Consumer Federation of America

Testimony of

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On

Improving Financial Education to Increase Financial Literacy

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I am Stephen Brobeck, executive director of the Consumer Federation of America. For three decades, CFA, and I personally, have sought to promote effective financial education to increase financial literacy. We commend you, Mr. Chairman, and members of you Committee for organizing these hearings and for providing us with the opportunity to explain our views about improving private sector financial education to increase financial literacy.

In this testimony, I will assume that the need for financial literacy is well-known and uncontroversial. Those interested in our views on the subject can reference our testimony before the Senate Banking Committee on financial education delivered on May 23 of this year. Instead, I will focus attention on the limits of financial education, the essential characteristics of effective financial education, one program which CFA helps lead that exhibits these characteristics, the single most important initiative we could take to promote financial literacy, and the role of the federal government in supporting this initiative.

The Limits of Financial Education

Financial education, whose aim is to increase financial literacy, is limited by its current weaknesses and by its inherent character.

Fragmented Character: The most important weaknesses of this education today relate to its fragmented character which, some say, reflects our society's lack of commitment to effectively providing this education. There are many institutions and individuals who are working with dedication and effectiveness to increase financial literacy. Many of their programs, including several in which we participate or lead, are described in the recently released "National Strategy for Financial Literacy" report. But these worthy programs do not begin to meet the financial literacy needs of our nation.

For a start, there is no coherent national strategy, or effective leadership of the implementation of this strategy, to meet these needs. Such a strategy must define as precisely as possible the needs themselves and how they vary for different population groups, effective programs needed to meet these needs, and a rigorous method for assessing the success of these programs.

In the schools, Jump$tart and its partners have made progress persuading state legislatures to pass financial education mandates. And, these mandates are in large measure responsible for the fact that hundreds of thousands of students now receive at least some financial education. Yet, many states still have not approved mandates, and in those which have, the education varies widely in intensity and effectiveness. The magnitude of the remaining challenge is reflected by Jump$tart's annual surveys of the literacy of students who have had financial education instruction that reveal little or no progress in knowledge levels. Moreover, it is not at all clear that even statistically significant increases in this knowledge adequately prepare students for the financial challenges of adulthood.

In communities, financial education efforts are even more fragmented. Just in the past decade, hundreds of public, corporate, and nonprofit organizations, including CFA, have initiated their own financial education efforts. They have produced information on a wide variety of topics that they attempt to communicate to consumers through publications, audio-visual materials, the Internet, and workshops.

The quality of this information varies considerably. Some of it, for example, ignores the most important messages consumers should receive. There are many materials on the use of credit cards, for example, that fail to emphasize the importance of trying to pay off all balances on time each month and the risks of being unable to do so. These and other materials also often tend to communicate more information than consumers are prepared to read and digest. Unfortunately, the lower-income and least-educated consumers, who have the greatest need for this financial education, also tend to be those who have the most difficulty understanding complex materials.

There is little adequate evaluation of the effectiveness of all this community financial education. Most initiatives contain no assessment of consumer impact. Those that do tend to limit their evaluation to onetime surveys of the experience of participants. Very, very few attempt to study the longterm effect of the initiative on participant behavior and whether any behavioral changes are sufficient to meet financial services needs.

Importance of Motivation and Opportunity as well as Knowledge: As noted above, financially literate persons must have adequate knowledge to effectively manage their financial resources, and the goal of financial education is to provide this literacy. However, since this literacy is only one condition necessary for effective management of resources, financial education alone cannot assure this skillful management. Two other conditions must also obtain: Consumers must value this skillful management enough to learn and practice it. And, there must be accessible opportunities in the marketplace for utilizing these skills.

The following examples illustrate the importance of all three conditions -- knowledge, motivation, and opportunity:

- Only employees with access to retirement plans at work can easily save for retirement. But they must want to participate in these voluntary plans, and they must know how to do so in ways that serve their longterm financial interests. That usually entails keeping most funds in equities not "safer" money market funds.

