

**No matter who you are, making informed financial decisions about what to do with your money will help build a more stable financial future for you and your family.**

FEDERAL RESERVE CHAIRMAN ALAN GREENSPAN



# PERSONAL FINANCIAL EDUCATION

## Making Sense of Money

No matter who you are, there's a lot to learn about money. On the face of it, this sounds straightforward, but technological innovations and a profusion of financial products make money management more complex—and financial education more important—than ever before.

Consider this. Even when choosing basic financial products such as checking and savings accounts, today's consumers face a myriad of options compared to the traditional one-size-fits-all accounts of the past. Checking options include free, no interest accounts; fee-based,

interest-bearing accounts; ATM-only accounts; and even plans tailored for college students, just to name a few. Savings options can include no fee, low interest accounts; market rate accounts with limited check-writing privileges; higher interest, higher cash balance accounts with limited transaction privileges; and indexed accounts.

Consumers often reap additional benefits when choosing financial services such as pay by phone, online banking, automatic bill pay, telephone banking, and credit card tie-ins. More decisions come into play if consumers opt to integrate checking, savings, and investment accounts into a portfolio of products. While these innovations provide consumers with greater options for tailoring personal financial plans, their complexity underscores the need for financial education. Like learning to drive a car safely, consumers must learn to navigate a complex financial road map to reach their goals.

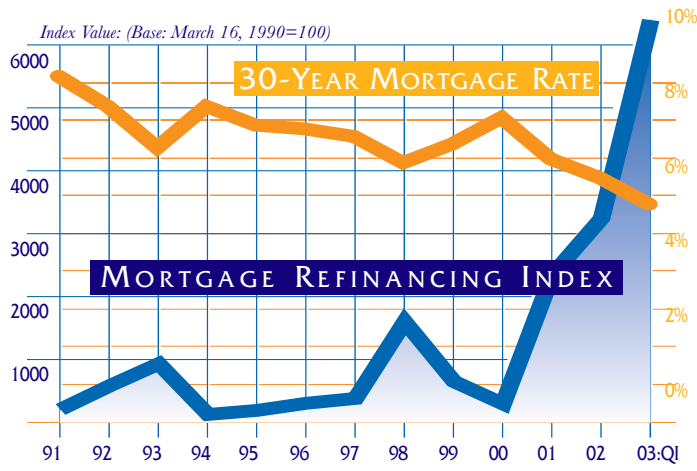
Consumers shopping for mortgage loans or refinancing face a similar proliferation of



choices that requires financial knowledge to make sound decisions. Even when choosing a standard 30-year mortgage, important financial decisions come into play such as how to evaluate interest rate and loan costs, when to lock-in a rate, and whether or not to pay points. These are not easy decisions and are especially difficult without financial knowledge.

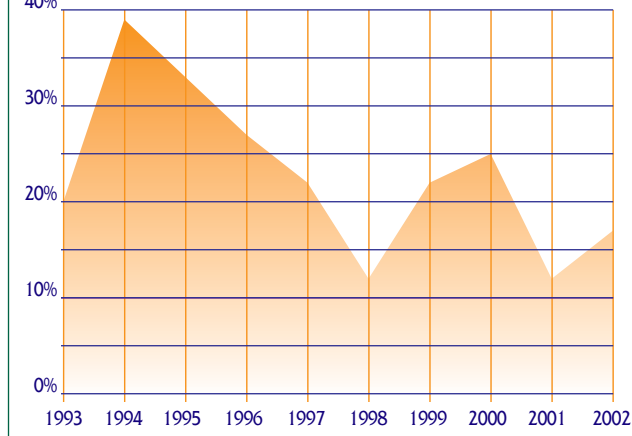
The year 2002 marked the lowest mortgage rates in over three decades. Low rates opened the door for many first-time homeowners to enter the market with fixed- and adjustable-rate mortgages (ARMs). Some adjustable mortgages offer an initial, low “teaser” rate and accompanying low monthly payment that adjusts after a predetermined period of time, anywhere from one month to seven years based on specified indices, with or without an interest rate cap. Other mortgage choices for homebuyers include zero or low down

