The Role of Financial Literacy in Mitigating Economic Crises

HONORS CAPSTONE

Katherine M. Olson
Professor Martha Starr
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Abstract

The current housing crisis provides evidence that groups with high levels of financial illiteracy, such as women, minorities and the lower-income are disproportionately victimized by questionable financial practices. This Capstone suggests that financial education can play a role in mitigating the effect of such economic crises.

In addition to emphasizing the importance of consumer education, this paper evaluates the effectiveness of current financial literacy programs promulgated by government agencies, government-sponsored enterprises, and nonprofit organizations. It also recommends improvements to these programs and encourages additional measures be undertaken by the private sector. Finally, a comprehensive booklet compiling financial resources provided by federal agencies and nonprofits specifically directed towards women and minorities in the D.C. area is included.

Introduction

"Financial literacy and consumer education – coupled with robust consumer protection – make the financial marketplace more effective and efficient, and better equips consumers to make tough yet smart financial decisions."[1]

It would seem appropriate to begin this, my Honors Capstone, with a discussion on why I have chosen to focus on the particular topic of financial literacy. My understanding is that a Capstone is to be a reflection of the academic, community, and professional experiences I have had as a student attending American University. To that end, I believe it appropriate to explain to my reader how these experiences have led me to the conclusion that financial literacy is a critical – if not the *most* critical – skill needed for survival in today's society.

I was attracted to AU over all the other D.C. area schools because it claimed a commitment to public service – something that always has been and continues to be extremely important to me. I was not disappointed – the emphasis the entire campus places on service turned out to be completely genuine. I had not even arrived at AU yet before I was welcomed into the School of Public Affairs Leadership Program, and it was not long after classes started that we began working on a year-long project to implement a Career Day for an elementary school in Southeast D.C.

After spending so much time working at Green Elementary that year, I was convinced I needed to do more to affect education in the District. Never had I seen a school environment with such poor conditions – broken facilities, a lack of resources, and unsafe locations. As a sophomore I became involved in AU's D.C. Reads program at a site called Facilitating Leadership in Youth (FLY) which I have continued to participate in actively ever since.

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[1] Bernanke, Ben S. "The Importance of Financial Education and the National Jump$tart Coalition." Speech. 9 April 2008. Accessed 21 April 2008. <http://www.federalreserve.gov/newsevents/speech/bernanke20080409a.htm>.

I also became involved with the Community Service Center's Freshman Service Experience (FSE). After participating as a freshman and serving as a leader my sophomore year, I spent the next two summers helping coordinate this three-day volunteer event.

Between these two experiences, I learned a lot about the D.C. community. FLY in particular introduced me to the Anacostia region – an area of the city rich in history and culture but otherwise impoverished. Many of our youths' parents cannot support their families. In fact, I believe FLY's executive directors estimated that at one point, over 90% of the youth we serve live with a grandmother or relative other than a parent. In getting to know the youth and their families, I often found myself saddened at the continuous cycle in which they find themselves – working paycheck to paycheck, their living subsidized by the government and therefore facing the constant threat of removal for gentrification purposes.

As an FSE Coordinator, it was my job to find enough sites where over 500 freshmen could volunteer during their first week of college. In this role, I had the opportunity to talk with a lot of community organizers and nonprofit leaders around the District. Though every organization was on a mission to fulfill basic needs of people within the community – food, shelter, etc. – almost everyone I spoke with emphasized the necessity of cultivating self-sufficiency among the people they serve. One of the more interesting ways I noticed this being done was at nonprofits like the Marshall Heights Community Development Organization (MHCDO). Beyond providing human essentials to residents of Southeast, I discovered MHCDO teaches classes on gaining employment and, once achieved, managing personal finances. I really appreciated that the mission of the organization involved looking beyond immediate concerns and building long-term skills. My feeling that this type of work ought to be promoted eventually led me to create the brochure outlining similar organizations in the D.C. area that is attached.

Though I might have focused on adult education more generally, it was my time as a cooperative education student at the Federal Reserve Board of Governors that inspired me to concentrate on financial literacy specifically. Working in the Public Affairs Office, I helped assemble a collection of news clips each morning and afternoon to provide the governors and various others in their immediate offices with a broad overview of issues relating to the economy.

I began working in the Public Affairs Office during the fall of 2007 – just when it became apparent that the housing crisis was going to take a serious toll on the economy. In addition to handling media relations, our office was involved in the Board's consumer education efforts. By tagging along to meetings of various government coalitions and talking to people in the Consumer and Community Affairs Division, it soon became apparent to me how widespread the problem of financial literacy is in this country. It then became obvious how much this lack of knowledge on the part of consumers had contributed to the housing crisis. Thus, I decided focusing on this type of education specifically through research and the eventual creation of a useful consumer tool would be an appropriate and meaningful way to put into practice all I had learned while an undergraduate student in D.C.

It is my theory that the housing crisis was easily perpetuated through predatory lending practices made to financially illiterate consumers. Only through consumer education can we prevent future economic crisis from reaching this extent again in the future.

