

Establishing a Circle of Financial Virtue

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Introduction

Having a personal financial plan and being committed to actively managing it is good for us, good for our families and good for Australia. Historically, most people have simply followed their own, uninformed instincts with their money. Where people have been 'informed', the information has often been skewed by product providers. A current poster, 'Waiting is boring', touts borrowing to fund instant gratification of non-investment, non-productive consumption.

Most people have little understanding of the long term financial consequences of what they do with their money. Few could calculate how long it would take to pay off a \$6,000 holiday charged to their credit card. Many Australians are actually spendthrifts: every dollar earned and every available dollar borrowed is spent on personal consumption, on things that have little or no lasting value. A small few may be so conservative and risk averse that they put all of their money effectively under the bed, into low returning bank-assured accounts. Neither behaviour portrays a rational understanding of financial concepts.

The fundamental thesis of this submission is that all Australians, no matter what their socio-economic status, should have access to simple, flexible tools and personal financial guides if they need them, so that they gain insight into the potential financial outcomes of their available financial choices. The underlying premise is that, most people, when they can see the options available and the probable outcomes, will make more rational financial decisions. For financial behaviours to change, individuals and families must first be able to see where their current financial behaviours will lead them and the benefits that can come from incremental changes in their behaviour.

Discussion

Clearly whilst most people wish to be better off financially and use their money more wisely, most can not see the financial consequences of their behaviour. Where can an individual go and ask 'how long will it take me to pay off the \$6,000 I borrow on my credit card for a holiday if I pay the minimum balance and use the credit card for other purchases?' Or 'How long will it take me to save for my deposit on a home?' Without knowing the answers to these types of questions, people will make emotional decisions without understanding the trade-offs. It is not that people should not borrow to go on a holiday – we all need a break and sometimes saving for a holiday does not meet the immediate need for stress relief. However, the decision to borrow to fund immediate consumption needs to be made in light of the consequences. If a person understands that it will take 3 years to pay off a holiday funded by a credit card, and that could delay their home ownership by 3 years, they might consider a cheaper source of funding, a lower cost holiday or schedule faster repayments. It is their

decision, but it should be an informed decision. Poor small decisions can lead to big consequences.

Questions that need to be asked at a government and product provider level are:

- Why does the average Australian retire with little more than 2 – 3 years of retirement income saved after a lifetime of work?
- Why are more than 80% of retirees full or part pensioners?
- Why is the average Australian \$400,000 under-insured?
- Why is the incidence of gambling so high in Australia as compared to other OECD nations?
- Why are national savings as a proportion of income dropping each year?
- Why, despite stick and carrot, are more and more Australians not joining private hospital cover funds?
- Why is Australia becoming a nation of debtors?

In general, most people's financial lives are poorly planned, uninformed and heading for significant disasters – and as the individual goes, so does the country.

The financial planning imperative

If this is the case, then it is imperative that individuals and families receive help to plan their financial lives and use this plan to make their spending and investing decisions. The first step in modifying individual and family behaviour is to gain an understanding of what actions or decisions they can control. A financial plan is the outcome of a process where people decide what is important in their lives. They then need to look at what these important factors cost to maintain or achieve. Once these goals or aspirations are clearly defined, including cost and timeframe, a plan can be detailed to achieve them. The plan needs to take into consideration trade-offs – no full set of goals will be achievable all at once or in full. This settled, the financial plan becomes an interactive road map that shows the milestones along the way, highlights when new decisions or trade-offs have to be made and illuminates the achievement of goals.

Clearly a financial plan must be dynamic, allowing for modification and changes of direction and 'speed' that will occur as people's lives and circumstances alter for better or worse. The quality of life for all Australians, now and in the future, is strongly influenced by how well each can manage their individual resources.

What resources does an individual have? Most people have four resources they can control to some degree:

- The time they have,
- The money they earn or have,

- Their willingness to limit personal and property risk through avoidance, management and transference, and
- Their willingness to sublimate their fear of financial loss for a higher potential of financial gain. .