### RECORD LOW MORTGAGE RATES IN 2002 LED TO A RECORD YEAR FOR MORTGAGE REFINANCINGS



Sources: Mortgage Bankers Association of America and Freddie Mac

### ARM MARKET SHARE AS A PERCENTAGE OF TOTAL MORTGAGE ORIGINATIONS



Source: Mortgage Bankers Association of America

payment options. These alternatives usually require consumers to pay higher interest rates and private mortgage insurance if their down payments are less than 20 percent of the purchase price. Another option among the many available is an interest-only loan. These loans feature lower interest rates and low monthly payments as incentives, but result in the borrower not paying down any principal for a period of time—typically five to ten years—leaving an unchanged loan balance at the end of the period.

Like basic banking products, mortgage loan variations can enhance consumer welfare for those who understand the financial trade-offs. First-time homebuyers, homeowners who are more risk-tolerant, or those who are just beginning their working careers may prefer the trade-offs offered by an ARM or an interest-only loan, but these options may not be the best choices. Over time consumers

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opting for these loans may incur higher interest rates and/or negative amortization.

Zero or low down payment options provide opportunities for more consumers to get into the housing market, but may pose risks due to the higher monthly payments. The bottom line when considering mortgage options or other financial products is that the complexity and variety of choices require consumers to take an active, informed role when evaluating products. Without training or education, making personal financial decisions can be a confusing, frustrating, and even dangerous road to maneuver.

## All-in-One Banking, Insurance, and Securities Services

When perusing financial services offered by banks, insurance companies, and securities brokerages, consumers may observe that many of the products are similar. Facilitated by the gradual relaxation of legal and regulatory restrictions, including major banking financial modernization legislation passed in 1999, the banking industry has evolved dramatically. While banks used to focus primarily on accepting deposits and making loans, they now may affiliate under common ownership with insurance companies, securities firms, and other nonbank entities to offer their customers a complete range of financial services. As a result, today's consumers can engage in "one stop" shopping, choosing from a host of financial products including investment, insurance, retirement, college tuition, and traditional banking services. As the lines between financial service providers blur and product complexity increases, consumers need the financial know-how to decipher features, including differentiating between insured and uninsured products, to make sound financial decisions.



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## Banking Evolution Meets Technology Revolution

The financial services boom and its impact on the need for personal financial education would not be as explosive without the push of technology and the Internet. Consumers can bank online, shop for mortgages at lending portals, and open e-brokerage accounts for their online investment portfolios. The impact of technology behind the scenes is just as dramatic. Using new technologies, consumer preferences can be matched with product offerings for targeted marketing campaigns. Credit scoring models use sophisticated technology to develop customer credit profiles that are the industry standard for assessing consumers' credit qualifications for mortgage products and other financial services.

The use of technology to fine-tune credit profiles has opened the door to a proliferation of new financial options for consumers who may not have been able to qualify under traditional credit standards. For example, with financial innovation and market deregulation, subprime mortgage lending has grown tremendously since the early 1990s, providing new homeownership opportunities for consumers with a limited or impaired credit

history. To obtain these loans, consumers pay interest rates that are higher than market rates. According to data reported by *Inside B&C Lending*, a mortgage finance trade publication, subprime lending originations rose from \$138 billion in 2000 to \$173 billion in 2001, to a record high of \$213 billion in 2002.



The rapid wave of technological and financial innovation requires greater sophistication from consumers and more personal responsibility to benefit from new financial opportunities. Consumer education is critical to dissect the marketing of financial products and to understand the implications of credit scoring and financial parameters associated with specialized products such as subprime loans.

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## Increase in Deceptive Lending Practices

Along with providing consumers with more choices, market innovation and deregulation have opened the door to an unsettling trend—a rise in deceptive lending. For mortgage products, deceptive lending practices may involve excessive fees and interest rates, “loan flipping” (frequent refinancing), unnecessary insurance, overly restrictive payment conditions, and misrepresentation of the impact of financial terms such as balloon payment loans. In extreme situations, predatory lending arrangements are explicitly formulated to lead to “equity stripping” and foreclosure.

