Joint Hearing of the Assembly Banking and Finance Committee and the Select Committee on Youth and California's Future

"Investing in Our Youth: A Discussion of Financial Literacy in California"

I. Introduction

Annual percentage rate, compound interest, adjustable rate mortgage, FICO score, reverse mortgage, universal default, prepayment penalties, negative amortization, 401(k), IRA, annuity, Certificates of Deposit, capital gain, equity, principal and balance transfer fees are just some of the terms of the contemporary financial universe. The market place functions best when educated consumers are able to make informed choices regarding their personal financial needs and goals. A well informed and financially literate consumer can save thousands of dollars at the closing table, avoid abnormal fees and charges and build up savings for retirement. Financial literacy is not only about learning the skills need to balance a check book, it is about personal empowerment.

II. What Is Financial Literacy?

The U.S. Financial Literacy and Education Commission defines financial literacy as “the ability to make informed judgments and to take effective actions regarding the current and future use and management of money.” Financial literacy is not only the basic skills of balancing a checkbook, or computing interest rates, but the ability to use that information to make informed decisions about ones financial future and stability.

III. Why is Financial Literacy a Problem?

In a Financial Industry Regulatory Authority (FINRA) survey, only 42% of Californians answered at least four questions correctly on a five question financial literacy quiz. Another 2009 survey found that 80% of the respondents received scores of 60 or lower on financial questions about retirement.[1] Just 20% received what amounted to a passing grade.

The problem is even more pressing for youth, minorities, and women. According to the Jump$tart Coalition, the average high school student’s score in financial literacy was 48%.[2] However, minority students fared far worse than their white counterparts; 89% of African-Americans and 83% of Latinos failed to score a passing grade on the

[1] Retirement Income Literacy Survey for American College of Financial Services. (September 2014) http://www.theamericancollege.edu/ricp-retirement-income-survey/docs/Greenwald_TAC_RICP_Retirement_Income_Literacy_Survey.pdf

[2] Mandell, Lewis. The Financial Literacy of Young American Adults for the Jump$tart Coalition for Personal Financial Literacy (2008). http://views.smgww.org/assets/pdf/2008%20JumpStart%20Financial%20Literacy%20Survey.pdf

financial literacy test compared to 64% of white students.[3] In addition, 38% of men, in contrast to 22% of women, correctly answered all three financial literacy questions in a 2014 survey. [4]

A. Impacts

Financially savvy people are more likely to save, invest in stocks, and accumulate more wealth.[5] They are also less likely to have credit card debt, and when they do, they manage it better by paying off the full amount each month. They also refinance their mortgages when it makes sense, tend not to borrow against their 401(k) plans, and are less likely to use high-cost borrowing methods (e.g. payday loans, pawn shops, auto title loans, and refund anticipation loans).[6]

1. On Youth

Financial illiteracy is particularly troubling for young people entering the labor market. College students tend to have large amounts of credit card and student loan debt upon entering the workforce. Lacking a clear understanding of basic financial concepts, students are more likely to rely on high-cost methods of borrowing. Risky borrowing not only undermines future homeownership but also the ability to control one's financial future.

The Financial Industry Regulatory Authority's (FINRA) Investor Education Foundation, which seeks to promote financial literacy, revealed high school students who are required to take personal finance courses have better average credit scores and lower debt delinquency rates as young adults.

FINRA's study also found that personal finance education lowers the probability of falling 90 or more days behind on future credit accounts, especially for students who took required classes in economics or personal finance after the first-year mandates were adopted.

2. On Adults

Financial literacy also hinders adults and their hopes for retirement. Without a base knowledge of financial tools, adults are less likely to invest in retirement plans.[7]

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[3] Id.

[4] Knowledge@Wharton, University of Pennsylvania. "Three Questions with Implications for Your Financial Future" (February 11, 2015). http://knowledge.wharton.upenn.edu/article/three-questions-major-implications-financial-well/

[5] Gale, William G. and Levin, Ruth, Financial Literacy: What Works? How Could It Be More Effective? (October, 2010). http://www.brookings.edu/research/papers/2010/10/financial-literacy-gale-levine

[6] Mitchell, Olivia S. and Lusardi, Annamaria, Financial Literacy and Economic Outcomes: Evidence and Policy Implications (January 7, 2015). Available at SSRN: http://ssrn.com/abstract=2568732 or http://dx.doi.org/10.2139/ssrn.2568732

[7] Research indicates that people who have had financial education participate more often in retirement programs, make larger contributions to the program and have a much higher savings rate than others.

According to the Employment Benefit Research Institute, 46% of Americans have less than $10,000 saved for retirement.[8] Another survey found that 15% had not saved a single cent.[9] Currently, there is a $6.6 trillion gap between the pensions and retirement savings of U.S. households and what they should have to maintain their living standards in retirement.[10] Low saving and retirement participation rates could lead to a dramatic increase in the number of people on welfare and drive up costs nationally.