Each of these resources has a monetary dimension that can be measured and about which people can make decisions. Obviously, given unlimited money, we could spend as we please. Given unlimited time, we could do everything that we wanted to and only work for our own satisfaction. Where there is no fear of consequence of personal and property loss, there would be no need to pay premiums to transfer risk to insurers. And if people had no concern of asset price uncertainty, they could allow their portfolio to work through periods of volatility without worry. Everyone's financial future would be secure. However, just as obviously, it has to be recognised that these resources are limited and so decisions about their usage have to be prioritized. Trade-offs have to be made. People need to consider:

- 'Do I work more/ longer/harder because I need more money or can I afford to take more time off, work part-time or retire to increase my leisure or the time I can give to family and hobbies?
- Can I continue my current lifestyle spending and limited saving and still fund the retirement lifestyle I want or must I cut back on current spending and save more?
- Do I need full insurance protection, how much would that be and can I afford to pay for it given my current income and saving needs?
- How can I reconcile my knowing that I need to invest more of my savings in volatile growth assets to achieve my long-term goals, with the knowledge that I get nervous when their value goes down?'

Almost all Australians face these same ongoing financial challenges. Balancing these four sets of resources effectively is difficult at best and impossible without solid information and a 'living' financial plan. With 'properly informed commitment' to make the trade offs and actively manage their financial lives, most people can significantly increase the level of control they have over their current and future lives. How do they get the help they need at a price they can afford?

Improving access to affordable financial planning

There are a number of reasons why financial planning information does not reach a significantly broader audience. The first critical failure in the meaningful communication of financial concepts lies in the inability of those who are responsible for the communication of financial information to move beyond a legalistic approach of dull words and even duller numbers. When a high court judge can not work meaningfully through a standard financial plan or a product disclosure statement, what hope do working or retired Australians have? What possibility is there for generations of maths 'challenged' people to read through 10 pages of fees disclosures and have any idea of what implementation of their financial plan will cost? How can people accept results from financial calculators that make no sense to them, have

internal flaws and are based on unrealistic assumptions? The reason for these flaws is that in most cases, the documents and calculators are not written for or by consumers, they are written for lawyers and regulators by people who would be considered high net worth individuals themselves.

Two things need to happen. Financial products and services, fees and charges and documentation must be simplified. Why does a major bank need 6 pages to disclose their fee arrangements? Secondly, the delivery of information and advice must:

- Be in a form suitable to the general consumer,
- Be delivered in a way that is accessible and convenient to the general consumer
- Be structured so that the consumer can ask the questions that they want answered in a non-technical way and immediately see results
- Provide indicative answers that are intuitively sensible to the general consumer and that lead to better decision making
- Allow storage and recall so that consumers can make new decisions based on changes in their lives or test previous results against new information
- Be at a minimal cost
- Provide ongoing education opportunities as the consumer becomes more adept at using the information/advice delivery system
- Provide appropriate references where the consumer needs further assistance.

What information do consumers want or need to know?

While each person's resources and willingness to make trade-offs will be different, there are a number of fundamental questions that most people would like answers for:

- When can I afford to retire and how much money will I need to retire on?
- What can I expect as income in retirement and will it be enough to meet my retirement needs?
- If I handle my money better can I save more?
- Do I have more debt than I can manage and if so what can I do about it?
- How can I have financial security for myself and my family and how do I protect myself against the losses that would occur if I died or became disabled?
- Can I afford the insurance protection I need?
- Are my current savings and investments suitable for me? Will I meet my long-term goals? If not, what do I need to do and what risks will I be taking?
- Can I do something to legitimately lower my taxes?
- Can I afford the planned lifestyle spending such as holidays, a new car, money to assist the children get started without risking my retirement income?

Beyond answering these types of questions, how can the answers be put into an actionable plan? General consumers need a 'Money Mentor' who can assist in putting together a generic action plan, free of any product selling conflict.

How can all of this be done?

How do we take financial planning to the people? Financial planning is currently provided by mostly well paid specialists, mainly for the well-off and pre and post retirees with large lump sums of money. In concept and cost it is not suitable or available to the vast majority of the community. And to be fair, financial planning as it is now practiced does not provide the results that a general consumer needs. For many of these people, financial advice will be generic.

