Improving the effectiveness of Federal financial literacy initiatives, and assessing the performance of the Financial Literacy and Education Commission in achieving its statutory mission.

"If you would be wealthy, think of saving as well as getting" Benjamin Franklin

Chairman Akaka. Ranking Member Johnson, thank you for the opportunity to testify today on ways to improve the effectiveness of Federal financial literacy initiatives and the performance of the Financial Literacy Education Commission. It was my privilege to testify to this committee in the past when I served as a government official, and I am pleased to now return in my private capacity as Senior Advisory to the Pew Charitable Trusts.

As this Committee knows, financial education has long been of interest to me in both my personal and professional life. I have written children's books and stories which deal with basic financial concepts and have made responsible financial management a priority in my own household. In my public life, I created Treasury's Office of Financial Education when I served as the Assistant Secretary for Financial Institutions, and when I later became Chairman of the Federal Deposit Insurance Corporation, I created an Advisory Committee on Economic Inclusion, or Come-In for short. This important committee helped guide the FDIC's work in promoting a banking system which is inclusive and serves the needs of all Americans, regardless of income status or financial acumen. At the core of Come-In's work was the recognition that full economic inclusion cannot be achieved unless those who use banks have command of certain basic financial skills. At the same time, it is essential that banks give their customers adequate information to understand the products and services that they provide, their key features and relative costs.

Why is financial education important? Certainly, it is essential from a consumer protection standpoint. I have often said that a financial regulator's best ally is a well-informed customer - one who will ask questions and turn away products that they do not understand or that sound too good to be true. But the importance of financial education goes beyond consumer protection, to the very functioning of our market-based economy. Markets cannot function efficiently if consumers do not understand the products they are buying and their relative worth. Consumers taken in by products which sound advantageous to them but are really laden with hidden fees and costs will skew the allocation of economic resources toward inefficient, abusive products to the detriment of other providers which offer more responsible products which provide better value. Thus, an ill-informed consuming public will not only hamper the efficient functioning of our markets, but will also disadvantage those in the financial services community who are trying to do the right thing.

Nowhere is this sad reality more apparent than in the recent financial crisis our country suffered which was brought on by aggressive marketing of unaffordable, in many cases, and abusive mortgages to people with troubled credit histories. To be sure, some of the borrowers who took out these low-doc, teaser rate mortgages were investment professionals who knew what they were doing and were willing to speculate on home prices continuing to rise. But far too many others were people with safe, affordable 30 year fixed mortgages, who were enticed into complex, adjustable rate mortgages with steep payment resets and stiff prepayment penalties. When I was at the Treasury Department in 2001 and 2002, adjustable rate subprime mortgages - the so-called 2/28s and 3/27s, as well as pick-a-pay loans with negative amortization - were perimeter products, the exception, not the rule offered mostly by unregulated, nonbank mortgage brokers. However, when I returned to public life in mid-2006, as Chairman of the FDIC, I was shocked to learn how these types of products had gone mainstream, and that once responsible mortgage lenders had succumbed to the fat fees and profits generated, in the short term, by these unsustainable loans. Better informed consumers, combined with a much more aggressive regulatory response, could have done much to stem the tide of the subprime debacle that washed upon our nation's shores.

So I commend this Committee, and you in particular, Mr. Chairman, for continuing to make financial education a national priority and to keep up the pressure to make government's financial literacy efforts as effective and meaningful as possible. Financial education must be more than a feel-good, public relations exercise. To be effective, financial education must ultimately change behavior. After many years of promoting financial education, we have learned some important things. For young people, building financial education into core curricula and having it taught year after year is more effective than "one-off" financial education classes. For adults, financial education offered in connection with a specific financial event, be it opening a banking account, applying for a credit card or taking out a mortgage, will be more effective than financial training which is offered in the abstract.

My own priorities have long focused on educating young people at the earliest possible age about the basics of financial management. Moreover, education that focuses on certain core, eternal concepts - compounding interest, the time value of money, the relationship of risk and reward, the risks of excessive leverage- can be far more effective than focusing on the particular financial fad of the day. Moreover, financial concepts can be woven into math problems in any number of creative ways, with increasing complexity and sophistication in the higher grades. Similarly, literature and history are replete with examples of financial greed, speculation, and leverage creating financial calamity for families as well as entire nations.