- The knowledge necessary to maintain an emergency savings fund is not complicated. But one must value this savings highly enough to keep a separate savings account with balances sufficient to meet normal financial emergencies. For lower-income individuals, it is easier to open such accounts if financial institutions set low opening and minimum balance requirements. And it becomes much easier to maintain adequate balances if employers and financial institutions permit, even encourage, split direct payroll deposits into saving as well as checking.

- Aggressive credit marketing and its "deceptive" pricing make it difficult for many consumers, especially the inexperienced, to use and manage debt wisely. They assume that, if a financial institution offers them credit, they can afford it and that, if they are able to make minimum credit card payments and initial payments on ARMs or interest-only mortgages, this credit is sustainable. So, many think they have little need to manage their debts carefully, for instance, until their credit card balances are so large that 2 percent monthly payments are burdensome or until ARM rates rise or until principal must be repaid on an interest-only mortgage. In our opinion, the only effective way to address these problems is for lenders to be more responsible about extending credit ("limiting credit opportunities") and intervening at the first sign of payment difficulties, perhaps by urging consultation with credit counseling agencies.

This past point deserves emphasis. Financial education cannot, by itself, ensure sensible financial decisions by consumers. In addition to supporting the development and spread of effective financial education programs, governments need to ensure that consumers have access to adequate information about financial products and protect vulnerable consumers against egregious abuses. Federal legislation requiring truth in lending and truth in saving, for example, have given consumers important tools for evaluating and comparing financial products. And, protections requiring that securities are sold "suitably" provide important safeguards against the sale of highly unsuitable stocks and bonds to investors. Given the recent proliferation of some very risky mortgage products, suitability standards should be developed that apply to their sales as well.

Characteristics of Effective Financial Education Programs

Truly effective financial education programs share two general characteristics: They work -- that is, they produce desired behavior change -- and they have the capacity to "go to scale" -- that is, they can reach large numbers of consumers.

Unfortunately, we have no idea whether the vast majority of financial education initiatives really work because their impacts have never been carefully studied. That is not to say these unexamined programs have no value. For the past 12 years, for instance, CFA has led a Consumer Literacy Consortium of national governmental, nonprofit, and corporate groups which carefully developed key consumer money-saving tips then distributed, on request, nearly two million copies of its "66 Ways to Save Money" brochure through the Federal Citizen Information Center, where it remains the most popular publication, and through other national networks. Frankly, we have no idea exactly what consumer impact this brochure, and related website, have had, but continuing strong consumer demand for this information, coupled with the program's low cost, strongly suggest it is cost-effective. That said, no-one in the Consortium believes that this initiative should serve as the cornerstone of a national financial education program -- it is much too limited in scope and ambition.

Accordingly, for financial education programs to be seriously considered as model programs they must give evidence, through rigorous evaluation, of significant behavioral change resulting in satisfactory ability to manage financial resources. There are some initiatives, described in the "National Strategy for Financial Literacy," that offer much promise for meeting these criteria. We are most familiar with the America Saves program, which in local and regional areas (often with Cooperative Extension leadership) has recruited public and private organizations to undertake campaigns to enroll thousands of nonsaving individuals as Savers. These participants are required to make written commitments to implement a specific plan that they have developed to meet a savings goal. To date, nearly 60,000 Americans, about half of them African-American or Hispanic-American, have enrolled as Savers. And, assessments funded by The Ford Foundation have revealed that, in the aggregate, these Savers are saving $.50 on each pledged dollar.

Just as importantly, as a related assessment reveals, the local campaigns have persuaded important local institutions, particularly financial institutions and employers, to more effectively promote saving. For example, in several dozen areas where campaigns exist, most banks and credit unions have lowered opening and monthly savings minimums considerably so that less affluent families can afford to begin building savings.

The America Saves program is relatively successful in large part because it seeks not only to communicate important financial information, but also to motivate individuals to apply this information in their financial lives and to create opportunities for the application of this knowledge. And, the program is expanding, both conceptually and physically, so that it can now realistically aspire to positively influence hundreds of thousands of Americans.

