INFORMATIONAL HEARING ON FINANCIAL LITERACY IN CALIFORNIA

ASSEMBLY COMMITTEE ON BANKING & FINANCE

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BACKGROUND PAPER

Assembly Committee on Banking & Finance
Informational Hearing
Financial Literacy in California

"All the perplexities, confusion and distress in America arise, not from defects in their Constitution or Confederation, not from want of honor or virtue, so much as from the downright ignorance of the nature of coin, credit and circulation."
John Adams-1787

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. Access to credit is available now more than ever before allowing millions of Americans to own homes, access goods and services and pay for educational needs. This world of growing credit also means greater responsibility on the part of consumers and providers. 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.

The statistics on American's financial literacy present a contradiction between the existing knowledge of financial matters and the actual use of finances. *For example, in early 2006 there were 190 million credit card holders who charged an average of $8,500 during 2005, with the average outstanding credit card balance for American households with at least two adults is over $13,000.*[1] Contrasts these statistics with the revelation that only 27% of Americans feel well informed about managing household finances.[2] Furthermore, in 2006 the savings rate for Americans fell to negative 1 percent, the lowest margin since the great depression![3]

Many explanations for this abound, however among the most widely held, is a lack of financial awareness: "Economists have put forward various reasons to explain the current lack of savings. These range from a feeling on the part of some people that they do not need to save because of the run-up in their investments such as homes and stock portfolios to an effort by many middle-class wage earners to maintain their current lifestyles even though their wage gains have been depressed by the effects of global competition."[4]

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[1] Prepared statement of Robert D. Manning, PhD, Research Professor of Consumer Finance and Director of the Center for Consumer Financial Services, US Senate Committee on Banking, Housing, and Urban Affairs, 1/25/07

[2] Networks Financial Institute, Indiana State University.

[3] Report of the US Commerce Department

[4] 2006 personal savings fall to 74-yr. low, *Business Week*. February 1, 2007

As mentioned before, the financial market place works best with informed consumers, and obviously this is the philosophy of many conumser protection laws at the federal and state level. Current statututorily required consumer protections in the financial arena are, in most cases, centered around consumer disclosures of terms and obligations. Needless to say, disclosures are ineffective when the consumer is unable to place the information in the proper context.

Apply for a credit card and you will receive a large pamplet of disclosure notices discussing interest rates and late fees. Thinking of buying a home? Almost 20 different state and federally mandated disclosures will find their way into a consumers hands even though most americans don't have the financial background to properly compute a mortgage amortization table.[5]

<u>What is Financial Literacy?:</u>

Before continuing, it is important to establish what exactly is the meaning of financial literacy, or what skills would we expect a person to have if they were financially literate? The National Endowment for Financial Education defines Financial Literacy as:

> *"Personal financial literacy is the ability to read, analyze, manage, and communicate about the personal financial conditions that affect material well being. It includes the ability to discern financial choices, discuss money and financial issues without (or despite) discomfort, plan for the future and respond competently to life events that affect everyday financial decisions, including events in the general economy."*

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.

<u>Financial Literacy Among Students:</u>

Financial literacy education often doesn't receive the same attention as other life skills such as math and science education. Furthermore, with decreasing resources to devote to education, government officials and educators must make difficult decisions as to what subjects they will teach to students in the k-12 setting. Vital subjects such as financial literacy left behind. However the importance of financial awareness may have a direct impact on other vital learning skills. A recent study examining the overall literacy of college students found that 20% of students in 4-year colleges and institutions have basic

[5] For an overview of state and federally mandated mortgage transaction disclosures go to the "existing law" section of the Assembly Banking Committee analysis of AB 459 (Oropeza) of 2005, April 26, 2005 version.

or below average quantitative literacy skills.[6] Considering this result, it is not surprising that Nellie Mae, an originator of student loans, found that 83% of undergraduate students have at least one credit card with an average balance of $2,237 and by the time they graduate with will have an average of $20,402 in credit card and education loan balances.

The Jump$tart Coalition for Financial Literacy conducted a survey of high school students that resulted in 52.4% of survey respondents getting the right answers, a score that translate to an F minus.

Undergraduates reported freshman year as the most prevalent time for obtaining credit cards, with 56% reporting having obtained their first card at the age of 18 with an average balance of $1,585.[7] Young people are using credit and engaging in the financial mainstream, yet appear to have a lack of basic skills and knowledge. Needless to say, this is a dangerous contradiction.

Furthermore, the overall results for adult Americans also reveals a dismal picture. While 65.1% of Americans consider themselves very knowledgeable when it comes to personal finance, 52% do not regularly review their credit reports, and 36.1% do not use any type of budget to manage their family expenditures.[8] In 2005 the Capital One Financial Back to School survey, found that 91% of students whose parents would be with them on their back to school shopping trips revealed that their parents had not discussed back to school finances with them. With 60% of parents spending at a rate of $125 per child this is a vital opportunity missed. In addition, a recent A.G. Edwards Nest Egg Score Survey (March 2006) found that:

- Only 57 percent of parents with children ages six to 17 have ever discussed savings or investing with their kids, while only 53 percent of parents with children aged six to 12 have.