Below, I first provide background on how the secondary mortgage market developed and then descended into a network of predatory lenders. I then cite evidence proving that groups such as women, minorities and the poor are purposefully targeted by these lenders due to their low levels of financial literacy. The subsequent section discusses the extent to which these groups lack financial education, as well as its obvious importance. Next, I present an overview of current resources being made available by the federal government, followed by an evaluation of these resources. Finally, I conclude with policy recommendations that the government, government-sponsored enterprises, and the private sector ought to undertake to better educate consumers.

Subprime Lending: The Root of the Housing Crisis

> "There can hardly be a better time to make the case for economic and financial literacy than right now. Others have doubtless stood before an audience like you in years past and made the same case, but now we face a downturn in our housing industry fueled, at least in part, by unwise mortgage borrowing and, at times, abusive lending practices. Improving consumers' knowledge of the home mortgage process will better equip them to avoid unsuitable mortgages in the future."[2]

These remarks, given by Governor Frederic Mishkin of the Federal Reserve Board earlier this year, underscore the need for economic education in light of the housing crisis. Arguably, the economy would not be as plagued by a downfall in the housing sector had the public been better informed as to the precautions necessary to take when dealing with subprime loans.

But first, what are subprime loans and how did they perpetuate a housing crisis?

> "Subprime mortgages are high-cost home loans intended for people with weak or blemished credit histories. Higher interest rates make sense for higher-risk loans to a point, but the subprime market has been rife with problems that are rare in the mainstream prime market: excessive fees, high penalties for refinancing, refinances that provide no real benefit to homeowners and steering families into more expensive loans when they qualify for a better rate. In recent years, subprime lenders and brokers flooded the growing subprime market with dangerous mortgages that come with "exploding" adjustable interest rates. The result is a massive epidemic of foreclosures that is harming families, entire residential communities, not to mention the availability of credit at home and abroad."[3]

Subprime lending is a relatively new practice. In fact, the secondary mortgage market has existed for less than 30 years. Three key pieces of legislation during the 1980s helped develop this market. First, Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980. In addition to strengthening the ability of federal financial

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[2] Mishkin, Frederic S. "The Importance of Economic Education and Financial Literacy." Speech. 27 February 2008. Accessed 21 April 2008. <http://www.federalreserve.gov/newsevents/speech/mishkin20080227a.htm>.

[3] Federal Deposit Insurance Corporation. "Depository Institutions Deregulation and Monetary Control Act of 1980." *FDIC Law, Regulations, and Related Acts.* Accessed 26 March 2008. <http://www.fdic.gov/regulations/laws/rules/8000-2200.html>.

institutions such as the Federal Reserve System and the Federal Depositary Insurance Corporation to devise and assist in the execution of monetary policy, this act was designed "to provide for the gradual limitations on the rates of interest which are payable on deposits and accounts."[4] Specifically, Section 501(a) (1) eliminated interest rates caps, allowing lenders across the country to set rates independently:

> "The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance…" [5]

Next, Congress passed the Garn-St. Germain Depository Institutions Act of 1982, the purpose of which was "…to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans."[6] Section VIII of this bill, often referred to as the Alternative Mortgage Transaction Parity Act of 1982, effectively allowed for variable interest rates. Reasons for this section included the charge that "increasingly volatile and dynamic changes in interest rates" made remaining inflexible in terms of their own rates difficult for lenders, as it strained their liquidity.[7] Second, Congress anticipated a spike in demand in the housing market during the 1980s, and hoped that variable mortgage conditions would help supply keep up. Similarly, Congress was encouraged by the Comptroller of the Currency, that National Credit Union Administration, and the Director of the Office of Thrift Supervision to allow their own agencies to alternatively finance consumer

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[4] Federal Deposit Insurance Corporation. "Depository Institutions Deregulation and Monetary Control Act of 1980." *FDIC Law, Regulations, and Related Acts.* Accessed 26 March 2008. <http://www.fdic.gov/regulations/laws/rules/8000-2200.html>.

[5] Ibid.

[6] Federal Deposit Insurance Corporation. "Garn-St. Germain Depository Institutions Act of 1982." *FDIC Law, Regulations, and Related Acts.* Accessed 26 March 2008. <http://www.fdic.gov/regulations/laws/rules/8000-4100.html>.

