Key Note Speech Delivered by Hon. Minister for Finance, Dr. Yuba Raj Khatiwada on OECD-SEBON International Conference on Financial Consumer Protection and Education in Asia-Pacific on July 2, 2019, Kathmandu, Nepal

Mr chairman

Deputy Governor of Nepal Rastra Bank,

Senior colleagues from OECD,

Distinguished Guests,

Ladies and Gentlemen,

I am pleased to be here this morning to be part of this high level Seminar. It is my great opportunity to share some of my observations about financial education, consumer protection, and so on and so forth. Let me spend few moments on appreciating OECD for its generous offer and acceptance to make SEBON host this event in Kathmandu. Actually everybody should be looking at this event, as OECD website also says to 'Look East', while East is growingly getting to be the economic power house of the world.

Asia is an emerging market, particularly very much emerging financial market with the need for financial education even more than in other continents of the world. Besides, amid the growing usage of technology which is getting sophisticated, we need to make people aware of the use of technology for financial services. This calls for higher financial education. Moreover, migration of people for foreign labour market is demanding more financial education for the migrant workers. OECD countries are getting lot of people perhaps also from Asia-Pacific and there is also a lot movement of people within the Asia-Pacific region. So, migration makes financial deeds a bit difficult or different from what we do in a normal life.

There could be other reasons as well. If you look in demographics of this region, Europe is no more the only region having problem of aged population, Asia is also growing rapidly towards it. Associated with this demographic issue is also the issue of gender. Women are growingly participating in the financial market activities but obviously the level of literacy and education being lower than that of male, they need higher level of attention. So, there are a lot of reasons for OECD financial education support to Asia, and to Nepal in particular which is a rapidly growing country. Some people say it is a ‘shining star’ in South Asia because it is growing very fast - on an average 7 % plus in the recent years and also emerging out of poverty very soon. Nepal is being also seen as a destination for green-field investment. So, a lot of new opportunities ! Thus, thanks to OECD once again for choosing Nepal as the venue and thanks to SEBON for hosting the event with OECD.

On the topic financial education, I was wondering how does it make different from financial literacy. We are talking a lot about financial literacy. Perhaps, literacy is one-time activity. You get literate. You learn alphabets, you learn numeric, and it is literacy. Literacy is the basics to be educated in financial terms. I think financial education is far deeper, and deeper knowledge than simply being literate in financial services. Second, financial education is a life time learning process. This is not one-time activity. Any education is lifetime learning and financial education is also lifetime learning. So, having attended this conference today does not mean that we do not have to attend another event or have another discussion. It is lifelong learning process irrespective of whether one is the topmost economist, financial analyst, a politician, a policymaker, a regulator, a general consumer, a financial consumer, a press person, a court judge or a police person who enforce financial laws. For everybody, financial education is an ongoing process, it is a lifetime learning process. So, naturally it has to be done and once is not enough.

The topic financial education is very much relevant to Nepal, particularly when we are debating on several dimensions of our financial inclusion. We are talking inclusive growth; but how does this inclusive growth come from? Growth becomes inclusive when people participate in the growth process itself: in decision making, in the production process, and in getting the benefit of the output that we generate from the growth process. So, this has to be participatory, equity based, resource sharing, and ultimately leading towards a society where everybody feels one has got one's share without feeling being cheated or deprived of one's productivity. If that's the case, how do we engage people in production process?

We have almost given up land redistribution schemes, it is so difficult to redistribute land as a productive asset. For technology, it is important but it has to come with other knowledge and finance. So, financial inclusion is the way, I would say, a key intervention by which we can engage people in the production process - engaging people in self-employment or in wage employment. So, if that is the case, then perhaps, we have to make people not only informed of financial opportunities, but also make informed of what resources are available around them. We have to let them know how to make prudent use of finance, how to link finance to production and how to be able to repay the loan and also save for future so that when one is aging, he or she does not have to solely expect state to protect all one’s life rather than becoming oneself a part of the broader social protection system which is self-financed and government financed. So, it goes to build a long story on social protection when we say financial inclusion.