Increasing financial literacy can improve quality of life, both now and in retirement, raise college attainment levels, increase homeownership,[11] reduce dependence on welfare services, and decrease bankruptcy filings.[12] In addition, financial illiteracy has been identified as a major driver of income inequality with up to a third of the wealth gap being explained by the gap in financial knowledge between the wealthiest and the poorest.[13] Educating our youth to be financially literate could help slow the growing disparity between the state's highest and lowest earners.

IV. Efforts to Address Financial Literacy

A. Federal

Title V of the Fair and Accurate Credit Transaction Act (FACT Act) established the Financial Literacy and Education Commission (Commission) with the purpose of improving the financial literacy and education of persons in the United States. This program is a partnership between twenty federal agencies to provide materials and resources for those interested in providing financial literacy services and programs. Congress charged the Commission with improving "the financial literacy and education of persons in the United States through the development of a national strategy to promote financial literacy and education."

("Integrating Financial Education into School Curricula," The Department of the Treasury). https://www.financialeducatorscouncil.org/financial-literacy-statistics/

[8] Employment Benefit Research Institute survey. https://www.financialeducatorscouncil.org/financial-literacy-statistics/

[9] Updegrave, Walter. How to Retire Rich in a Totally Changed World: Why You're Not in Kansas Anymore. (2007)

[10] Retirement Income Deficit report by Retirement USA; www.financialeducatorscouncil.org/financial-literacy-statistics/

[11] Eighty-five percent of college graduates plan to move back home after graduating. (Twentysomething Inc. 2010 survey). https://www.financialeducatorscouncil.org/financial-literacy-statistics/

[12] Providing financial education to the least educated individuals prior to their entrance into the labor market improved their well-being by an amount equivalent to 82% of their initial wealth. Mitchell, Olivia S. and Lusardi, Annamaria, The Economic Importance of Financial Literacy: Theory and Evidence. Journal of Economic Literature. (2014). *See also*, Harnisch, Thomas L., Boosting Financial Literacy in America: A Role for State Colleges and Universities. (2010) http://www.aascu.org/policy/publications/perspectives/financialliteracy.pdf

[13] Mitchell and Lusardi, (2015). Available at SSRN: http://ssrn.com/abstract=2568732 or http://dx.doi.org/10.2139/ssrn.2568732

The Federal Deposit Insurance Corporation (FDIC) created Money Smart, a financial literacy program composed of ten training modules that can be used by financial institutions and schools. The FDIC also provides trainers to assist in teaching the program or to bring together interested parties to form partnerships.

B. State

The Council for Economic Education in their latest study released in 2016 titled, "Survey of the States: Economic and Personal Finance Education in our Nation's Schools," found the following:

- 20 states require high school students to take a course in economics. This is two fewer than in 2014.
- 17 states require high school students to take a course in personal finance. Only 5 states require a standalone semester course in personal finance.
- 16 states require testing, which is down significantly from 25 in 1998.
- 45 states include personal finance in their K–12 standards, up from 21 in 1998. (Alaska, California, Montana, New Mexico, Wyoming and the District of Columbia still do not.) 37 now require that those standards be implemented, up from 14 in 1998.
- All 50 states, plus Washington, D.C., now include economics in their K–12 standard curriculum, up from 39 in 1998. Also, 45 states, including Washington, D.C., require those standards be implemented by the districts, compared with 28 in 1998. (Alaska, Connecticut, Kansas, Massachusetts, Oklahoma and Wisconsin are the holdouts.)

C. California

Currently in California, there is no mandated curriculum on financial literacy. Due, in part, to the Local Control Funding Formula (LCFF), school districts retain broad authority over curriculum and how subjects are taught. However, many nonprofit organizations have attempted to fill the gap and provide financial education in their communities.

1. Instructional Quality Commission's Framework Update

In 2013, Governor Brown signed AB 166 (Hernández) which required the California State Board of Education (SBE) to include financial literacy in its next revision of textbooks or curricula and incorporate such topics as budgeting and managing credit, student loans, consumer debt, and identity theft security. Consistent with this requirement and its defined duties as a subsidiary of the SBE, the Instructional Quality

Commission (IQC) convened in 2014 to update the History-Social Science Framework.[14]

On November 20, 2015, the IQC approved and released for public comment the 2014-2016 Draft History-Social Science Framework for second review. As part of this framework, and consistent with AB 166, the IQC included financial education topics in its framework for Principles of Economics. Principles of Economics is a one-semester required course for grade 12 high school students. The framework suggests that students learn how to budget effectively by having hands on learning modules where they must develop and stick to a monthly budget with a mock monthly salary. The framework suggests that this module build upon itself by teaching students about debt and different ways to accumulate personal wealth in addition to learning about credit card payments, student loan debt, and mortgages as well as how the stock market operates.