[7] Federal Deposit Insurance Corporation. "Depository Institutions Deregulation and Monetary Control Act of 1980." *FDIC Law, Regulations, and Related Acts.* Accessed 26 March 2008. <http://www.fdic.gov/regulations/laws/rules/8000-2200.html>.

mortgages to meet demand. Finally, Congress hoped to eliminate any disadvantages felt by non-federally chartered housing creditors, thereby making them more competitive in the market.[8]

The Tax Reform Act of 1986 also made mortgages more attractive by offering deductions on the interest on home mortgages while simultaneously ending the practice of consumer loan deductions.[9]

The St. Louis Federal Reserve Board notes that in addition to these new legal measures, a change in the markets also led to the increase in subprime lending:

> "In 1994, for example, interest rates increased and the volume of originations in the prime market dropped. Mortgage brokers and mortgage companies responded by looking to the subprime market to maintain volume." [10]

As evidenced by Figure 3 in the St. Louis Review, the number of adjustable rate loans began surpassing fixed rate loans around 2001. *(Please see attached).*

While it is indisputable that legislative measures and changes in the market created the subprime market, the motivation for its expansion is questionable. Based on data reflecting the demographic typically receiving subprime loans, researchers can easily make the argument that lenders capitalized on the opportunity to "prey" on borrowers they knew would eventually foreclose due to shaky financial circumstances.

The Victims of Predatory Lending

Following the proliferation of subprime lending, the Department of Housing and Urban Development (HUD) conducted a study in the mid- to late- 1990s "in light of the growing evidence of widespread predatory practices." [11] Beyond revealing merely "evidence," the study,

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[8] Federal Deposit Insurance Corporation. "Depository Institutions Deregulation and Monetary Control Act of 1980." *FDIC Law, Regulations, and Related Acts.* Accessed 26 March 2008. <http://www.fdic.gov/regulations/laws/rules/8000-2200.html>.

[9] Chomsisengphet, Souphala and Anthony Pennington-Cross. "The Evolution of the Subprime Mortgage Market." *Federal Reserve Bank of St. Louis Review* Vol. 88, No. 1 (Jan/Feb2006): 38.

[10] Ibid: 38.

[11] United States Department of Housing and Urban Development. "Unequal Burden: Income & Racial Disparities in Subprime Lending in America." 1998. Accessed 26 March 2008. <http://www.huduser.org/Publications/pdf/unequal_full.pdf>.

which analyzed approximately 1 million mortgages, exposed extensive discrimination on the part of lenders.

HUD's finding that the number of subprime loans grew from 80,000 to 790,000 – an increase of nearly 1000 percent – is incredible in and of itself. But even more shocking are the findings that suggest that loans are targeted specifically at low-income and minority individuals. Whereas the increase in subprime mortgages from 1993 to 1998 was reflected in predominantly white communities by an 8 percent growth in these types of loans, the number of subprime mortgages made in predominantly black neighborhoods grew 43 percent. Even in neighborhoods of comparable wealth, minorities were far more likely to hold a subprime loan than their white counterparts. In upper-income neighborhoods, for instance, 6 percent of white homeowners had subprime loans in comparison to 39 percent of black homeowners. And as income decreased, this gap increased: in middle-class neighborhoods, 44 percent of black homeowners had a subprime loan versus 10 percent of white homeowners; in low-income neighborhoods, those figures were 54 percent and 18 percent for black and white homeowners, respectively.[12]

The discriminatory trend was again apparent in analyzing data by neighborhood income. In low-income neighborhoods, the number of subprime loans jumped from 3 to 26 percent between 1993 and 1998; in moderate-income neighborhoods the increase was not nearly as drastic, rising from 1 to 11 percent. Tellingly, the number of loans made in upper-income communities went up a mere 6 percent, from 1 to just 7 percent.[13]

[12] Ibid.
[13] United States Department of Housing and Urban Development. "Unequal Burden: Income & Racial Disparities in Subprime Lending in America." 1998. Accessed 26 March 2008. <http://www.huduser.org/Publications/pdf/unequal_full.pdf>.

HUD's study obviously suggests that certain groups – namely, minorities and the lower-income – were purposefully targeted during the expansion of the secondary loan market in the 1990s. Recent research by the Center for Responsible Lending provides evidence that this trend of preying on minorities in particular has since continued. According to the Center, as of 2006 there were 7.2 million families in the U.S. with a subprime loan. Of the African-American families studied with mortgages, 52.44 percent had a subprime loan. Looking at Hispanic families, 40.66 percent of home loans made to people with that ethnicity were subprime. A noticeably lower percentage of white families with mortgages – just 22.2 percent – were given a subprime loan.[14]

A study conducted on behalf of the Consumer Federation of America (CFA) of almost 4.4 million single-families with loans also found significant biases on the part of lenders – this time against women, in addition to minorities. CFA found that women are 32 percent more likely to receive subprime loans than men. Further, researchers discovered that only 7.7 percent of men received high-cost subprime mortgages – as compared with 10.9 percent of women. And while women compose less than a third of borrowers, they represent nearly two-fifths (38 percent) of those with a subprime loan.[15]

Even when compared with males of the same ethnicity, women are more likely to receive a subprime loan. But CFA also concluded that race plays a role in the type of mortgage a consumer is likely to receive:

> "…African-American women were 5.7 percent more likely than African-American men to receive subprime mortgages; Latino women were 12.7 percent more likely than Latino men to receive subprime mortgages; and white women were 25.8 percent more likely to receive subprime purchase mortgages than white men. African-

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[14] Center for Responsible Lending. "A Snapshot of the Subprime Mortgage Crisis." 27November 2007. Accessed 19 April 2008. <http://www.responsiblelending.org/ issuesmortgage/quick-references/a-snapshot-of-the subprime.html>.

