, and as a consequence the economic weight of the EU countries within the global economy further decreases. Besides the artificial operating environment thus created, to which even the real economy has not been able to adapt, conditions for the functioning of the banking sector are further exacerbated by uncertainties on the political scene and the growing strength of political forces which cite the crisis and draw legitimacy from the ensuing discontent of the masses" (*Kovács*, 2014).

CLOSING THOUGHTS

The development of financial literacy is in the common interests of the economy, credit institutions and the state, and for this reason a joint response is needed; this is materialising within the framework of Pénz7 (the Hungarian initiative within the European Banking Federation's European Money Week programme). Deficiencies in the public's financial knowledge are so serious as to hinder recovery and consolidation when cyclical economic crises occur. Practically oriented education should extend to every level of society, from students to top decision-makers. The latter need to accumulate deeper knowledge in order to recognise the inherent risks for economic development that lie in overregulation of the banking sector.

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