Nowadays, we are talking sustainable development goals. What we mean by sustainable development goals? It is a development which doesn't overly consume environment, which doesn't overly exploit one section of the productive forces to other, and which takes care of the nature, which takes care of the distribution, and which is creating decent jobs and equal opportunities, and also equal distribution of income as per the production share one has or as per the contribution one has. So, if we have to achieve sustainable development, we have also to ensure that growth is inclusive; and to make growth inclusive, we have to have financial inclusion. To ensure that more people are included in the financial services and benefits, we have to have financial education. This is why this conference matters a lot for Nepal.

Some other aspects about the demographics of financial education. When we are young, what would we do as young? We have the ability to take risks, we want to take risks. So, for younger population, perhaps we need to introduce financial instruments which are having good profile of risk-return. And, younger generation are ready to cope with the new technology, new challenges and they are risk lovers. So, we can device financial instruments for the risk lovers. But, as we grow old, our ability and appetite for risk loving become lesser and lesser. We start becoming risk averters. So we want to have safe investments, secured investments and we need financial products to make us risk averter but still to make some profit out of that. That simply means that we need to have designed our financial instruments in such a way that the risk lovers, risk averters and everybody has something to invest, something to get service of. So, that's something about life cycle issues of financial services.

The other aspect of demographics is the life cycles of savings. Who saves more and who spends more? I do not need to speak more on this issue when Japanese colleagues are sitting around. How much Japanese save in the first earning stage of life and how much they spend in their older age? That implies to other several other countries. So, the life cycle theory of saving tells you that you have to save when you have the ability to save. And, you have to save for your future when you are not able to join the labor market. That simply means that we need to have our mechanism also to have social protection of our own rather than simply depending on the state. So, depending upon the life cycle and the demographics that we have to devise our financial services.

In Nepal, the country is entering in a state of demographic dividend. Our young population below sixteen years of age is more than 40% of the population. But, after 30-35 years, the share of aging population will increase faster. So as a forward looking financial service providers or as a state which makes policy, we have to see what we do for the youth, who are in bulge at this stage and for the people who are aging after 35-40 years. We need to put together our financial service products and social protection schemes. So, we have sometimes to put together all these schemes to see the demographics and changing social patterns and also changing economic pattern of our country, particularly our country Nepal which is emerging very fast with demographic changes.

There is also financial education implication of remittance economy. About 5 million of Nepali people have travelled abroad for work. They have been sending money back. And their family members, mostly women, not knowing where to invest because they are not literate to the financial services. Many of them even do not know which of the bank is safer to put their deposits and which of the insurance companies is good to buy an insurance scheme. Or, which of the company's shares are good to buy so that one can get at least safe return and is not losing the hard earned money that one's spouse sends from abroad. So, we have to educate the women counterparts who are left at home to manage the money sent by their spouse abroad. Partly, it applies to the male counterparts as well. But look at the composition, about 90 per cent of the remittance workers are male. So, this simply means that the financial literacy is to go to women who are managing the funds send by their counterparts from abroad. So, there is also the gender dimension and we have to see how we can do it for women and for other family members, many of whom are mostly illiterate.

It is not that everybody is a school graduate. We have still about a third of our population which is illiterate, totally illiterate. How do we make them financially educated/literate where people even do not know how to count numbers or read alphabets? Why do we talk about financial education? The reasons are many. First, as I said, it is for better inclusion, it is for inclusive growth, it is for sustainable development. It is more for jobs – self created jobs, self-employment or wage employment. That's the economic story. Second, the issue is of financial stability. If we do not know which financial instrument are safer to invest, which financial institutions are worthiness of making big investments, what is the credibility of the institutions and their financial parameters, the strength, there is always a risk of market failure. As such, unless the investors know about their respective financial institutions abilities, strengths, and weaknesses, they end up investing in junk products, junk deposits, junk credit instruments, and other kind of junks including shares and debentures. And, this has been the tendency that lack of awareness among the consumers also have created crisis in the world, in the last three or four decades.

We know that the initial years of financial crisis came through the mishandling of the market by the government. Take for example the Asian financial crisis of 1997; and that was mostly a mishandling of the macro economy by the governments. Then we thought, market will do everything right and came the crisis of 2007 when we found that the market has failed. Markets fail because of uninformed decisions. We have the herd psychology, or the animal psychology whereby some people take the lead in financial markets and others just follow without having known anything about the market conditions or products. So, market often does not behave in a rational manner. What does it mean? Do we need to go back to reregulation? I am talking all these things because OECD has done lot of works in financial regulation, in financial literacy, in accounting, auditing, and financial safety-nets. So, I am talking to the right persons that OECD should be thinking about all these things if they have not. I know they have done almost all things to my little knowledge; but if there is something missing, that should be also done.