[15] Fishbein, Allen J. and Patrick Woodall. "Women are Prime Targets for Subprime Lending." Consumer Federation of America. December 2006. Accessed 26 March 2008. <http://www.consumerfed.org/pdfs/WomenPrimeTargetsStudy 120606.pdf>.

American women were 256.1 percent more likely to receive subprime purchase mortgages than white men and Latino women were 177.4 percent more likely to receive subprime mortgages than white men." [16]

Statistics clearly reflect predatory lending, of which women, minorities and the poor appear to be specific targets. The faces of these groups have appeared in the news recently as well, often sharing stories of how the fallout of bad subprime loans is wrecking havoc on their lives today.

One story highlighted the difficulties facing the residents of a particular neighborhood in Baltimore. In 2007, the Belair-Edison community found 181 of its 6,400 (or one in 35) homes facing foreclosure. A local woman described buying a house in 2003 for $130,000, utilizing a subprime loan. Though her monthly payments began at $841, by 2005 she was paying $1,769 per month. A nonprofit offering homeownership counseling claimed it often saw similar situations hitting women in particular. In the greater Baltimore area, single women have been responsible for 40 percent of home sales – 50 percent of which were mortgaged with a subprime loan.[17]

To continue the focus on local women, Glenda Ortiz of Alexandria, Virginia found herself a victim of predatory lending. She and her husband, both of whom did not speak proficient English, were talked into paying $430,000 for a home – the value of which was a third of that price. They also agreed to pay $3000 a month, despite the fact that together, the Ortizes' income was barely $4200 each month. Why did they go through with it? First, there was obviously a language barrier. But Glenda and her husband were convinced owning their own

[16] Fishbein, Allen J. and Patrick Woodall. "Women are Prime Targets for Subprime Lending." Consumer Federation of America. December 2006. Accessed 26 March 2008. <http://www.consumerfed.org/pdfs/WomenPrimeTargetsStudy 120606.pdf>.

[17] Leland, John. "Baltimore Finds Subprime Crisis Snags Women." *The New York Times.*15 January 2008. Accessed 15 January 2008. <http://www.nytimes.com/2008 /01/15/us/15mortgage.html?fta=y>.

home was a possibility by a mortgage company who approved their mortgage application, despite the couples' lack of credit.[18]

It gets worse. *The New York Times* recently related the following story:

> "Ms. Francis, 31, was living in a homeless shelter in Queens in 2006 after she lost her job during her pregnancy. When she got a new $10-an-hour job as a security guard, she wanted to rent an apartment and approached the principal of her child's school, who happened to have a real estate business. Ms. Francis said the woman told her that she had no apartments available, but asked how her credit was. After a quick credit check, the woman told Ms. Francis she was available for a special Fannie Mae program for first-time buyers that did not require any down payment. She knew a two-family house in Jamaica, owned by a relative, which would be available for sale. In October 2007, Ms. Francis signed up for a $470,000 adjustable rate mortgage with an interest rate that began at 10.8 percent and shot up to 16.8 percent. The mortgage payment was $4,517 a month. She never made a single payment before the house went into foreclosure."[19]

Clearly, there is not sufficient consumer education to counteract lenders who are malicious or thoughtless enough to push people already down on their luck even further away from achieving financial stability.

The Underlying Problem: Financial Illiteracy

Why are these groups being targeted by lenders? Research (obviously also studied by those issuing subprime loans) has found that women and minorities are the groups most likely to be financial illiterate. Further, consumer surveys have found these groups self-identify as being in need of financial skills; sample testing has also confirmed a general lack of this type of knowledge.

A November 2006 MetLife survey of 1500 consumers spread across the general U.S. population found that minorities worry more about both micro and macro financial matters than whites. "Micro stressors" include the cost of health care, general savings, retirement savings, income, and housing costs. In light of the housing crisis, an important finding of this survey is

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[18] Schulte, Brigid. "'My House. My Dream. It was all an Illusion.'" *The Washington Post*.22 March 2008. Accessed 22 March 2008. <http://www.washingtonpost.com/wp-dyn/content/story/2008/03/21/ST2008032103607.html>.

