The Director's View
George J. Papaioannou, Ph.D.

On Financial Literacy

Let's think for a moment of some underlying common factors for the following: subprime mortgage crisis, inadequate savings for retirement, low insurance coverage, uneven wealth distribution, underdeveloped capital markets. How many would propose financial literacy, or rather lack of it, as a possible explanation? And yet financial literacy and education have started to gather increasing attention as significant factors for a nation's financial well-being.

There are notable examples of this interest. The U.S. Congress passed The Financial Literacy and Education Improvement Act in 2003 and established the Financial Literacy and Education Commission under the aegis of the Treasury Department with the collaboration of 19 federal agencies. The Organization of Economic Cooperation and Development launched its financial literacy project in 2005 by conducting international surveys and completing guidelines for good practices in financial education. The 2006 G-8 conference in Moscow also gave priority to the cause of financial literacy.

The sudden interest and urgency concerning financial literacy are driven by several realizations:

- According to former Federal Reserve System Chairman Alan Greenspan, the financial world has become a lot more complex than one generation ago.
- Surveys have shown that there are serious gaps in the financial literacy of citizens, including those of industrialized countries.
- Research has shown that improvements in financial literacy have beneficial effects on the financial well-being of people, particularly those with limited financial means and education.
- Financial literacy impacts all stakeholders of the financial system, from investors to institutions and policy makers.

Financial literacy can be defined as how cognizant people are of the various financial needs during their life cycle and the ability to make reasonable and informed choices to meet these needs. The statistics are not encouraging on either front. For example, more than a third of Americans have not saved at all or have saved inadequately for retirement. In other countries, insurance coverage against grave risks is perilously low. Even when people are familiar with their financial needs, they lack the ability to seek the appropriate information or process it correctly. Thus, broad segments of the population lack a proper understanding of the concepts of risk diversification and compounding interest rate, or are unfamiliar with the long-term yields of different asset classes. Surveys have also shown that even more detrimental than ignorance is the overconfidence large factions of the public have about their financial knowledge.

Improving a nation's financial literacy can have important and multifaceted beneficial effects such as:

- Raising the savings rate and preparing individuals better for retirement.
- Allowing persons of limited means to manage their savings to produce greater returns, thus, reducing inequalities in wealth.
- Improving financial sophistication that can make a nation's capital markets more hospitable to financial innovation and development.
- Improving resource allocation through more efficient pricing of an economy's assets.
- Compelling financial institutions to behave in a more responsible way and avoid dubious practices by relying on the public's ignorance or lack of understanding.
- Reducing the cost of information intermediation as savers and investors have higher levels of financial understanding.
- Reducing the need and the accompanying cost of more expansive regulation, as individuals become more informed and sophisticated financial consumers.

To reduce financial illiteracy, national authorities, financial institutions and educational systems need to raise their level of awareness about its pervasive costs and start to implement systematic programs of financial education. In this regard, anecdotal evidence and research findings appear to be encouraging. For example, delinquency rates for consumer debt fall when individuals attend financial education seminars.

Similarly, financial education contributes to greater usage of more complex financial products and better wealth management results. These effects are especially visible in the case of individuals of low means and limited education.

As with other areas of education, enabling people to build successful and stable financial lives can have wider implications regarding social cohesion, better health care, and better living conditions for individuals, families and society at large. The rising frequency with which we hear about financial literacy and the involvement of higher layers of governmental and private stakeholders embracing this cause suggest that financial literacy and education will finally receive the widespread attention they deserve.
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Monday, May 5, 2008

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FRANK G. ZARB SCHOOL OF BUSINESS
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Visit our Web site at www.hofstra.edu/MLC for details regarding the conference, including the panelists from academia and business, and registration information.

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Research Support Provided by Merrill Lynch Center

To fulfill its mission to promote and facilitate faculty and student study in the field of international financial services and markets, the Merrill Lynch Center continues to provide research support to faculty and students. This year, we are proud to report that, with the support of the Dean's Office of the Frank G. Zarb School of Business, the following grants for occasional papers were awarded:

Dr. James Neelankavil, Department of Marketing and International Business, Zarb School of Business

Dr. K.G. Viswanathan, Department of Finance, Zarb School of Business
Topic: Cross-Listing by Firms From Developing Countries

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Preface

In October 1998 I had the privilege of speaking about the “Japanese Economy and Its Role in the Global Economy” as part of a conference on Financial Services in the Evolving Global Marketplace sponsored by the Merrill Lynch Center of the Frank G. Zarb School of Business at Hofstra University. Almost a decade since then, the economy of Japan, which remained in the doldrums for more than 10 years after the 1991 economic bubble burst, has been showing signs of slow but steady recovery. At the same time, however, the birth rate has been dropping and the Japanese population has been aging much faster than in any other advanced country of the world. Consequently, the total population has begun to decline after reaching a peak in 2004.