The degree of predatory lending is difficult to measure, but anecdotal evidence indicates it is a serious problem. While legislation has been passed to curb abuses, overly restrictive laws may close the door to credit opportunities for previously underserved consumers. As a result, financial education is viewed as an important part of the solution. Many homeownership programs include anti-predatory lending educational components. In recent years, lenders and community organizations have partnered to launch awareness campaigns to educate and empower consumers.



## Rise in Consumer Debt and Personal Bankruptcies, Drop in Personal Saving

Significant changes in personal financial conditions on the heels of the phenomenal growth of the “new economy” highlight policymakers’ concerns over the need for personal money management. Consumer credit was a primary source of consumer spending during the 1990s and continued to expand through most of 2002. As measured by Federal Reserve Board quarterly household debt-service data, consumer debt hit a 20-year high in 2001, averaging just under 14.4 percent of disposable income. This measure dropped only slightly by the third quarter of 2002 to 14 percent.

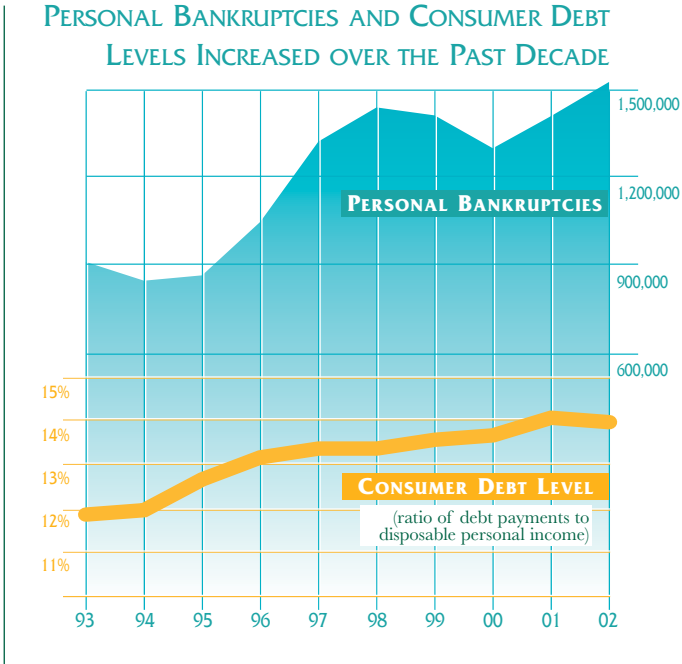
During 2002 a record number of personal bankruptcies added to the unsteady financial climate for consumers. According to data reported by the Administrative Office of the United States Courts, personal bankruptcies hit just over 1.5 million in 2002, a 6 percent increase over those recorded in 2001.

Lower personal saving may be another factor contributing to consumers’ financial vulnerability. The U.S. personal saving rate has edged markedly lower since the 1980s when it averaged 8 percent according to the Federal Reserve Board’s February 2003 *Monetary Policy Report*. In 2001 personal saving averaged 2.25 percent, rising to nearly 4 percent in 2002. Economists debate the saving measure because it doesn’t reflect capital gains and pension contributions, but they clearly recognize the importance of saving as the basis for accumulating assets and mitigating personal financial setbacks.

Viewed together, all of these factors point to the need for personal financial education to help consumers plan for unforeseen economic shocks that may leave them financially vulnerable.

The new financial services marketplace offers the potential to enhance personal welfare and expand financial opportunities for knowledgeable consumers. Within this new marketplace, there is one certainty—the pace of financial and technological innovation will continue to increase and grow more complex.

Sophisticated financial knowledge will be a prerequisite for consumers to take advantage of and keep pace with new financial opportunities. The challenge within this complex environment will be ensuring that everyone—regardless of their education, income, or age—has financial knowledge to benefit from these new opportunities.