[19] Lee, Jennifer. "Homeless? Low-Paying? Her Mortgage Was Approved." *The New York Times*. 13 February 2008. Accessed 13 February 2008. <http://cityroom.blogs.nytimes.com/2008/02/13/homeless-low-paying-job-her mortgage-was-approved/>.

that 42 percent of African-Americans and 43 percent of Hispanics find housing costs associated with either owning or renting to be a significant concern. This is compared with just 33 percent of whites. Similarly, 51 percent of African-Americans and 48 percent of Hispanics are concerned with "having enough savings" while this number for whites is 40 percent.[20]

The MetLife survey also found that women across three generations feel less financially secure than men. Of the Baby Boomers surveyed, 71 percent of women as compared with 61 percent of men "thought they would be farther ahead" financially than they are today. The numbers are similar for women in Generation X (born between 1965 and 1976) and Generation Y (born between 1977 and 1994) – 71 percent and 62 percent of women, respectively, feel less secure than they expected to be.[21]

One of the most useful indicators of Americans' financial literacy is the Federal Reserve's 2002 Study "Financial Knowledge, Experience and Learning Preferences." Researchers at the Board administered a 28-question survey designed to test consumers' general knowledge of financial issues such as credit, mortgages, savings, and so forth. The results are a strong indication of the disproportionate levels of financial illiteracy across race and gender. The survey was administered as a supplement to the monthly Survey of Consumers, conducted on a monthly basis by the University of Michigan of 500 U.S. households.[22]

Overall, the survey's respondents knew most about mortgages, scoring an average of 81 percent on that section of the quiz. Respondents knew least, however, about general financial management, scoring on average just 60 percent in that category. But as previously mentioned, the most striking aspect of the survey's results was the breakdown by race and gender.[23]

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[20] MetLife. "The MetLife Study of the American Dream." 25 January 2007. Accessed November 2007. <http://www.metlife.com/WPSAssets/23720648601169583027V1FMetLifeAmericanDreamStudyFinal012507.pdf.
[21] Ibid.
[22] Hogarth, Jeanne M. and Marianne A. Hilgert. "Financial Knowledge, Experience and Learning Preferences: Preliminary Results from a New Survey on Financial Literacy." *Consumer Interest Annual* Vol.48 (2002): 1-3.
[23] Ibid: 2.

Participants were sorted into two categories based on results: those with quiz scores of 18 (out of 28) or higher were considered to have "more financial knowledge"; those with quiz scores of 17 or less were labeled as having "less financial knowledge." The survey notes that participants who fell into the former category "tended to be married, non-minority, middle aged, more highly educated, and have higher incomes." Further analysis reveals that of the "less knowledgeable" group, 14 percent were single men as compared with the 33 percent that were single women. The knowledge gap between races was even more disparate. In the "more knowledgeable" group, 85 percent were white while just 6 percent were black and 4 percent were Hispanic.[24]

Annamaria Lusardi, a professor of economics at Dartmouth College, has also conducted considerable research on financial literacy across various demographics. Her findings confirm that people in the U.S. generally lack financial skills, but the most illiterate tend to be women, minorities, and those with low education. One of Lusardi's studies focused on the financial literacy of older women in particular, and she discovered that even among this group skills were severely lacking. She warns in the conclusion of her study that this is particularly worrisome, given that women tend to outlive men and thus require enough financial knowledge to plan for a longer life. Yet, according of the women in her study, just 17 percent had determined how to survive financially during retirement. As the housing crisis persists, women will likely need to understand their finances to be able to afford the costs associated with renting or buying (and for longer periods of time) than ever before.[25]

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[24] Ibid: 3-4.

[25] Lusardi, Annamaria and Olivia S. Mitchell. "Planning and Financial Literacy: How Do Women Fare?" University of Michigan Retirement Research Center Working Paper No. 2006-136. August 2007. Accessed November 2007. <http://www.dartmouth.edu/~alusardi/Papers/PlanningWomen.pdf>.

The recent examples appearing in the news, combined with statistics, are proof that poor lending practices have created a financial crisis in this country and further, that these practices are disproportionately affecting women, minorities and the poor. Arguably, a financially literate populace might have prevented the crisis reaching the extent that it has.

The Importance of Consumer Education

Obviously, the statistics stated in the previous section imply a need to develop financial literacy skills of the public. And as Sandra Braunstein and Carolyn Welch of the Federal Reserve Board's Division of Consumer and Community Affairs note:

> "financial literacy deficiencies can affect an individual's or family's day-to-day money management and ability to save for long-term goals such as buying a home, seeking higher education, or financing retirement."[26]

In their article reflecting on consumer education efforts, Braunstein and Welch go on to explain that financial skills are becoming all the more vital as society and the financial services industry both grow increasingly complex:

> "Compelling consumer issues, such as the very visible issue of predatory lending, high levels of consumer debt, and low saving rates, have also added to the sense of urgency surrounding financial literacy. Other important demographic and market trends contributing to concerns include increased diversity of the population, resulting in households that may face language, cultural, or other barriers to establishing a banking relationship; expanded access to credit for younger populations; and increased employee responsibility for directing their own investments in employer-sponsored retirement and pension plans."[27]

Current Resources

Fortunately, a rise in the number of financial literacy programs appears to have corresponded with increased consumer issues. According to a study by Fannie Mae of 90 financial literacy programs, nearly 70 began in the late 1990s; another survey by the Consumer Bankers Association found that in light of the housing crisis, homeowners in particular have become the target audience for financial education.[28]

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[26] Braunstein, Sandra and Carolyn Welch. "Financial Literacy: An Overview of Practice, Research, and Policy." *Federal Reserve Bulletin* (November 2002): 445.
[27] Ibid: 445.
[28] Braunstein, Sandra and Carolyn Welch. "Financial Literacy: An Overview of Practice, Research, and Policy." *Federal Reserve Bulletin* (November 2002): 448.