This program cannot solve all financial problems or fully prepare participants to effectively manage their financial resources. Its principal goals have been to jumpstart personal saving and wealth-building and to create an institutional environment that supports this wealth-building. So, no-one with the some 1000 participating organizations believes that the program in and of itself is sufficient. But the experience of America Saves does suggest that there are great benefits to organizing a broad array of influential institutions to work together to develop and implement programs -- which combine knowledge with motivation and opportunity -- to change consumer behaviors in ways that are measured and evaluated.

In our view, many of the most successful future efforts will be closely linked to "products" that are sold by institutions which can reach millions of Americans. These organizations include employers, tax preparers, banks and credit unions, other mortgage lenders, mutual funds, credit counseling agencies, the military, and schools. There is increasing study and experimentation in this area, which should be encouraged. One especially promising initiative, for example, involves "financial education" by employers and financial institutions to persuade employees to split directly deposited paychecks into saving as well as checking. Nearly three-quarters of employees now directly deposit these paychecks, the ACH technology allows such splitting, and once employees have agreed to the split, saving is automatic.

Linking Existing Financial Education Programs Through a New Initiative

As noted earlier, an important reason financial education programs are relatively weak is that they are so fragmented. Can they somehow be linked, not institutionally but programmatically, to provide greater program coherence, mutual support, public identity and visibility, and attractiveness to the tens of millions of Americans with financial literacy needs?

Unfortunately, general messages, even the tested, relatively effective ones of programs such as America Saves -- "Build Wealth Not Debt" and "You Can Build Wealth" -- are too diffuse to meaningfully link diverse financial education programs. A more effective linkage would involve a call to a specific action that is personally relevant to consumers. We believe the most effective call would urge consumers to estimate then periodically monitor their net personal wealth.

As financial educators as diverse as columnist Michelle Singletary, the Financial Planning Association, and my own organization have concluded, awareness of net personal wealth is an important motivator for better money management, debt management, and savings accumulation. People who have a pretty accurate idea of their wealth -- real and financial assets minus debts -- are more likely to spend money carefully, monitor their finances, live within their financial means, and patiently accumulate wealth through 401k contributions, amortizing mortgage payments, and other savings strategies. In other words, if Americans were more aware of their net personal wealth, they would be receptive to a broad array of financial education programs that helped them monitor, conserve, and accumulate financial resources. In a recent column, Singletary noted the parallels between keeping track of your physical weight and your net personal wealth. While weight-watching does not always result in weight-restraint, for many it is a precondition and motivator for such restraint.

In such an initiative, there would be a great benefit to having one or two wealth estimators that financial educators would recommend and even help consumers use. The America Saves wealth-estimator fairly easily helps one estimate their current net assets and their future wealth-building potential. But there are other useful asset estimators. Perhaps the most valuable would be one developed and promoted by a credible federal agency, such as the Federal Reserve Board, which all other financial education organizations also promoted and linked to.

Would using such an estimator be too discouraging for the tens of millions of Americans with few assets, including nearly one-tenth of households with negative net wealth? In our view, that might be the case for some but not for most of these individuals and families. There is a simple reason. People tend to grossly underestimate their capability to build substantial personal wealth over time through the combined working of regular deposits and interest compounding. In a new America Saves pilot financial education program with National City Bank, in which a series of case study scenarios show how less affluent households can build six or even seven-figure assets, hundreds of participants with modest incomes have gained hope that they too can build personal wealth. In doing so, they have become more optimistic about their financial futures. When we begin to carefully study any related behavioral changes, we are confident we will learn that this "How to Save $1 Million" program has also persuaded many participants to manage their money and debts more carefully.

What could the role of the federal government be in such an initiative? For it to collectively mobilize its resources behind a public/private initiative to encourage and assist all Americans to estimate and monitor their net personal wealth would give such an initiative a big boost. That boost could involve not only making available and promoting wealth estimators, but also encouraging and assisting a wide array of non-governmental organizations, especially financial institutions who service virtually all American households, to join the initiative.