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**STATEMENT OF**

**ROBERT W. MOONEY**
**DEPUTY DIRECTOR**
**DIVISION OF SUPERVISION AND CONSUMER PROTECTION**
**FEDERAL DEPOSIT INSURANCE CORPORATION**

**on**

# FINANCIAL LITERACY AND EDUCATION: THE EFFECTIVENESS OF GOVERNMENTAL AND PRIVATE SECTOR INITIATIVES

**before the**

**COMMITTEE ON FINANCIAL SERVICES**
**U.S. HOUSE OF REPRESENTATIVES**

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**2128 Rayburn House Office Building**

Chairman Frank, Ranking Member Bachus, and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding financial education.

In my testimony, I will discuss the importance of financial literacy. I also will touch on a number of specific programs undertaken by the FDIC aimed at improving financial literacy and enabling individuals and families to build wealth. In particular, I will describe the FDIC's *Money Smart* program and the results of a survey of the program's effectiveness completed last year. In addition, my testimony will discuss the importance of integrating financial education into school curricula and FDIC activities in this area. Finally, my testimony will briefly touch on FDIC efforts to increase access to financial services that provide alternatives to predatory lending for consumers.

## The Importance of Financial Literacy

The extraordinary transformation of financial markets over the past decade has placed a new premium on financial literacy, making it nothing less than an essential survival tool. While consumer credit is more available than ever, technological advances and an array of new consumer products, services and providers have made modern banking much more complicated. In today's marketplace, it is more important than ever for consumers to be educated about their rights and options regarding financial offerings.

Notably, U.S. demographics have shifted to open up new pools of potential financial customers, while markets themselves have changed to increase credit availability. The relative inexperience of some new borrowers, along with the escalating complexity of financial products, for example, in the credit card market, and an array of providers, makes it difficult for consumers as a group to consistently exercise informed financial judgment. A lack of financial knowledge can contribute to poor decisions that harm individuals, families, and ultimately, entire communities.

The current problems in the mortgage market make clear some of the consequences that unwise financial decisions can bring. The rapid proliferation of subprime, hybrid adjustable rate mortgages (ARMs) versus other options suggests that many borrowers either did not understand or were not told about other, less volatile, products. While financial literacy is not a panacea and does not excuse irresponsible lending, a more informed consumer population might have recognized the problems with these products and demanded appropriate fixed rate products -- limiting the issues we confront today in the subprime mortgage market.

The FDIC has called for national standards to address many of the problems and abuses that are now coming to light in the subprime mortgage market. These standards should impose underwriting based on the borrower's ability to repay the true cost of the loan, especially among the non-bank lenders currently operating with little or no regulatory oversight. Such standards also should address misleading or confusing marketing that prevents borrowers from properly evaluating loan products. However, even with new national standards, there is only so much regulators and the legal system can do. A comprehensive solution requires that consumers be equipped with sufficient financial educational tools to protect themselves against inappropriate or, in some cases, predatory products.

Inadequate financial knowledge is not only a problem for mortgage borrowers but is pervasive throughout many segments of society. The April 2007 National Foundation for Credit Counseling (NFCC)[1] consumer financial literacy survey found that many American consumers do not follow basic sound financial management practices. In particular, of those surveyed:

- Only 39 percent track expenses;
- Less than half have ordered their credit report;
- 38 percent do not pay credit card bills in full each month; and,
- One-third do not know where to go for financial advice.

Low- and moderate-income families who lack financial education skills are exposed to magnified financial hardships when they are forced to manage financial shocks from unexpected healthcare emergencies, death, divorce, or household job loss. Because of these and other factors, income volatility has grown significantly for lower income households in recent decades. Households in the lowest fifth of the income distribution can now see their incomes fluctuate by as much as 50 percent from year to year.[2] To the extent that low- and moderate-income households lack basic financial skills, they may be especially ill-prepared to cope with such dramatic changes in their economic conditions.

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[1] "A Teachable Moment and a New Mission," The National Foundation for Credit Counseling, April 23, 2007.
[2] *See* Suzanne Nora Johnson, Lisa Mensah and C. Eugene Steuerle, "Savings in America: Building Opportunities for All," Global Spring 2006.