So, do we want to go back to the reregulation for financial stability? How do we want to manage globalization of financial services? Do we close down the curtains or the windows? Are we making clean air only to come to our room? Or how do we filter the good things coming in and the bad things not being able to enter the country? What kind of financial regulation, if needed in global perspective, we do operate? So, there is always an issue between deregulation and reregulation, and the role of the market versus the state. Balancing the role of the state and the market is then the issue of critical discussions. We must balance both of them. It is not either state or the market - it is both.

We first give a level playing field to the market but if the market does not function properly, state as a guardian has to intervene and that exactly is what Nepal is doing at the moment. We let the market function properly but if the market behaves irrationally, the government steps in. I think this should be the global policy discussion, either it may be globalization or deregulation, to be reviewed critically. So this is where I am thinking about deregulation versus regulation of financial system and for that how to regulate our customers and educate them that these are the services under state regulations, and these are the services under market condition. Take for an example, when there is a bank run, when there is a crisis in the bank, the depositors come and sit-in what we call *dharna* in front of the Central Bank asking their deposit money to be paid back. What do you do? They think that every bank is a government bank, every money they have deposited is to be insured and they have to get it back. Whereas all the profit and the interest they have earned has to go in their pockets. This is the kind of financial literacy we have.

We have four classes of financial institutions: commercial banks, development banks, finance companies and microfinance institutions and add to that credit cooperatives, the fifth one which is also about 15 per cent of our banking industry. For every institution, they call it finance, irrespective of their legal status. And they think that the money they have deposited is equally safe, whereas it is not. So, as central bank governor, when I tried to introduce insurance for small savers who do not have much information about the market, there was hue and cry. Why do we need this insurance i.e deposit insurance in a market economy? The customers themselves should able to access the risks, otherwise there would be a total moral hazard. This was the notion. I said no. Gone are the days of these moral hazards. We must take cares of small savers who are not literate, who are not informed of the market condition, and whom you have to protect being a responsible state. And, this is why for some of the financial safety-nets, we introduced this deposit insurance of Rs 200 thousand initially and then of Rs 300 thousand after some years. Now more than 25 million accounts have been insured in a population of about 30 million. In this, accounts are duplicated; and there are institutional savings also. But I would say that most of the small savers are now protected in terms of their little savings. This is running well. For the last one decade, we have not seen any one having seen people in front of the counters of the banks waiting for their money to get withdrawn. The panicky is over. It is not only that insurance has worked but banks are also made solvent. So, we have to see that insurance still works good in our context but we have to make people aware of insurance services.

In Nepal, most of us think that financial literacy is all about banking because this is a predominantly banking industry. About ¾ of our financial service is banking. So everybody thinks it is banking. But it is not only deposit or credit, it is not only insurance, it is not only stocks or bonds, it is related to so many other activities which are now new technology driven instruments. And, it is also about the services provided by shadow banking institutions, informal financial institutions that include cooperatives, trusts, hundis or whatever means we use for money transfer. The latter has become popular despite being informal and also illegal activity. But every person, when one gets the benefit in terms of low transaction cost, is trying to obtain them. So, how to make people educated and informed of the associated risks with this semi-formal, informal or the kind of illegal financial services is a challenge for countries like ours.

What should we be doing to the next couple of other issues is financial technology. The disruptive technologies such as internet of things, fin-tech, or artificial intelligence or some other technology driven financial services are making our life difficult. I have been a career central banker for 25 years and still I am hesitant to do something on cloud, very seriously speaking. Is it safe? Is it good? Where should I keep my all information? How do I transact with the electronic means? Many people like me (whom others think that I am known to financial services) do not have much confidence about the technology driven financial services. What about the rest? So, we have to see how this disruptive technology used in financial services will work in future? From the mode of payment, the medium of exchange shifting from cash to card, from card to internet banking and then, I don't know much, it is going up to the virtual currency. Still we have new challenges to cope for the consumers and they have to be protected. So, here comes the role of institutions, the regulators, the think tank organizations, who can really work to make people educated for all these things. And on that, I take OECD as the guru, the teacher or the resource institution which is right here. You have the opportunity to learn more from guru. And if you read all OECD information, the available resources and knowledge, I think we would be better educated with them in financial services. We are in front of the resources and this is a rare opportunity to participants to participate and to exchange views and to benefit the most from their presence today and tomorrow.