Sources: Administrative Office of the United States Courts and Federal Reserve Board

### Federal Reserve Financial Education Programs

The San Francisco Reserve Bank and the other Reserve Banks around the country work with financial institutions, educational organizations, nonprofits, and public and private groups encouraging them to develop financial education resources and deliver programs. “Fostering these partnerships helps the Federal Reserve support its regulatory

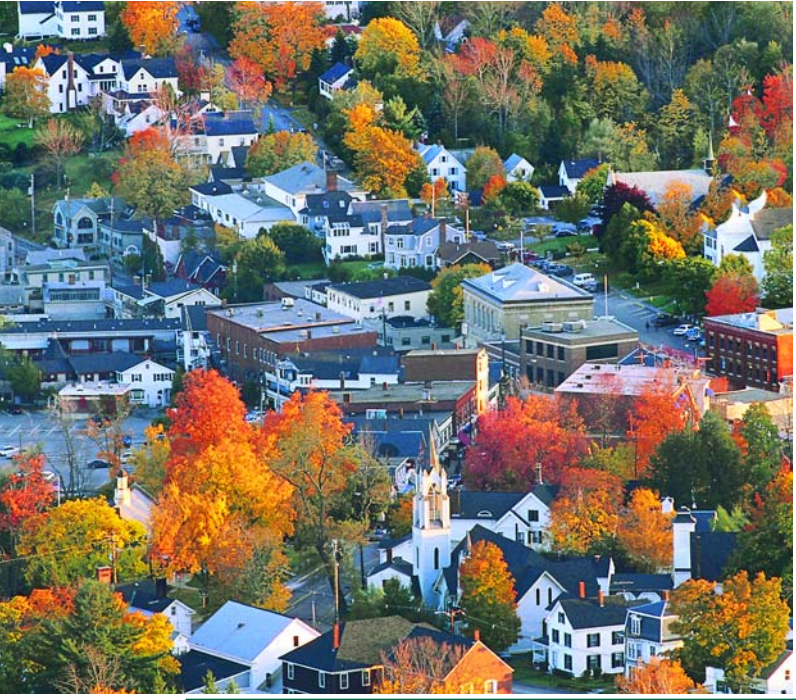
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responsibilities related to the Community Reinvestment Act, which requires banks to meet the credit needs of their local communities including low- and moderate-income neighborhoods,” says Joy Hoffmann, vice president of Community Affairs and Public Information. The San Francisco Reserve Bank’s involvement in personal financial education takes numerous forms. The Bank actively leads and influences change in its local communities to help develop asset-building opportunities, credit access, and banking services for underserved

consumers including immigrant markets. As a natural outgrowth of local efforts, the Bank has spearheaded a number of national programs, including the development of a national outreach strategy for Native American financial training.

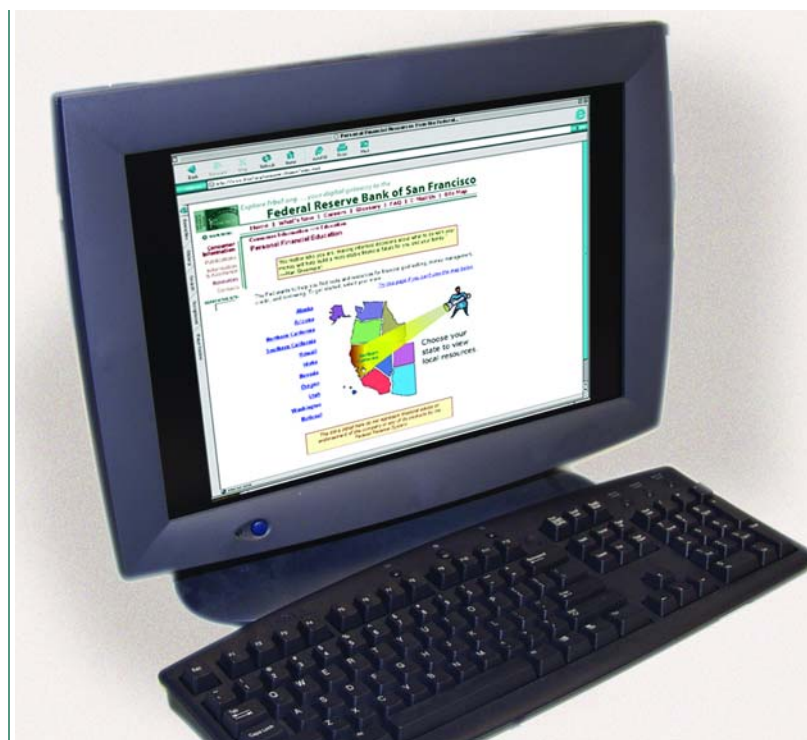
The Bank’s financial education outreach to educators involves sponsoring workshops and programs to bring financial education into the classroom. *Econ Ed and the Fed*, the Bank’s economic education newsletter, reaches approximately 16,000 teachers throughout the West, spotlighting financial education topics and resources.