In the discussion that follows, I will describe the course of the Japanese economy over the recent decade and its future outlook.

Real Economy

The economy of Japan did not recover rapidly enough from the aftermath of the early 1990s bubble burst and faltered along for quite some time. It was the first time since World War II that Japan experienced such a prolonged period of economic stagnancy.

Real GDP growth rates have been volatile during the past decade. Figure 1 illustrates the real GDP growth rate for five-year periods from 1987-2006. In the booming 1987-1991 fiscal year (FY) period (April-March), the rate rose to an average of +4.7%, but fell sharply to +1.8% in FY 1992-1996, reflecting the bubble burst. In the 1997-2001 period, real GDP growth further dropped to a low of +0.2% mainly due to the 2% increase in the consumption tax rate in 1997. In the 2002-2006 period, it finally lifted from the bottom to +1.9%. However, personal consumption, which should act as a dynamic propeller of economic growth, still lacks vigor. Public spending is curtailed due to pervasive financial constraint. From a long-term perspective, the Japanese economy has undeniably entered a recovery phase. However, a steep upswing is not expected in the near future.

Official Aid to Financial Institutions

After the bubble burst, Japanese financial institutions were struggling with a swelling volume of nonperforming loans. Consequently, their profits plummeted and some institutions became insolvent. Without exception, Japanese financial institutions became extremely cautious in their lending practices, creating a heavy drag on a potential economic upturn. Under these circumstances, the Japanese government extended special emergency loans totaling approximately 35 trillion yen ($290 billion; $1 = ¥120) in installments over the 1998-2003 period. Thereafter, the aggregate amount of nonperforming bank loans gradually shrank, and nearly 10 trillion yen ($80 billion) of the government’s special loans was repaid by the end of March 2007. The potential threat to the economy posed by these nonperforming bank loans was temporarily averted.

Low Interest Rates and a Weak Japanese Yen

Since 1991, the growth of the money supply remained extraordinarily slow. (Figure 2). As Figure 3 illustrates, the Bank of Japan had no choice but to continue an ultra-low interest rate policy rarely seen in history. During this time, prices were also on a downward trend and the Japanese economy has been wrapped in the gloom of deflation (Figure 4).
Over the long term, a serious structural problem looms ominously before Japan. During the past 10–12 years, the Japanese population has aged faster than all other countries in the world, due to the national decline in birth rates and the concurrent increase in life expectancy (Figure 5). In addition, an unusual shift has occurred. Despite the absence of war, plague, famine or natural disaster, the total population of Japan has begun to decrease after peaking in 2004. This structural population shift, when caused by aging coupled with decreasing total population, has grave social and economic ramifications. Firstly, the social security system will be subjected to great financial stress (Figures 6 and 7). For instance, concerns are mounting among younger generations that the government pension plan that they are required to contribute to might eventually fail them, leaving them with less than what was promised. In the area of health care, anxieties are being voiced about shortages of medical doctors and the degradation of their expertise. In addition, the business community will not be spared severe blows. Serious discussions have been initiated about how to counteract the shrinkage of the domestic market and the shortage of labor. The future of Japan, the second-largest economy of the world, critically hinges on its success or failure in dealing with the various haunting problems unprecedented in its history.

Hofstra Students Take Top Four Places in NYMEX Open Outcry Trading Competition

On Friday, April 27, 2007, an “Open Outcry” simulated trading competition was held at the New York Mercantile Exchange (NYMEX) trading floor. Participating students assumed the role of pit traders, buying and selling crude oil futures contracts. Dr. Ahmet Karagozoglu, associate professor of finance and academic director of the Martin B. Greenberg Trading Room at Hofstra University, announced that first prize, $1,000 cash and a prestigious summer internship at NYMEX, was awarded to Surbhi Kapoor, a Hofstra finance M.B.A. student. Sila Nazli Saylak, an M.S. in finance student, and Tansel Alan, a finance M.B.A. student, both from Hofstra, won second and third place cash prizes. Three additional Hofstra finance M.B.A. students – Girish Bhalla, Anshul Shah and Deepak Chandela – were among the competition’s 10 prize winners. A panel of judges made up of NYMEX officials and floor traders evaluated 30 student traders on their ability to execute trades. After two rounds of competition, judges identified the top 10 traders who then advanced to the final “money round,” where individual winners received cash prizes. This trading competition was the final round of the Fourth Annual NYMEX Commodity Challenge. Earlier this year, 21 teams participated in an electronic trading competition, in which Hofstra’s team placed third.