The IQC is in the process of preparing its advisory report to the SBE on the 2014-2016 Draft History-Social Science Framework. Upon approval, it is possible that financial education curricula could be implemented by districts for the 2017-2018 school year.

2. Independent Financial Literacy Programs

While California does not require financial education curricula for each student, there are multiple programs that attempt to fill this gap throughout the state. Below are short profiles of just a few of these organizations.

a. Bank on California

Too many Californians are financially illiterate and unbanked or underbanked. The goal of the Bank on California Program is to encourage voluntary collaborative partnerships that work together to lower the number of unbanked and to get more Californians to enter the financial mainstream. With a bank account, unbanked Californians can achieve financial security, start to save for the future, and establish a credit history.

Since Bank on California launched in 2008 without statutory oversight, the program has been housed in several state departments including the Governor's Office of Planning and Research, the State and Consumer Services Agency, and found a home in the Department of Financial Institutions now known as DBO in 2012. Due to the program's history of inconsistent resources and leadership prior to DBO, it is difficult to determine the success of the program. The program has thrived predominantly due to the local level programs and the large-scale recognition of Bank on San Francisco. AB 1292 ((Dababneh) Chapter 750, Statutes of 2015) created long-term stability and

[14] For more information on the IQC's duties and membership see http://www.cde.ca.gov/be/cc/cd/index.asp

guidance to the Bank On programs. The state provides no funding for the Bank on California program and most activities are operated by regional coalitions using local government and non-public funding from nonprofits and private companies.

Bank on California involves a voluntary partnership between certain financial institutions and cities, is intended to increase the supply of starter account products offered by participating financial institutions, raise awareness among unbanked individuals about the benefits of account ownership, and make quality money management education more easily available to un- and underbanked individuals.

According to research conducted by the U.S. Treasury, statewide initiatives have the opportunity to serve two important roles. First, Bank on California "can help cultivate new local programs by providing technical assistance, leveraging connections with statewide partners and assisting local programs in understanding financial regulations. Additionally, they can help leaders of statewide Bank On programs share best practices and resources. It is important that statewide programs clearly define their role and their relationship with existing local Bank On programs."

Second, Bank on California may "also be able to overcome financial access challenges facing rural areas and smaller towns, which often lack the resources and infrastructure necessary to get a Bank On effort off the ground."

Bank on California, as the first established state-wide program in the nation, is a leader but the longevity of the program remains unstable. Bank on California has the ability to organize local programs, provide a clear and focused point of contact for financial institutions participating in multiple local programs, and provide technical assistance and other support to reduce the burden on local programs and financial institutions.

Bank on California is necessary to:

- Financially empower lower income consumers by making it easier and more affordable for them to deposit their paychecks, pay their bills, and start saving.
- Increase the supply of starter account products that work for the low-income, unbanked Californians by developing baseline product criteria that must be offered by all participating financial institutions.
- Raise awareness amongst unbanked consumers about the benefits of account ownership and spurs Californians to open accounts.
- Make quality money management education more easily available to low-income Californians and raises statewide awareness of the unbanked problem and potential solutions.

b. CalCPA Dollars & Sense

Dollars & Sense is CalCPA's financial literacy initiative designed to improve financial literacy in California.[15] Dollars & Sense workshops are jointly hosted by CalCPA and local entities such as schools, businesses, PTAs, nonprofit organizations, community centers, state legislators, and more. CalCPA provides three to four volunteers to lead a 45-60 minute presentation on financial topics such as budgeting, money management, managing credit cards, saving and investing, tax tips, and financial preparedness. The presentation is followed by an hour of questions and answers with the audience. CalCPA also provides take-home materials for audience participants.

Dollars & Sense has a customizable curriculum that can be tailored to college students, graduates, parents, small businesses, home owners, as well as a module for high school students developed in collaboration with NEFE.

c. California Jump$tart Coalition

The CA Jump$tart Coalition is a not-for-profit organization affiliated with the National Jump$tart Coalition for Personal Financial Literacy. The purpose of the California Jump$tart Coalition is to improve the quality of life in California by teaching young people how to succeed with money, including organization, earning, spending, saving, investing and credit.[16] Its mission is to improve the personal financial literacy of California's youth in two ways. First, by helping the personal finance education community become more connected, effective, and powerful and second by supporting the implementation of personal finance education at every level in K12.

Jump$tart's members are individuals and organizations who recognize and support the lifetime benefits of personal financial education, including teachers, corporations, CPA's, banks, credit unions, not-for-profits, school administrators, school districts, boards of education, parents and students.