Other groups that may benefit from financial education programs are students and young adults. According to a 2008 survey by the Jump$tart Coalition for Personal Financial Literacy, financial literacy scores among high school and college students are quite low. The survey found that high school seniors answered correctly, on average, only 48 percent of the questions on the Coalition's personal finance examination.[3] College students fared better, but still answered correctly only 62 percent of the time.[4] Students are graduating to young adulthood with high debt loads and poor financial management habits. The Project on Student Debt found that the college class of 2006 had an average debt close to $20,000.[5] More than half of college students accumulated more than $5,000 in credit card debt while in college, and one-third accumulated more than $10,000.[6]

***Money Smart***

*Money Smart* is a financial training program that was developed by the FDIC in 2001 to help low- and moderate-income adults enhance their money management skills, understand basic mainstream financial services, avoid pitfalls and build financial confidence to use banking services effectively. Last year, the FDIC issued an updated version with a module specifically designed to help consumers evaluate and compare mortgage products, in particular those that can create problems for subprime borrowers. This free curriculum is available in English, Spanish, Chinese, Korean, Vietnamese and Russian, as well as a version for the visually impaired, and is

[3] Jump$tart Coalition for Personal Financial Literacy, 2008 Survey of Personal Financial Literacy Among High School Students.
[4] Jump$tart Coalition for Personal Financial Literacy, 2008 Survey of Personal Financial Literacy Among College Students.
[5] The Project on Student Debt, "Student Debt and the Class of 2006," September 2007.
[6] "Sallie Mae launches new 'Be Debt Smart' campaign to educate students, parents and graduates on managing debt and understanding credit," Sallie Mae news release, February 14, 2007, http://www.salliemae.com/about/news_info/newsreleases/021407_bedebtsmart.htm.

available both as an instructor-led or a computer-based training program. Just yesterday, Chairman Bair announced that the FDIC recently surpassed the goal established at the inception of the *Money Smart* program to reach 1 million consumers. We expect to reach many more consumers as we continue to enter into new partnerships, expand upon our established relationships and move forward with several new initiatives.

To reach as broad an audience as possible, the FDIC continues to partner, as we have since the start of the program, with scores of federal, state and local agencies, national nonprofit organizations, financial institutions, bank trade associations and community- and consumer-based organizations. The FDIC also continues to encourage financial institutions to develop partnerships with community-based organizations and other local entities, such as housing authorities, to offer *Money Smart* classes. Research suggests that established community organizations that understand local community needs are in a strong position to deliver effective training even where there may be a cultural distrust of financial institutions.[7]

**Quantifying the Benefits of *Money Smart***

Measurement is an important aspect of determining the success of financial literacy programs and their efficacy in improving consumers' ability to make informed financial decisions. A growing body of research demonstrates that there is a causal connection between

[7] *See, e.g.*, Jacob, K., Hudson, S., and Bush, M. "Tools for Survival: An Analysis of Financial Literacy Programs for Lower-Income Families, Woodstock Institute;" Toussaint-Comeau, M., and Rhine, S. L. W., "Delivery of Financial Literacy Programs," Federal Reserve Bank of Chicago Policy Studies.

increases in financial knowledge and positive changes in financial behaviors.[8] Financial education has been shown to improve savings, homeownership, retirement planning, and credit use.[9] However, many financial literacy programs are still relatively new, and the body of evaluative research on financial literacy's effectiveness is still being developed.[10] Most research in this area does not yet fully measure the long-term impact on adult behaviors.

To address this gap in the research, last year the FDIC completed a major multi-year study designed to measure the effectiveness of financial literacy training, specifically training using the *Money Smart* curriculum. The goal was to measure, over time, not only whether the trainees' knowledge of financial matters improved and whether they *intended* to change their financial behaviors, but also whether, months after the training, they had actually improved financial behaviors. The study was conducted to determine the effect of financial education on participant behavior regarding basic banking, saving, budgeting, and credit.

This study, which was conducted in cooperation with NeighborWorks America, consisted of a three-part survey of participants in *Money Smart* courses across the country. The FDIC engaged The Gallup Organization to assist with the development of the survey questions and to administer the survey. The assessment used: a pre-training survey to gather baseline data on students' knowledge, behaviors and confidence; a post-training survey to gather data on changes in participants' knowledge, behaviors, confidence and their future intentions; and a telephone follow-up survey six to twelve months after the training to identify changes in those factors.