The research by Braunstein and Welch indicates that the providers are “a diverse group” comprised of employers, banks, state governments, the military local colleges, churches, and nonprofits. Topics range from homeownership and savings to investment and bankruptcy.[29]

For its part, the government has taken an active role in promoting financial literacy. In 2003, the Financial Literacy and Economic Commission (FLEC) was created under Title V of the Fair and Accurate Credit Transaction (FACT) Act. Member organizations include:

- Board of Governors of the Federal Reserve System
- Commodity Futures Trading commission
- Federal Deposit Insurance Corporation
- Federal Trade Commission
- National Credit Union Administration
- Office of the Comptroller of the Currency
- Office of Thrift Supervision
- Small Business Administration
- Social Security Administration
- U.S. Department of Agriculture
- U.S. Department of Defense
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of Housing and Urban Development
- U.S. Department of Labor
- U.S. Department of the Treasury
- U.S. Department of Veterans Affairs
- U.S. General Services Administration
- U.S. Office of Personnel Management
- U.S. Securities and Exchange Commission

In addition to convening these members on a regular basis to discuss financial literacy issues, FLEC also sponsors a website where consumers can find resources on a variety of topics, including homeownership, savings, credit, and retirement planning. The website, mymoney.gov, also includes investment calculators and budgeting tools for college students.[30]

President George W. Bush also created a President’s Advisory Council on Financial Literacy in January of 2008, to be headed by Charles Schwab. One of the issues that many of

[29] Ibid: 448.
[30] United States Financial Literacy and Education Commission. “FACT Act.” Accessed November 2007. <http://www.mymoney.gov/aboutus.shtml>.

our folks are facing now are these sub-prime mortgages. In his announcement, President Bush commented on the urgency of financial literacy in light of the housing crisis, and on the importance of consumer information more generally:

> "I just wonder how many people, when they bought a sub-prime mortgage, knew what they were getting into: The low interest rates sounded very attractive, and all of a sudden, that contract kicks in and people are paying high interest rates. One of the missions is to make sure that when somebody gets a financial instrument they know what they're getting into, they know what they're buying, they understand…We want people to own assets; we want people to be able to manage their assets. We want people to understand basic financial concepts, and how credit cards work and how credit scores affect you, how you can benefit from a savings account or a bank account. That's what we want."[31]

In addition to government financial literacy programs, a number of public-private entities have been created with the goal of consumer education in mind – many with a specific focus on housing problems. NeighborWorks America is one such example. NeighborWorks is a network of over 235 locally-based community development organizations which provide financial education programs and specialize in homeowner counseling. The organization's Center for Foreclosure Solutions serves as a central resource for potential homebuyers, providing education on the housing market, mortgages, and insurance. Federal Reserve Board member Randall Kroszner praised NeighborWorks in a speech last fall, noted that its successful hotline (1-888-995-HOPE) had fielded 100,000 calls from consumers in need of housing counseling already that year. Operated by Department of Housing and Urban Development-approved counselors, the hotline is open 24 hours a day and seven days a week.[32]

Evaluation of Government and Government-Sponsored Resources

But how valuable are these resources to the average consumer? In a report released just days prior to the time of this writing, the State Foreclosure Prevention group found that not only is government assistance for homeowners inadequate, but foreclosures have actually increased.

[31] The White House. "President Bush Announces President's Advisory Council on Financial Literacy." 22 January 2008. Accessed 3 January 2008. <http://www.whitehouse.gov/news/releases/2008/01/20080122-7.html>.

[32] Kroszner, Randall S. "The Challenges Facing Subprime Mortgage Borrowers." Speech. 5 November 2007. Accessed 21 April 2008. <http://www.federalreserve.gov/newsevents/speech/kroszner20071105a.htm>.

The report, which surveyed 58 percent of all subprime mortgage servicers, found that 70 percent of homeowners currently borrowing are not receiving any assistance. Further, only one-third of borrowers actually being helped determined a solution in less than 45 days. Given the lack of speed and efficiency, the numbers of homeowners facing foreclosure rose by 15 percent. Finally, the report specifically admonished the Hope Now Alliance (President Bush's coalition of public and private homeowner advocacy groups) for the fact that the group has not produced any results, according to its own reports.[33]

As for other coalitions like FLEC, one has to wonder if it is truly reaching its neediest customers, given that all of its resources are online. The problem, obviously, is that not everyone has a computer or Internet access in their homes. Further, evidence suggests it is not yet widely utilized by the general public as a source for financial education.