- 40% of parents of six- to 17-year-olds consider their children too young to understand. That number increases to 48 percent for parents of children aged six to 12.

Many other opportunities are missed for linking together the everyday activities of teens and young adults and financial literacy. We are no longer in the days where we must use hypothetical abstractions such as the number of apples and oranges in a transaction. For those students with Ipods, they pay up to 99 cents a song on Itunes, which can only be accomplish with a credit or debit card. Many popular video game servers and sites offer online gaming a content, that also can only be acquired with credit or debit cards.

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[6] "The Literacy of America's College Students." American Institutes for Research, January 2006. (Quantitative literacy was defined as the ability to perform computations such as balancing checkbooks, calculating tips and completing order forms.)

[7] *Undergraduate Students and Credit Cards in 2004: An Analysis of Usage Rates and Trends*, Nellie Mae, May 2005.

[8] Results of a Capitol One/Consumer action joint survey.

Programs and Approaches:

A myriad of programs and options exist to assist and direct the financial literacy education of students and young adults. Most all banking institutions offer some type of literacy program or make materials available educators to use in the class room. However, efforts have come about in recent years to find creative approaches to this problem.

For example, the Sargent Shriver National Center on Poverty Law established the Curie Branch of Park Federal Savings Bank is a student-run bank located in Curie Metro High School in Chicago, Illinois. Each year Curie High School selects 10 students to be hired by Park Federal and trained as bank tellers, savings counselors, or teller supervisors. The student bankers earn wages working about 15 hours per week as part of the Chicago Public Schools' Education To Careers program in accounting at Curie High School. The Curie Branch opened on April 12, 2005. The branch is open to students, faculty, staff, parents, and others at Curie on school business. Account holders have access to all Park Federal products. The Shriver Center is currently working other efforts to open similar branches in schools across the country including locations in California.

Student run banks are not alone in this approach, as currently, 74 credit unions in 25 states operate student-ruin branches in 238 schools.[9]

California's credit unions also engage in numerous programs and approaches. The California Credit Union League and the Richard Myles Johnson Foundation (a 501(c)3 charitable organization affiliated with the League) provide credit unions with access to many financial literacy programs.

Eight credit unions participate in USA TODAY Education's "Choice is Power" program. Schools receive daily delivery of 20 copies of the USA TODAY newspaper, and a lesson plan that is specific to the news in that day's paper. Credit union sponsorships reach more than 35,000 students. Fifteen or more credit unions are expected to participate in the 2007-08 school year. Credit unions are also the sole sponsors of an upcoming PBS television program, "Biz Kid$," which teaches entrepreneurship and basic money management skills. The program will debut with a special episode in April, during Financial Literacy Month.

Other innovative approaches include using board and computer games to teach financial skills. The oldest of these is the Stock Market Game, which allows students to simulate the trading of stocks on the stock market using real time data. Starting with a virtual cash account of $100,000, students strive to create the best-performing portfolio using a live trading simulation. They work together in teams, practicing leadership, organization, negotiation, and cooperation as they compete for the top spot. In the process of playing

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[9] Colleen Kelly, *Financial Literacy* in Schools: The Credit Union Commitment*, (Washington, D.C.: Credit Union National Association, 2002).

this, game students learn core financial concepts and skills. Since 1977, more than 8 million students have participated in The Stock Market Game.

West Virginia has a new state law mandating financial education as a high school graduation requirement with the West Virginia Treasurer's office tasked with delivering financial education to the schools in that state.

In order to assist in ensuring that all West Virginian high school students receive the appropriate knowledge Visa, in partnership with the National Football League, recently developed an educational video game and accompanying curriculum called Financial Football. Based on the model of other popular football video games, players advance down the field and score points by correctly answering questions about personal finance. This innovative approach to learning financial life skills quickly turned into a classroom favorite for teachers and students alike.   Financial Football is offered free of charge and can be accessed over the Internet or shipped on a CD.

The Treasurer's Office conducted a multi-week pilot program to test the effectiveness and response of the curriculum. The pilot was conducted in five West Virginia high schools and the response from the teachers and students was overwhelmingly positive. Visa simultaneously hired a West Virginia educational expert to ensure that the lessons learned in the Financial Football curriculum mapped closely with state academic requirements.

Based on the success of the pilot program, the Treasurer's office and Visa agreed to a statewide roll out of Financial Football. The statewide roll out will begin on December 19, 2006 and will involve the Treasurer's office sending Financial Football CDs to all 184 high schools and 176 libraries in West Virginia. The CDs will be co-branded with the Treasurer's name and Seal and will be accompanied by a letter from the Treasurer explaining the program, along with an informational brochure describing Practical Money Skills for Life.

<u>Government Response:</u>

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." In 2006, the Commission released their strategic plan for national financial literacy entitled, *Taking Ownership of the Future, the National Strategy for Financial Literacy.*[10]

[10] Report can be found at http://www.mymoney.gov/

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.