Hofstra Students Take Top Four Places in NYMEX Open Outcry Trading Competition
Merrill Lynch Center Hosts Conference on Private Equity

The dynamic topic of private equity was the subject of the Merrill Lynch Center’s annual spring conference held at Hofstra University on May 2, 2007. Attended by more than 100 Hofstra students, faculty and business professionals, the conference brought together academics and practitioners in three consecutive sessions followed by a roundtable discussion. The conference, titled Private Equity: A New Force for Value Creation, was directed by Dr. Andrew Spieler, associate professor of finance and Merrill Lynch Center associate.

The Center was honored to begin the conference with an executive breakfast featuring Leo A. Guthart, chairman and CEO of Topspin Partners, LP, as the keynote speaker. Mr. Guthart, a member of the Hofstra University Board of Trustees, discussed “Private Equity: A Long Island Perspective.” Capitalizing on his extensive experience in business and particularly private equity, Mr. Guthart candidly discussed the excitement and challenges market participants face in the private equity markets. Prior to founding Topspin Partners, Mr. Guthart was president, CEO and chairman of ADEMCO. Under his tenure, the company grew from a fledgling manufacturer to become a $1.5 billion enterprise before its sale to Honeywell International in 2000 for $2.2 billion.

Following the executive breakfast, conference participants convened at Hofstra University’s Scott Skodnek Business Development Center for the first conference session. Private Equity Fundamentals: Markets, Process and Participants was moderated by Dr. Ehsan Nikbakht and featured three distinguished speakers: Clark L. Maxam of the University of Colorado-Colorado Springs; Michael R. Flynn of Sonnenschein Nath & Rosenthal LLP and John MacKessy of FTI Forensic and Litigation Consulting. Markets for Private Equity Deals was the topic of the conference’s second session, which was moderated by Dr. Nancy White, chairperson of the Finance Department of the Frank G. Zarb School of Business. This session featured Mark Bieber of New York Life Investment Management LLC; Mark Deutsch of Hudson Ferry Capital and Douglas Cumming of Rensselaer Polytechnic Institute.

Dr. Kenneth Lehn, the Samuel A. McCullough Professor of Finance at the Katz School of Business at the University of Pittsburgh, served as the luncheon keynote speaker. Dr. Lehn, who previously served as chief economist of the U.S. Securities and Exchange Commission, focuses his research in corporate finance on issues that include mergers and acquisitions, corporate governance and capital structure. In his address, Dr. Lehn took a historical perspective, discussing the origins of the private equity market of today to the leveraged buyouts of the 1980s period.

The third session, moderated by Dr. Esmeralda Lyn, followed the luncheon. Oversight and Linkages to Public Markets was discussed by Jennifer Marietta-Westberg of the U.S. Securities and Exchange Commission and Georgiana Fung of Merrill Lynch & Co. The conference concluded with a roundtable discussion moderated by Dr. Cynthia Campbell of Iowa State University. The panelists included Mark Deutsch of Hudson Ferry Capital, Frank D. Lackner of American Safety Insurance Holdings, Ltd. and Greenlight Capital Re, Ltd. and Michael J. Odrich of Lehman Brothers.

Hofstra senior finance major David Spinowitz (second from left) chats with (from left) Dean Sodano, Mr. Guthart and John Miller, chair of the Hofstra University Board of Trustees, following the breakfast.


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The following Hofstra faculty serve as Merrill Lynch Center associates for the 2007-2008 period:

A. Sinan Cebenoyan, Ph.D.
Finance

David Flynn, Ph.D.
Management, Entrepreneurship, and General Business

Richard Jones, Ph.D.
Accounting, Taxation, and Legal Studies in Business

Ahmet Karagozoglu, Ph.D.
Finance

Wi Saeng Kim, Ph.D.
Finance

Steven Krull, Ph.D.
Finance

Laura Lally, Ph.D.
Business Computer Information Systems and Quantitative Methods

Keun Lee, Ph.D.
Marketing and International Business

Esmeralda Lyn, Ph.D.
Finance

Susan Martin, J.D.
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Rusty Mae Moore, Ph.D.
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Elizabeth Venuti, Ph.D.
Accounting, Taxation, and Legal Studies in Business

K.G. Viswanathan, Ph.D.
Finance

Nancy White, Ph.D.
Finance

Edward Zychowicz, Ph.D.
Finance

Private Equity Conference ...
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Hofstra finance students Steven Lauricella, Sarah Lackner, Carissa Peluso, Jaclyn Pizzella, Steven Alves and David Spinowitz gather at conference breakfast.