In addition to the financial literacy quiz, the Survey of Consumers administered by the University of Michigan and supplemented by the Federal Reserve asked questions regarding how they had acquired any financial knowledge.

The highest percentage (68 percent) of respondents reported having learned the most about finances from personal experiences and half reported this as being "the most important way of learning." By contrast, 11 percent found they had learned the most via the Internet, and just 2 percent claimed this would be the most useful means of gaining more information.[34]

Even prior to having seen this statistic, I had assumed as much. Drawing on my experience working in Southeast D.C., I knew that very few people have a computer in their

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[33] Elphinstone, J.W. "Study: Help for Subprime Borrowers Falls Short." *USA Today*. 23 April 2008. Accessed 23 April 2008. <http://www.usatoday.com/money/ economy/housing/2008-04-22-subprime-mortgage-help study_N.htm>.

[34] Hogarth, Jeanne M. and Marianne A. Hilgert. "Financial Knowledge, Experience and Learning Preferences: Preliminary Results from a New Survey on Financial Literacy." *Consumer Interest Annual* Vol.48 (2002): 6.

homes, let alone the Internet. Part of the reason FLY helps youth from that community improve their grades is simply because having a computer increases their access to information they need to complete their homework and allows them to present their work (papers, reports, etc.) in a format that is acceptable to their teachers. Without FLY, the kids cannot use computers outside of school because their parents or whomever they live with do not generally own one.

As I mentioned, during my co-op experience at the Federal Reserve I had the opportunity to attend a number of intergovernmental financial literacy summits. What shocked me most at these summits was the amount of emphasis each member organization announced it would be placing on Internet publications. I believe I heard only one time, one member of a panel suggest that perhaps attention be paid to consumers without computers.

Seeking a reason for this seeming lack of attention, I interviewed Jeanne Hogarth of the Board's Division of Consumer and Community Affairs. According to Hogarth, the reason her division relies so heavily on the Internet is because they are hoping to reach what she calls "multiplier" organizations – trusted groups such as churches, nonprofits, and other community centers that would be able to more efficiently direct people's attention to financial resources. Hogarth also assured me that her division, along with the rest of the Board, is seeing the current crisis as a "teachable moment" in terms of consumer education, and hoped to improve outreach efforts by working with marketing and design firms to reach the maximize awareness.[35]

To the extent that this is the strategy most federal agencies have adopted, it must be said that they have produced some remarkable resources.

Braunstein and Welch hold a brief discussion of this in their article as well. They write of how technological innovations such as the Internet allow increased accessed to financial

[35] Hogarth, Jeanne M. Personal Interview. 31 March 2008.

services and processes, but they also note that additional information may not necessarily provide extra advantages to consumers if they do not understand it:

> "To benefit from the innovations…consumers need a base level of financial knowledge so that they can identify and access pertinent information as well as evaluate the credibility of the source of the information."[36]

Policy Recommendations

Given the 68 percent of survey respondents saying they learned most from personal experiences, it follows that the most successful financial literacy programs have involved direction intervention. It seems people basically just need to be walked through a financial planning practice. Braunstein and Welch's report again provides valuable insight into the types of programs that might be successful. First, they suggest savings initiatives, such as that developed by the Consumer Federation of America. "America Saves" as it is called, is a program being piloted in various communities across the country that "includes efforts to enroll residents with no-fee savings accounts, motivational workshops, and one-on-one consultation." In the Cleveland area alone, where the program was first initiated, over 10,000 residents have improved their ability to save.[37]

Second, Braunstein and Welch encourage workplace programs on financial training. They cite various examples of successful employer-based education – including a chemical production company where three-fourths of its employees "reported deriving a sense of benefit from workplace-sponsored training…and were overall more confident in making investment decisions." Similarly, they point to a telephone survey of U.S. citizens between the ages of 30 and 45 which found that retirement savings of those whose employers emphasized financial education were actually higher.[38]

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[36] Braunstein, Sandra and Carolyn Welch. "Financial Literacy: An Overview of Practice, Research, and Policy." *Federal Reserve Bulletin* (November 2002): 446.
[37] Ibid: 450.
[38] Braunstein, Sandra and Carolyn Welch. "Financial Literacy: An Overview of Practice, Research, and Policy." *Federal Reserve Bulletin* (November 2002): 451.