I also believe we should start thinking about financial education more broadly -- not simply in terms of financial concepts, but also in terms of the ethics of money and financial transactions. I do worry that as a culture, our attitudes toward money have drifted away from the traditional view that money is earned through hard work and effort, and by providing others with a product or service which they value and for which they will pay. Too often, money is viewed today as something to obtain through gimmickry or speculation. We need to underscore in our financial literacy efforts that both parties have an obligation to act ethically and responsibly in a financial transaction. The financial services provider has an obligation to fully explain the product or service being offered, its value to the customer and the full range of its potential costs. Similarly, the consumer of the financial product who willingly enters into a transaction after being fully informed of the costs and benefits has an obligation to make good on his or her obligations. Both consumers and providers need to rebuild much-needed trust in each other through better ethical behavior which I believe can be facilitated through the incorporation of financial ethics into our educational efforts.

Let me now turn to some specific work that The Pew Charitable Trusts is doing on consumer financial security. In recent years, Pew has generated a variety of research focused on enhancing consumer financial security and understanding long-term economic mobility. Helping people make beneficial financial decisions is integral to this work.

Below, I summarize a number of Pew's latest findings and recommendations. Over time, Pew will monitor the issues that groups such as the Financial Literacy and Education Commission identify, and will evaluate ways to help develop research that furthers the important cause of household economic security in America.

An important part of financial literacy is having information presented in a way that consumers can understand and use to make appropriate choices. Thus, disclosures for financial products and services need to be presented in a format that is clear and understandable. They should convey key terms and conditions with clarity so that consumers can compare products and make purchasing decisions that best meet their needs. Clear disclosures will foster a transparent, fair, and competitive marketplace for all financial institutions by allowing them to compete for customers on a more level playing field.

This is particularly important for checking accounts, which allow consumers to transact and save and often serve as the gateway to the use of more sophisticated financial products and services. Unfortunately, when Pew studied the checking account disclosures provided by the ten largest banks, we found a median of 111 pages, consisting of account agreements, addenda to account agreements, fee schedules, and pages on the bank's website. The banks often used different names for the same fee or service; put the information in different documents, different media (Web or hard copy), or different locations in a document; and did not summarize or collect key information anywhere. Many of these documents are not user-friendly, with much of the text densely printed, difficult to decipher, and highly technical and legalistic. In response, Pew developed a model disclosure box that could be used by financial institutions to provide relevant information to checking account customers. So far, seven financial institutions have voluntarily adopted this box.

In developing the disclosure box, Pew tested different versions with consumers. In Philadelphia, Minneapolis, and Los Angeles, two groups of consumers who had opened a checking account within the past two years: one with parents who had assisted a young adult child and one with adults ages 21 to 35 were convened. Participants described the information in the box as "comprehensive" and "clear," and felt that a concise, easy-to-understand disclosure document would be useful and valuable when opening a checking account. Some suggested that the box would be a good tool to teach their children about the intricacies of a checking account.

Last fall, Pew released the results of a longitudinal study of 2000 low-income Los Angeles area households, 1000 with and 1000 without a bank account, which explores the connections between financial services, the populations they serve or are failing to serve, and the financial stability of those populations. Pew found, not surprisingly, that between 2009 and 2010, a time of great economic turmoil throughout the country, the ranks of the unbanked (those without a bank account) increased, with more families leaving banking than opening bank accounts.

But what was surprising was that the most common reason these households cited for leaving banking was unexpected or unexplained fees. Nearly one in three listed these fees as the reason for leaving banking. This is particularly relevant given that even in difficult economic times only 27 percent attributed their departure from banking to job loss or lack of funds. The banked could also better sustain their savings behaviors, including those associated with long-term goals such as paying for college, even during economic turmoil and when faced with high rates of job loss and declining household income.

Given the need for consumers to understand and therefore maintain their checking accounts, the Consumer Financial Protection Bureau (CFPB) should require all financial institutions to provide a clear, concise and uniform disclosure that would present accountholders with important fees and terms.