Hofstra President Stuart Rabinowitz joins John Miller; Leo Guthart; George Papaioannou; Gioia Bales, Merrill Lynch Center administrator; Dean Sodano; and Herman A. Berliner, provost and senior vice president for academic affairs of Hofstra University.

Luncheon keynote speaker Dr. Kenneth Lehn (left) is congratulated by Dr. Andrew Spieler, conference director.

Hofstra student discusses conference topics with (from left) Mark Bieber, Douglas Cumming and Mark Deutsch.
On September 28, 2007, the Merrill Lynch Center hosted its inaugural Distinguished Scholars Series at Hofstra University. Slated as an annual event, our first speaker was Reena Aggarwal, professor of finance and deputy dean of the Robert Emmett McDonough School of Business at Georgetown University. Dr. Aggarwal, who serves on the Academic Advisory Board of the Merrill Lynch Center, spoke on “Globalization of Financial Markets: The Changing Competitive Environment.” Professor Aggarwal, who has authored numerous articles in leading financial journals on corporate governance, international stock markets, microstructure of stock exchanges and IPOs, discussed the key factors influencing global stock exchanges, including the significant impact of the growth of exchanges outside the United States. Performance and regulatory issues relating to the demutualization of major exchanges was explored by Dr. Aggarwal. She also reviewed issues examined at the Treasury Conference on United States Capital Market Competitiveness, which she attended.

Dr. Aggarwal reviewed findings of two of her recent publications. The first, coauthored with Rohan Williamson, titled Did New Regulations Target the Relevant Corporate Governance Attributes? examined the relationship between governance attributes targeted by new regulations, such as Sarbanes-Oxley and firm valuation. The study concludes that new regulations did target governance provisions that were relevant from a market perspective and there was a positive relationship between governance and valuation. In a second study, Dr. Aggarwal examined the differences in governance practices between U.S. and foreign firms. The study found that in general foreign firms invest less in governance than U.S. firms.

Following the seminar, Dr. Aggarwal joined Hofstra faculty and administrators for an engaging luncheon discussion, “Issues in Higher Business Education: The Georgetown Perspective.”

Reena Aggarwal

Spotlight on Research by Merrill Lynch Center Associates

GEORGE PAPAIOANNO
C.V. Starr Professor of Finance and Investment Banking


SUSAN MARTIN
Cypres Family Distinguished Professor of Legal Studies in Business


JAMES NEELANKAVIL
Professor, Marketing and International Business


A. SINAN CEBENOYAN
Professor, Finance

“Regulatory Regime Changes and Acquisition Attributes: The Case of Commercial Bank and Thrift Acquisitions of Thrifts,” co-authored with Fatma Cebenoyan and Elizabeth Cooperman, Quarterly Journal of Finance and Accounting (forthcoming).

The associates of the Merrill Lynch Center represent Hofstra faculty from a wide range of disciplines. Each of our 21 associates is committed to contributing to the study of one specialization within the field of international financial services and markets. Their responsibilities include: maintaining current familiarity within their area; moderating roundtable discussions; and initiating and organizing programs - such as seminars and symposiums - that enhance the understanding and expand the knowledge base in their areas.

Specializations include:
- Emerging Markets
- International Investment
- Derivatives
- Law and Regulation
- Information Technology
- International Economics
- Marketing of Financial Services
- International Banking
- Accounting for International Markets and Services
- Management and Organization of Financial Services
- International Investment Banking

### ACTIVITIES REPORT FOR THE ACADEMIC YEAR 2006-2007

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<td>Dr. George Papaioannou, Director, The Merrill Lynch Center</td>
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<td><strong>March 14, 2007</strong></td>
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<td><strong>April 25, 2007</strong></td>
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<td>Li Cai, Ph.D., Senior Economist, IMF, Asia Desk; Dr. Wi-Saeng Kim, Finance Department, Zarb School of Business; Dr. Yong Zhang, Department of Marketing and International Business, Zarb School of Business</td>
<td>Dr. James Neelankavil, Moderator</td>
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