- How to understand their income, tax and cash flow
- How to create a sustainable budget
- How to save more and save regularly
- How to manage credit and borrowings
- How to recognise financial scams
- How to find out their rights and to lodge and follow a complaint
- How to make decisions regarding their superannuation savings
- How to deal with a redundancy
- What social security benefits they are entitled to
- Where to get affordable advice regarding legal matters
- How to better manage the cost of insurance

From this list, it is obvious that this advice is not what financial planners are used to providing. Yet these issues are fundamental to the lives of all Australians. That being the case, how can this basic but critical information be provided to a large number of relatively unsophisticated people in a low cost and meaningful way. It should be clear that it can not be provided in face-to-face interviews with highly paid advisers. I believe that as obvious as this is, the solution is just as obvious. Web-access is available to a large percentage of Australians, and there is the potential to extend it to many more by more effective use of libraries, schools and public facilities. Web-access delivers solutions practically cost-free, at a time convenient to the consumer. There are no barriers to storage and few constraints on its flexibility. Therefore; what needs to be done is:

- Make available to all consumers a lifestyle financial planning illustrator.
- Have it aligned in language, tone and visuals to the general consumer, but have the engine sophisticated, flexible and robust.
- Make it attractive to use through the use of colour, graphics, intuitive steps, and iterative financial building blocks.
- Give it the capacity to provide outcomes in words, numbers and pictures.
- “Advertise” the lifestyle planning illustrator through schools, churches, trade unions, community groups, Centrelink, etc.
- Fund the project by a small levy on the primary beneficiaries of better savings; investment fund managers, banks, super funds and life companies.
- Develop a 'Money Mentor' volunteer group to assist consumers with putting the blocks of their financial plan together and act as a liaison and source of

reference to other service providers including Centrelink and other community services.

What would be the Government's obligations?

While web and the community would provide the resources for consumers, the government has an important role. It needs to:

- Provide the initial leadership and a centralised focus for the program
- Provide the forum where interested parties can work towards the common goal
- Provide a centralised data-base and consolidate the vast array of available educational materials
- Monitor and review the program to ensure transparency in financial product and service disclosure that will support consumers' decisions
- Continue to provide a safety net for those in our community who can not help themselves

What would be Financial Institutions' obligations?

As the primary beneficiaries of better financial behaviour by consumers, the financial institutions that provide risk, and savings and accumulation products have a vested interest in seeing the general community better informed and being more conscientious in the management of their financial affairs. Aside from supporting the concept of educated and informed consumers, these institutions need to:

- Provide simple, low cost, and well managed products
- Develop simple and easy to understand fee structures
- Provide low initial dollar amount products that have automatic saving options
- Provide targeted, clear and concise documentation
- Provide dedicated call centres that can assist clients with non-advice questions
- Link with community service providers to provide educational, non-product related education programs
- Support the Money Mentor program

Who Wins?

Actually, every one wins except those businesses who thrive on providing excessive credit or who run financial scams.

- From a consumer's perspective, developing and working towards their financial goals provides them and their families long-term security
- Confident savers and investors provide the government and business with a supply of capital that helps the economy grow
- Larger insurance pools modify the risk levels for both the insured and the insurer

- Personal savings are available to fund retirement incomes, lowering the community cost of providing safety net social security payments
- Interest rates will remain more consistent and inflation should remain under control
- Australia's need to seek offshore money either borrowed or equity will diminish
- Economic activity will be stimulated
- Growing corporate profits and personal income will generate growth in tax collections
- And so on – a virtuous circle of wealth and security for individuals and the community. .

The biggest winners will be ordinary individuals and families, who can become financially free, neither dependent on state support nor paralysed with debt and financial risk.

Paul Resnik has been in the financial services industry for over 20 years. He has been involved in product and services design. He is an active participant in web-based financial education and illustration tools and understands the important function that web-based services could play in the delivery of financial education to the general community.