Pew's research demonstrates that bank policies and practices have a central role in allowing consumers to use and manage their money responsibly. Yet unexpected fees continue to plague consumers. For vulnerable populations, these fees can mean the difference between having a checking account and forgoing these services altogether. Providing information in a clear, concise and uniform disclosure box so that consumers can both understand and comparison shop for an account that best meets their needs will promote financial literacy.

In addition, I urge the CFPB to prohibit practices that unfairly maximize fees or that are difficult or impossible for consumers to avoid, like transaction reordering, since this practice makes it very difficult for consumers to manage their money and avoid these charges. While at the FDIC, we issued guidance to our supervised banks to halt this practice. Transactions need to be processed in a predictable manner that responsible consumers can follow. Changes such as these will allow consumers to understand the financial products and services they need in order to build and sustain wealth.

Pew's Safe Small-Dollar Loans Research Project is currently evaluating the complicated issue of payday lending. Here is another reminder that empowering Americans to manage their finances effectively requires more than just simplified price disclosures. Payday loans often come with a clear price tag – say, $15 per $100 borrowed. But in this case, the price tag does not begin to tell the story of the typical cost.

Even without considering the ways in which payday loans might help or harm borrowers, two problems are clear. One is that borrowers rarely experience payday loans as the short-term solutions that advertisements claim them to be. Lenders frequently describe payday loans as something to help borrowers deal with emergency cash shortages until the next payday. Yet a variety of research shows that for most borrowers, the reality is quite different. As they struggle to repay the loans in full at the next payday – these are loans that require a single, full repayment – borrowers find that they must use many more than one payday loan throughout the course of the year.

A second key problem with the payday loan market is that the business model fundamentally relies on this kind of repeat usage for its profitability. Yet despite this reality – and despite the fact that, as Pew's upcoming report will show, most people use these loans to deal with recurring living expenses – the depiction of payday loans as temporary fixes for emergency problems persists.

Pew will publish a variety of research in coming months to further explore these issues and potential solutions. And the CFPB surely will be evaluating what actions are necessary to fulfill its mandate to regulate payday lending. But for purposes of today's conversation, I would note that the case of payday lending reminds us that consumers must be enabled to understand not just what it costs to obtain a financial product, but also to calculate the ongoing costs and risks of using those products.

People who are struggling to make ends meet desperately want to believe that they can achieve the promise of a payday loan: that is, a small loan that will go away on their next payday and not become a big burden over time. Consumers need to be educated so that they less susceptible to such fictions; but it is also important that companies package their products in realistic ways. That is why I supported the creation of a Small-Dollar Loan pilot program while I was at the FDIC. This program recognizes the value of safe and affordable small dollar loans. Two of the most important features of this program are a minimum repayment term of 90 days, and solid underwriting practices.

There is one final point I would like to make, which will bring us back to the importance of teaching – and helping to instill – positive financial behaviors. There is a variety of research suggesting a correlation between savings and financial well-being.

For example, there appears to be a link between savings and increased ability to withstand financial shocks and avoid risky or harmful credit products. For example, Pew's research shows that those who rent their homes use payday loans more frequently than home owners. This finding holds true throughout the income distribution: Renters earning $40,000 to $100,000 annually use payday loans at significantly higher rates than homeowners earning $15,000 to $40,000. Traditionally, home ownership, though not a sure path to increasing savings, has of course been a primary asset building vehicle for many Americans over the years. The link between renting and payday loan usage throughout income segments would seem to indicate that availability of assets can matter as much or more as amount of income.

Other Pew research has shown, for instance, that there is a connection between personal savings and upward economic mobility, both within a person's lifetime and across generations. These are but two examples of why we must do a better job of instilling savings behavior at all levels of American society.

In conclusion, first let me thank you for the opportunity to testify today on this important issue. There is more we can do to further Americans' financial literacy. First, we need better research to test the efficacy of those programs already in place and to test new programs. The fees, terms and conditions of consumer financial products should be clear and provided in ways that allow consumers to comparison shop so that they can choose what best meets their needs. Practices that undermine a consumer's ability to responsibly manage his or her money, like transaction reordering solely for the purpose of maximizing overdraft fees, should be prohibited. Finally, consumers need to be able to understand the ongoing costs of the products they use, as well as any risks involved in their ongoing usage. It is my hope that the Financial Literacy Education Council will continue to focus on all of these concerns. Thank you.