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[8] *See, e.g.*, Matthew Martin, "A Literature Review on the Effectiveness of Financial Education," Federal Reserve Bank of Richmond Working Paper No. 07-03, June 15, 2007.
[9] *See, e.g.*, Matthew Martin, "A Literature Review on the Effectiveness of Financial Education," Federal Reserve Bank of Richmond Working Paper No. 07-03, June 15, 2007.
[10] *Id.*

The findings, based on 631 respondents, suggest that the *Money Smart* financial education training -- covering the basics of checking, saving, budgeting, and credit -- can positively change consumer behavior and improve financial confidence. The six to twelve month follow-up survey determined that, after taking the *Money Smart* training, participants were more likely to open deposit accounts, save money in a mainstream deposit product, use and adhere to a budget, and have increased confidence in their financial abilities. Survey findings indicated that immediately after completing the course:

- 69 percent of respondents reported an increase in their level of savings,
- 53 percent reported their debt decreased, and
- 58 percent stated they were more likely to comparison shop.

The follow-up survey revealed that:

- 13 percent of participants who already had a checking account after the training opened a different type of account at the same institution and 22 percent opened a checking account at a different financial institution by the time of the follow-up survey, thereby evidencing the participants' ability to comparison shop;
- 43 percent of those without a checking account opened a checking account after completing the course;
- 37 percent of those without a savings account opened a savings account after completing the course;
- 28 percent of those with checking accounts and 22 percent of those with savings accounts began using direct deposit for the first time at the end of the course;
- 61 percent of those not using a spending plan/budget at the end of the course used one by the time of the follow-up survey;
- 95 percent of those who used a spending plan/budget at the end of the course still used it at the time of the follow-up survey; and

- There was a 12 percentage point increase in those who “always” pay bills on time between the beginning of the course and the time of the follow-up survey.

The findings of the survey demonstrate that financial education programs can have a positive impact and, hopefully, will act as an incentive for more banks to offer financial education programs as a means to open accounts and build long term customer relationships. While the FDIC is proud of the improvements in financial literacy indicated by the *Money Smart* survey, there is still much work to be done in this area.

**Expanding Financial Education in Schools**

*Money Smart for Young Adults*

As I noted earlier, *Money Smart* was developed initially to reach low- and moderate-income adults, for whom there appeared to be a dearth of financial education curricula. However, the curriculum is sometimes used to teach younger persons. Yesterday, Chairman Bair announced the release of our new *Money Smart for Young Adults*, tailored to secondary and college level students (ages 12 to 20). It is aligned with educational standards for all 50 states and the District of Columbia, as well as Jump$tart’s national financial literacy standards and the National Council on Economics Education’s national economics standards.

*Money Smart for Young Adults* has an added visual appeal geared toward youth, and uses activities and examples that are age-appropriate and relevant. Characters are used in situational comic strips in each module to show students a real-world application of the content. The curriculum combines activities, lessons, and practical scenarios to help teens better comprehend bank accounts, credit and debit cards, and money management. The materials give students a basic understanding of common financial situations, as well as the confidence and know-how to make smart decisions with their money.

This builds on the work the FDIC has already done to integrate *Money Smart* into public schools. For example, in 2007, the FDIC contacted more than 300 schools, school systems, and government entities to recommend the use of the *Money Smart* curriculum, which has been unanimously endorsed by the Board of Directors of the National School Boards Association for use in public schools. At the same time, we are distributing -- through schools, churches, and other venues -- copies of a special edition of the FDIC's consumer newsletter for teenagers, and another newsletter for young adults becoming financially independent.

A number of states have already integrated *Money Smart* into their educational programs. Allegany County, Maryland high schools use *Money Smart* in business education and family and consumer science classes. In Virginia, many schools are utilizing *Money Smart* in middle and high schools to comply with state legislation mandating economic and personal financial education instruction performance standards. Some jurisdictions, such as Blairsville, Georgia and Long Island, New York, require completion of a financial education program as a condition for graduation and *Money Smart* has been approved for this purpose. In Hawaii, the Department of Education's Adult Education Program incorporated two *Money Smart* modules into their computer-based High School Diploma Program.