At least 37 states have personal finance educational standards, however, these standards are often included in courses on general economics. At least seven states, Idaho, Illinois, Kentucky, Louisiana, New York, South Carolina and Utah, have actual requirements that students complete a personal finance management skills course.

Currently in California, there is no mandated curriculum on financial literacy. Many other states have financial literacy programs that are fully funded, or have created public-private partnerships. Also, some states have taken a creative approach by creating a central clearinghouse of information and curricula available for schools who decide to teach courses in financial literacy.

Policy Recommendations:

The National Conference of State Legislatures, in their report on financial literacy outlined some policy choices for legislatures around the country.

- **Personalized flyers to send to constituents and to use in events.** Many state agencies and organizations have flyers and pamphlets that legislators can personalize and distribute to constituents through mailings, town hall meetings and other constituent contacts. Another option for legislator involvement is to participate in activities such as housing fairs, which often are used to reach out to low- and moderate-income individuals who may be buying their first homes. Fairs and other activities often occur in April, which several states have designated as "Financial Literacy Month." Legislators' involvement in financial literacy efforts demonstrates to constituents the importance of this issue.

- **Build partnerships between private and public organizations.** State legislators can help build partnerships between private and public organizations to encourage these groups to work together on financial literacy efforts for school and college age individuals, and for adults. New Jersey, for example, created the New Jersey Financial Literacy Awareness Network (NJFLAN) through the state Department of Banking and Insurance. The network is a statewide distribution channel that aggregates and provides easy access to existing financial education programs and materials through a learning center display and resource guides, both online and in book version, to children and adults.

- **Federal and state financial literacy initiatives for adults.** The federal Financial Literacy and Education Commission established under the Financial Literacy and Education Improvement Act of 2003 as part of the Fair and Accurate Credit Transactions Act of 2003—could focus increased attention on the financial literacy needs of baby boomers and older people.

- **Establish interagency councils to coordinate efforts.** Interagency councils could be used to coordinate existing and future efforts to increase financial literacy. These councils could include organizations and agencies that serve older persons, such as financial service providers, consumer groups, researchers, educators and government agencies, such as a state Department of Aging.

- **Increase funding for financial education efforts.** Funding and assistance for student financial education efforts can be increased through the Excellence in Economic Education Act of 2001, created through the federal No Child Left Behind Act. The Excellence in Economic Education Act promotes economic and financial literacy for K-12 students. The objectives of this program are to: 1) increase students' knowledge of and achievement in economics; 2) strengthen teachers' understanding of economics; 3) encourage economic education research and development, disseminate effective instructional materials, and promote best practices and exemplary programs that foster economic literacy; 4) help states to measure the effects of education in economics; and 5) leverage and expand increased private and public support for economic education partnerships at the national, state and local levels.

- **Create state-level office to coordinate state financial education policies.** A state-level office dedicated to coordinating and promoting the state's financial education programs and policies could further a state's financial education policies, similar to an office created in Pennsylvania. The Office of Financial Education will help state agencies work together and with community and private sector partners to create and maintain a clearinghouse with an accurate and up-to-date inventory of help available.

- **Include financial education in assistance programs.** States could include financial education efforts for low-income families through the Temporary Assistance for Needy Families (TANF) program. Legislatures could recognize participation in financial literacy training as an approved work activity meeting the 30-hour per week work requirement for TANF recipients, similar to the state of Illinois. TANF funds can be used to support financial education strategies. States could also increase funding for individual development account (IDA) programs, which often include financial education as part of participation requirements.

- **Financial literacy professional development for teachers.** Investing in professional development for teachers and encouraging and motivating teachers to incorporate financial literacy into their lesson plans will help further financial literacy efforts. The Pennsylvania Governor's Task Force concluded that, " … it cannot be assumed that all teachers have a full understanding of financial principles themselves. Professional development opportunities must be made available to teachers to enhance their own knowledge and skills."

- **Sponsor additional research to improve the effectiveness of financial literacy programs.** The private sector, foundations, federal and state governments, and others could support additional research aimed at improving the effectiveness of financial literacy and consumer counseling programs, particularly with regard to obtaining outcomes that lead to better money management and wealth-building behaviors and skills.

Conclusions:

Financial literacy is not just about computing the interest on an auto loan, or the rate on a savings account or government bond. Financial literacy is the foundation to personal financial empowerment and a powerful defense mechanism against bad actors in the financial market. As mentioned previously, the majority of our consumer protect laws are disclosure based, or at the least require the consumer to know who they should report to in the event of an incident. These skills can ensure that a borrower gets the best mortgage for which the qualify, or how to spot unusual fees or charges.   If a young consumer never learns to examine their credit report, or that they can access their three reports for free once per year, they may never learn that they are victims of identity theft or false charges against their credit. If they are unaware of the difference between a 550 and a 750 FICO score they will never know the benefits of maintaining good credit.

While numerous programs exist in California from the financial community and from non-profit organizations, no central authority determines what materials or programs are best suited for students in high schools. If a high-school in California decided to teach a course in financial education they would not find any guidance from the state, nor a central location to go for materials. At this point, educators are on their own to find materials and speakers for a personal finance class.