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An Investor Viewpoint: *The fall of financial literacy*

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Introduction

Nowadays, there are two main opportunities for European citizens to get financial education:

- When they are still children or teenagers at school
- When – as adults - they meet financial intermediaries

Unfortunately these opportunities have been less and less exploited in the recent decades.

School education

The first priority for any plan to improve financial literacy must be to re-instate basic financial mathematics in European curricula; and this as soon as the primary school stage.

A French elementary school book from the 1880s shows that more than a century ago, young children were taught interest, interest rates, compounding interest and even annuities, together with related practical computation exercises. Today, at the beginning of the XXIst century, the math curricula of my children did not include any of those very necessary notions and how to use them: not in primary school and not in secondary school either. Instead, they were taught for two or three years in a row quite sophisticated geometry tools such as the Thales theorem, the practical uses in adult life of which are quite more limited than those of interest rates for instance.

It is quite astonishing to notice the regression of financial literacy at school: today's much longer life expectancy and the diminishing contribution of "pay-as-you-go" pension systems would indeed warrant that the younger generations learn what an annuity is and how it is computed.

Education at the point of sale

Unfortunately in our view, the regression of financial literacy is also more recently noticeable for adult education. In real life, the main way adults get any additional financial education to what they learned (or not) at school is through their interaction with financial intermediaries such as banks, brokers, etc. Four decades ago, households held directly about 40 % of European listed equities. They also very often held bonds. Financial intermediaries were routinely offering shares and bonds at the point of sale, having to "educate" customers about shares and about bonds. Nowadays, households hold directly only about 13% of European listed equities. Funds on the other hand grew from holding 5% to now 25% of European equities. Nowadays, people are much more told about "packaged" investment products than about shares and bonds.

With the emergence of "packaged" products, starting with investment funds in the 1970s and 1980s, the focus of retail investment intermediaries indeed radically changed in the last decades: they no longer focus on informing and explaining about shares and bonds, because they are busy informing and explaining about the packaged products (funds, life insurance, banking products, etc.) they are offering. It would be quite interesting to measure the evolution of the level of European citizens' literacy about capital markets (equities and bonds) in the recent decades: we would bet it has actually gone down.

Such measures could start with our elites. For example, almost none of the current Ministers of the French Government declare holding any listed equities. One wonders then how much they know / understand of the long term financing of the economy. Another example of today's elites' financial illiteracy struck me when I recently asked a European Commission executive why so few cases of market abuse ever ended in the conviction of the abusers in Europe. He responded that too often the judge would not even understand the difference between a share and a bond…

Of course, at the same time, financial products and services have become more and more complex; and sometimes too complex even for financial professionals to really understand, as recognized by the industry itself when looking at the roots of the 2008 financial crisis[45]

The role of the financial industry

This widening gap between the literacy level of households and the growing complexity of financial services offerings is no stranger to the evidenced[46] loss of confidence of individual investors in financial markets in general, including investment funds. It is therefore the mid and long term interest of the financial industry - and of the retail intermediaries in particular - to find ways to help reverse these damaging trends, and to go back to the basics of capital markets with their clients. Asset managers could engage with distributors and advisors to explain to clients what a typical investment is made of and why it matters a lot for our economy and jobs: People NEED to understand what they invest in. "*Never invest in a business you can't understand*." (Warren Buffett).

Perhaps the best service to financial education the investment industry could offer is to promote a narrower range of simple performing products to individuals, with crystal clear investment objectives, especially in the long term / pension area.

[45] "instruments that pooled mortgages and their risk became overly complex. That complexity and the fact that some instruments couldn't be easily bought or sold compounded the effects of the crisis." (Lloyd Blankfein, CEO of Goldman Sachs, 2010)

[46] Investment products were ranked 30th and last (worst) consumer service category three years in a row in the EU Consumer Markets Scorecard – December 2012