In keeping with the trend that nonprofit and private organizations seem to have met with considerable success, given their direct work with consumers, a study conducted by the Center for Housing Policy on the impact of homeownership counseling found that consumer education conducted by two nonprofit organizations, the Neighborhood Housing Partnership and HomeWise, Inc. significantly increased purchasing power. Customers in the housing market of three different cities were asked to participate in a series of classes featuring such topics as mortgages, home maintenance, and credit reports. Researchers discovered that in two of the three cities, these classes significantly increased the customers' purchasing power – namely, their credit scores improved and they were able to obtain better loans. In Santa Fe, for instance, credit scores rose, on average, by 23 points. The purchasing power of consumers taking classes increased by approximately $7,017; savings levels also increased by $1,874. In Indianapolis, credit scores rose by 22 points – 28 points for those customers who began with a score below 650. Further, savings increased by $309 while debt decreased by $577, on average. Purchasing power rose $4,515 given improved credit scores.[39]

In a paper summarizing best practices for lenders, by NeighborWorks emphasizes the importance of this type of direct work with borrowers. NeighborWorks encourages, for instance, the use of "third-party counseling" to aid people who may particularly struggle with repaying loans. This could include interpreters for those borrowers with language barriers; it might also involve nonprofits who help borrowers practice savings. Another suggestion NeighborWorks makes is making staff at lending institutions more available and efficient so as to avoid

[39] Hangen, Eric and Jeffrey Lubell. "Impacts of Homeownership Education and Counseling on Homebuyer Purchasing Power: Summary of Findings." Center for Housing Policy. November 2007. Accessed 26 March 2008. <http://www.nhc.org/pdf/chp_impacts_summary1107.pdf>.
NeighborWorks America. "Financial Institutions and Foreclosure Intervention: Innovative Partnerships and Strategies to Better Serve Borrowers in Default." Nobember 2007. Accessed 26 March 2008. <http://www.nw.org/network/pubs/studies/documents/Foreclosure_Intervention.pdf>.

frustrating a person with a loan who needs to help immediately. Automated phone systems ought to be eliminated, the organization suggests, so as to "enhance communication."[40]

The study by the Center for Housing Policy, the paper by NeighborWorks and the conclusions reached by the Federal Reserve Board's Community Affairs section regarding the both lack of reliance on the Internet and the success of personal training on the job all suggest that the more direct the intervention, the more useful it proves for consumers. Government resources, as surmised from personal observations and research, do not always reach the average consumer as intended for accessibility reasons.

Conclusion

Obviously it is critical to look even beyond the housing crisis at the more central issue of financial illiteracy. Though the aforementioned government counseling agencies and public-private partnerships are excellent resources, it seems that education should be even more accessible and laid out more basically for the average consumer.

I put myself in the position of a woman in D.C., lacking financial literacy skills and perhaps a victim of the housing crisis. Where would I be able to go, should I desire to acquire these skills? What if I was already in way over my head with bankruptcy, credit, or mortgage issues? Keeping this perspective in mind, I set out to find local government agencies and nonprofit groups in D.C. where consumers could literally walk in seeking to further their education and/or receive attention for their financial problems. I then produced a brochure stating each group's mission, the services it provides, and contact information. I envisioned something that could be distributed by nonprofits, schools, and churches.

I personally would like to see this information condensed as such in the future. To draw again on the Survey of Consumers, respondents ranked informational brochures second only to

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media sources such as TV, radio, magazines, and newspapers when asked the "most effective way to learn about managing money" – 69 percent to 65 percent, respectively.[41]

Perhaps Lusardi describes the approach that ought to be taken by the government, public-private partnerships, and the private sector best in noting that above all, efforts must be consistent. She also makes a strong case for the relevancy of financial literacy in today's world:

> "The mixed evidence on the effectiveness of financial education programs has led some to question whether it is worth trying to improve financial literacy. In fact, it is not clear there is even a choice. As it was impossible to live and operate efficiently in the past without being *literate*, i.e., knowing how to read and write, so it is very hard to live and operate efficiently today without being *financially literate.* Given the complexity of current financial instruments and the financial decisions required in everyday life, from comparing credit card offerings, to choosing methods of payments, to deciding how much to save, where to invest, and how to get the best loan, individuals need to know *how to read and write* financially. Note that, as with reading and writing, the objective of any policy designed to promote financial literacy should be basic knowledge. While it may not be feasible to transform financially illiterate people into sophisticated investors, it may be possible to teach them a few principles about the basics of saving and investing."[42]

Although few in number, the resources I found for consumers in D.C. provide hope that financial education is taking place on a micro level – and that resources are going directly into the hands (or should I say, reaching into the pockets) of the people who need them most. Although the federal government's resources may not quite match the extent of the crisis, it is refreshing to see that local government and the private sector seem to be making up the difference.

As Lusardi notes, providing adequate consumer education is a difficult challenge. But measures such as homeowner counseling and employer training reflect the potential to create a financially literate public. It is my hope that these efforts will be of continued importance to the

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[41] Hogarth, Jeanne M. and Marianne A. Hilgert. "Financial Knowledge, Experience and Learning Preferences: Preliminary Results from a New Survey on Financial Literacy." *Consumer Interest Annual* Vol.48 (2002): 6.

[42] Lusardi, Annamaria. "Financial Literacy: An Essential Tool for Informed Consumer Choice? Dartmouth College and National Bureau of Economic Research. November 2007. Accessed November 2007. <http://www.dartmouth.edu/~alusardi/Papers/Literacy_Tool.pdf >.

community, and my belief that the impact of future economic crises can be lessened with efforts to educate the public on financial issues.

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