I take another one issue that is anti-money laundering and combating financing of terrorism (AML/CFT). This came heavily after 2001. Now, as people have been making international transactions and domestic transactions not knowing sufficiently that they are complying or are against the existing laws. These laws have been enacted for last more than one decade or so. When I was the governor of the Central Bank, I faced so much of problems enacting those laws because people are not literate about financial terminologies, financial systems, financial services; and even today many of the financial transactions are not properly done not because they want to violate the laws but simply because they do not know the existing laws. They are not properly disseminated of the existing provisions of the laws and we know violation of law is not an excuse from its enforcement. That's the exact problem we have been facing in AML/CFT also. We have to also ensure that in financial literacy we do not miss this component of AML/CFT which is getting integral part of our financial services and consumer protection.

I take a few more issues about the overall corporate governance and then about the issues that the financial service providers can do in terms of consumer protection, and in financial literacy and education. When I was the Central Bank Governor, I started financial literacy program with the support of the banks. I even visited secondary schools to talk about financial literacy. That was a good start. I think as CSR or as a good corporate governance, the financial institutions whether they are banks, or insurance companies, or stock companies or brokers or dealers or cooperative people, must be doing this responsibility if they really want to have good corporate governance and if they want to have good corporate social responsibility as part of their financial services. So I take CSR also as the integral part of financial literacy and financial education program.

On the corporate governance, I would like to talk a few more points on disclosures. Informing to the market the balance-sheets, the audited reports, matters presented to the boards and in their annual general meetings, audit done by Charter Accountants or Auditors and the account kept by the professionals having heavily paid, they all have to do the justice to their profession. If you do not do justice to your profession, and if you manage bad accounts, the same bad accounts are audited and reported saying that 'to the extent of our knowledge, this information is right; and based on the information we got from the office of the respective financial institutions, the account should be okay'. Their reports are always conditional, and even the audited reports and balance-sheet are not properly red by the consumers; and they unknowingly participate in the shares of the companies or their dead instruments which otherwise may not deserve to be the investment case. So disclosure and before disclosure, proper auditing and accounting, book keeping is the fundamental case to our country. And, only with transparency and proper disclosure, our market, our consumers are well informed and only then they can make informed decision - not following some of the market leaders and not following the impending crisis. So, I would say, disclosure would be important aspect of financial education and telling people which are the companies better disclosing the information, which are not; and if not, one has to think twice before making any investment or making any decision to work with such financial institutions.

The final point I would like to touch upon would be on education system. How do we bring this financial education as the lifelong learning process (financial education) right from kinder garden to the stage of youth and also to the age when you retire as an old age person? In my tenure as the Central Bank Governor, I tried to include financial literacy, financial education in the school course, high school course. Some of them have done. Our students now know more about basic financial instruments. But what they know more is about bank accounts, bank notes, foreign currencies, so on and so forth. They do not know about the disruptive technology led financial instrument yet. How do we include financial education along with IT education in schools? That would be the next agenda. And how to make education very credible so that people engage in this kind of knowledge right from their school education. So, we have to think about this and also the adult literacy program that we conduct. We must also be doing that. This new financial services or the new technology is also at least being heard about by these elderly populations. Only then we will have to make this financial education system as a life time learning process. Otherwise, we need to keep on doing all these things and reinventing everything as when we feel its urgency. I do not want this to make a discrete kind of activity but has to be very regular activity for those who are involved in financial services. This is the area in which I am very much interested and this is the only opportunity when OECD supported activity in financial services or financial education has started in Nepal. I must take one more time to thank OECD for having chosen Nepal and Kathmandu, the right venue, and for having chosen the right topic, to the right audience we have today for the right conclusion and for the right direction for policy makers.

I wish this seminar a grand success.

Thank you very much.

(Transcribed from the extempore speech)