In addition, many states, such as Massachusetts, have developed school-based banking programs. Building on these programs, the FDIC is developing school-based initiatives in several cities with the FDIC's Alliance for Economic Inclusion (AEI), which I discuss in detail later in my testimony. The FDIC is providing technical assistance to help financial institutions and others interested in establishing school-based banking programs in high schools. These programs have a number of outcomes including integrating financial education into core classes and/or career pathways; job-training and resume building for students; and expanded access to mainstream financial services for students, faculty, and their families.

**Other Financial Education Activities**

The FDIC partnered with NeighborWorks America to produce and deliver a financial education and housing recovery curriculum for those affected by the 2005 Gulf Coast Hurricanes. This curriculum provides practical information for families faced with financial decisions related to building, rehabilitating, selling or buying a home after the hurricanes.

Additionally, over the past five years, the FDIC has conducted a number of financial education outreach and training events on military bases around the country to teach the fundamentals of money management, ways to avoid the pitfalls of high cost loans and strategies for steering clear of predatory lending. Beginning in late 2006, the FDIC expanded these efforts by providing financial education to military personnel and families in partnership with the Department of Defense's Financial Management Programs, the Association of Military Banks (AMBA), the Corporation for Public Broadcasting, New River Media, and local PBS stations.

**The Financial Literacy and Education Commission**

In addition to the work we have done through our own programs, the FDIC is a member of the Financial Literacy and Education Commission (FLEC) which has helped focus attention on the importance of financial literacy.

At the request of the Treasury Department, the FDIC and several other members of the FLEC, cosponsored a series of conferences to share best practices on bringing unbanked people into the financial mainstream. The conferences brought together community-based organizations, financial service providers, and federal, state, and local regulators to broker partnerships and discuss the latest developments and strategies. Some of these conferences were focused on minority communities, such as Native American, Asian American and Pacific Islander, and African American communities. The FDIC also has provided substantial support to the FLEC operations and activities.

**Activities Beyond Financial Literacy**

Offering a financial education program provides few benefits if consumers only have access to high cost financial products. For this reason, the FDIC is actively involved with integrating financial education into broader initiatives designed to promote asset-building and access to mainstream financial services. Along with financial institutions and other partners, the FDIC is working to bring currently unbanked and underserved populations into the financial mainstream through innovative low-cost products and services, and expanded financial education efforts. These include savings accounts, affordable remittance products, small dollar loan programs, targeted financial education programs, alternative delivery channels, and other asset-building programs. To assist in this effort, Chairman Bair established the FDIC Advisory Committee on Economic Inclusion in 2007 to provide the FDIC with advice and recommendations on important initiatives focused on expanding access to banking services by underserved populations.

*Affordable Small Dollar Loans*

High cost loan products can push consumers deeper into debt. Many people who use high cost products, such as payday loans, already have checking accounts. However, their financial institutions do not offer small-dollar, short-term credit products that meet their needs. The FDIC is encouraging institutions to use the Affordable Small Dollar Loan guidelines, issued last year by the FDIC, to develop low-cost, small dollar loans coupled with savings vehicles.

The FDIC also has started to explore incentives for banks that offer wealth-building products targeted to the underserved. FDIC-supervised banks that offer low-cost alternatives to payday loans in a manner consistent with our guidelines, including a savings component, will receive favorable consideration under the Community Reinvestment Act as an activity responsive to the credit needs of the community.

The FDIC recently began a two-year pilot project to review affordable and responsible small-dollar loan programs in financial institutions. Through this study, we hope to identify effective and replicable business models to help other banks incorporate affordable small-dollar loans into their other mainstream banking services. An initial group of 31 banks was selected to participate in the study, and the FDIC will begin collecting quarterly data about each institution's experiences in May 2008.

*Alliance for Economic Inclusion*

Over the years, the FDIC has paired its promotion of financial education with programs designed to promote inclusion in the banking system. With the assistance from the Advisory Committee, the FDIC has recently undertaken two major initiatives in this area – the Alliance for Economic Inclusion and two surveys intended to provide extensive data regarding economic inclusion.