Jump$tart also funds research and surveys on the prevalence of financial illiteracy and the efficacy of financial education curricula and programs to determine the best methods to address this issue.

d. National Endowment for Financial Education and CashCourse

Founded in 1972, the National Endowment for Financial Education (NEFE) is a self-funded private foundation that provides free financial education resources to both high school and college students. NEFE funds cutting edge research on financial literacy and provides its High School Financial Planning Program (HSFPP) curriculum to over 5,000 schools and programs. It also developed and provides its CashCourse

[15] For more information about CalCPA and Dollars &Sense see http://www.calcpa.org/public-resources/financial-literacy/dollars-and-sense
[16] For more information about the California Jump$tart Coalition see http://www.cajumpstart.org/about-us

online financial education program to schools across the country.[17] CashCourse is used by more than 70,000 students in more than 900 schools—including small private colleges, large public universities and both two-year and four-year programs—in all 50 states. In California, CashCourse is available at 8 CSU campuses, 9 UC campuses, and over 100 community colleges across the state.

CashCourse goes beyond just discussing financial aid and student loans, and covers everything from basic financial skills like budgeting and credit cards to prepare for post-college life, finding a job, repaying loans and knowing what to do in a financial crisis. While CashCourse isn't a traditional Default Prevention program, by helping students build financial skills that apply to each area of their lives they are better prepared for both success in college and after graduation.

e. Operation HOPE: Banking on Our Future

The mission of Operation HOPE, Inc. (HOPE) is financial dignity, making free enterprise work for everyone.[18] HOPE works on the ground as the nonprofit private banker for the working poor, the underserved and struggling middle class.

HOPE's Banking on Our Future (BOOF) division focuses on keeping the most at risk youth from repeating the cycles of poverty and despair that has trapped so many in their families and communities by teaching them basic financial literacy. BOOF elevates the dignity, hope, and economic self-sufficiency of people in low-wealth and underserved communities through financial literacy. Since its inception, the Banking on Our Future Program has reached over 910,000 students in more than 3,176 schools and community-based organizations in the U.S. and South Africa.

Banking on Our Future classes are free of charge for schools and communities. The program is led by HOPE Corps volunteers who have undergone comprehensive training in financial literacy and teaching techniques. Our BOOF students are given the tools they need to take control of their financial futures - by learning about empowerment, responsibility, and hope.

f. YWCA-Berkeley Financial Literacy Program

Founded in 2011, YWCA Berkeley/Oakland's High School Financial Literacy Program is designed to empower Oakland public high school students to learn the essentials of personal finance.[19] Through hands-on, interactive activities students develop the skills and knowledge they need to make good financial decisions throughout their lives. In addition to benefitting high school students, this unique

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[17] For more information about NEFE and CashCourse see http://www.nefe.org/ and http://info.cashcourse.org/about/about-cashcourse.aspx

[18] For more information about Operation HOPE and Banking on Our Future see http://www.operationhope.org/program/pid/1#sthash.Syh8Z8kn.dpuf

[19] For more information on the YWCA-Berkeley's Financial Literacy Program see http://www.ywca-berkeley.org/financial-literacy/

program provides UC Berkeley students with the opportunity to develop leadership and teaching skills, as well as to give back to their community.

Since its inception over 65 UC Berkeley students have volunteered to teach over 1,400 students at 7 Oakland high schools. The program is seven to eight weeks and focuses on the following topics:

- Understanding the beliefs that formulate our financial choices.
- Financial goal setting to create achievable goals that can be broken into actionable steps.
- Budgeting and making good financial choices.
- Types of bank accounts and their use, and the purpose of saving money.
- How interest is calculated and why time is an important factor in saving.
- The process of the stock market and the impact of risk.
- How a credit score is calculated and its impact financially.
- Consumer awareness promoted through identifying advertising techniques and the cost of common items.
- Information on choosing a career, applying to college and financial aid.
- Basics of taxes and the difference between an employee and independent contractor.

In addition, the YWCA-Berkeley hosts an annual Young Women and Money Conference as well as regular community workshops. Both initiatives are geared towards increasing financial knowledge regarding credit cards, interest rates, mortgages, checking and savings accounts, and retirement strategies. Through its Financial Literacy Program, Young Women and Money Conference and its financial education workshops, YWCA-Berkeley is committed to improving financial literacy in its community.

V. Conclusion

Financial literacy is a growing issue and is already affecting Californians in a myriad of ways. Financial illiteracy depresses college graduation rates, homeownership, and increases dependence on welfare services, the number of bankruptcy filings, as well as mortgage default rates. Research shows that financial literacy should be treated early, in our K-12 education system, in order to prevent these consequences from negatively impacting our youth and their future. Yet, a new K-12 curriculum isn't the only salve for this problem; there are numerous private entities and nonprofit organizations working diligently to improve financial literacy in our state. Moving forward, the goal of the legislature must be to address existing gaps in these approaches and ensure that the next generation doesn't lose out on the American dream simply because we didn't give them the tools needed for success.