The AEI is a national network currently working in several communities across the country to bring more of the unbanked and underserved into the financial mainstream. These communities include the Greater Boston area; Wilmington, DE; Baltimore, MD; South Texas (Houston/Austin); Chicago; the Louisiana and Mississippi Gulf Coast; central Alabama; Kansas City; Los Angeles; and – as of next month – Rochester, NY. These diverse markets include low- and moderate-income neighborhoods, urban neighborhoods, minority communities, and rural areas.

AEI membership is comprised of financial institutions, community-based organizations and other partners that share the FDIC's commitment to bring unbanked and underserved consumers into the financial mainstream. AEI members focus their efforts on expanding access to basic retail financial services, including savings accounts, affordable remittance products, small-dollar loan programs, targeted financial education programs, alternative delivery channels and other asset-building programs.

More than 700 banks and other organizations have joined the AEI. Under the auspices of the AEI, approximately 28,000 bank accounts have been opened; 29,000 consumers have received financial education; 41 banks are developing small dollar loan programs; and 21 banks now offer remittance products allowing customers to send money to friends or family members outside the U.S.

*Foreclosure Prevention*

An AEI partnership with NeighborWorks America to promote foreclosure prevention and education was announced in July 2007. Since then, both NeighborWorks America and the FDIC have conducted more than 28 local outreach and training events. These events are designed to assist NeighborWorks Centers for Foreclosure Solutions and other local organizations in developing and implementing strategies to educate at-risk homeowners about the availability of foreclosure prevention counseling services and other resources.

Each of the AEI coalitions is also coordinating foreclosure prevention efforts to provide support and expand local foreclosure prevention programs already underway within their communities. These efforts are being expanded this year, through a series of foreclosure symposia to be held by the FDIC and NeighborWorks America in cities with high concentrations of foreclosures. The symposia will be targeted to bankers and community organizations that can help support counseling, mitigation and outreach efforts to distressed homeowners facing mortgage delinquency and foreclosure. The first symposium is scheduled to be held next month.

*The Economic Inclusion Surveys*

In keeping with the requirements in the Federal Deposit Insurance Reform Conforming Amendments Act of 2005, the FDIC has initiated biennial surveys of FDIC-insured institutions regarding their efforts to serve the unbanked. We anticipate that the surveys will help us better understand the unbanked population and banks' roles in serving them

The first of these surveys, the *National Survey of Banks' Efforts to Serve the Unbanked and Underbanked*, is expected to yield significant insights. We believe the information gathered in the survey will be useful in helping banks improve their abilities to meet the diverse financial needs of U.S. households. The survey focuses on banks' financial education and outreach strategies, and deposit, payment, and credit products offered to underserved consumers. The results of this survey, the first in a series of biennial surveys, will be reported to Congress later this year.

The FDIC also is exploring the feasibility of conducting a survey with the U.S. Census Bureau to estimate the percentage of the U.S. population that is unbanked and underbanked. This would be the first national household survey to collect data on the numbers and demographic characteristics of these targeted households, as well as the barriers they perceive when deciding how and where to conduct financial transactions.

*Promoting Savings*

The FDIC is a partner in *America Saves*, a national social marketing campaign, organized around local, statewide, and affinity group campaigns, which promotes asset-building among individuals, particularly in low- and moderate-income households. To date, *America Saves* has enlisted more than 90,000 individuals. The FDIC participates in partnerships with local *America Saves* coalitions, promoting financial education through the *Money Smart* program, and providing technical assistance on Individual Development Account (IDA) programs to financial institutions and non-profit/municipal organizations.

**Conclusion**

Not only is financial literacy essential to evaluate the multitude of choices available to consumers, but this knowledge serves to protect informed consumers from bad products and scams. A consumer who knows the right questions to ask, understands economic fundamentals and has the confidence to challenge products and practices that seem “too good to be true” is a regulator’s best weapon in consumer protection.

Our 2007 survey results demonstrate that programs like *Money Smart* can be effective in changing and improving the financial lives of consumers. While the survey results are very positive, many populations still need improved education and services to enter the financial mainstream. We look forward to continuing to work toward that goal.

This concludes my testimony. I would be happy to answer any questions.