During 2002 the Federal Reserve System took part in numerous efforts to increase the visibility of personal financial education as a critical policy issue. Federal Reserve Chairman Alan Greenspan provided testimony on the importance of improving financial literacy for consumers before the U.S. Senate Committee on Banking, Housing, and Urban Affairs during hearings on financial literacy and education in America. Partnering with the National Council on Economic Education, the Minneapolis Reserve Bank convened a national summit attended by policymakers, educators, and business and community leaders from around the country with the goal of creating a road map to raise the nation’s financial and economic literacy level through effective pre-college education.



In the first quarter of 2003 the Federal Reserve launched a national initiative that includes a public service announcement (PSA) and Web-based and printed resources to help consumers and Federal Reserve employees learn more about personal financial education. Federal Reserve Chairman Alan Greenspan is featured in the PSA, which debuted first for Federal Reserve employees. Reserve Banks around the country, including San Francisco, have augmented national materials with regional financial education resources and programs to help consumers and Federal Reserve employees in their local communities. The Federal Reserve Bank of San Francisco's Web site, [frbsf.org](http://frbsf.org), includes a section devoted to personal financial resources in the Twelfth District, along with online consumer resources covering credit and banking topics.

Moving forward, Hoffmann says encouraging research into what works in financial education will be an important focus for the Federal Reserve and the San Francisco Reserve Bank as will continuing active support of local initiatives. "Through our own research and partnerships with organizations working on the issue, we will be able to build upon existing programs, develop new ones, and make a difference with a wide range of audiences in need of financial education."



Visitors to the San Francisco Fed's financial education Web page click on a state in the Twelfth District to view local resources: [frbsf.org/consumer/finance/index.html](http://frbsf.org/consumer/finance/index.html)

The four programs profiled on the following pages demonstrate the Bank's commitment to financial education and illustrate common programs, their audiences, and goals. The programs include one aimed at Federal Reserve employees, one geared toward high school audiences, one focused on saving and homeownership opportunities in low- to moderate-income neighborhoods, and one promoting financial education for Native communities.

*The majority of company savings and retirement programs are employee-directed contribution plans. Employees must elect to participate in the plans, then independently manage and invest their funds among options offering varying degrees of risk. Employee-directed plans increase an employee's responsibility to become a knowledgeable investor as decisions can have lifetime consequences—especially for those who don't participate. A survey cited in the November 2002 Federal Reserve Bulletin article, "Financial Literacy: An Overview of Practice, Research and Policy," indicates that as many as 30 percent of eligible employees do not participate in their employer retirement plans despite benefits such as employer matching components offered by some companies. Recognizing employee education is an important focus for financial education efforts, the Federal Reserve turned its attention inward in 2002, bringing a new financial education program to employees.*

## Financial Education for Employees Federal Reserve System

**D**uring 2002 the Federal Reserve offered a retirement planning seminar for employees age 50 and older, the first in a series of personal financial planning

Parry is a strong supporter of financial education efforts within the System. From his vantage point as an economist and monetary policymaker, Parry says the Fed's renewed emphasis on employee education is particularly important in light of the complexities of the financial marketplace and responsibilities employees have to direct their financial futures.

When asked what messages he would convey to employees about the importance of financial education, Parry says, "the first is to start early in their careers at the Fed, take advantage of the Bank's 401(k) program, the financial education workshops, and get additional help if needed." He adds that there are many instances where a good understanding of financial matters is invaluable: buying items on credit, financing a mortgage, investing, budgeting. All of these decisions have a



Robert T. Parry

seminars the Fed intends to offer its employees. San Francisco Reserve Bank President Robert T. Parry attended the seminar to view firsthand the quality of the program.

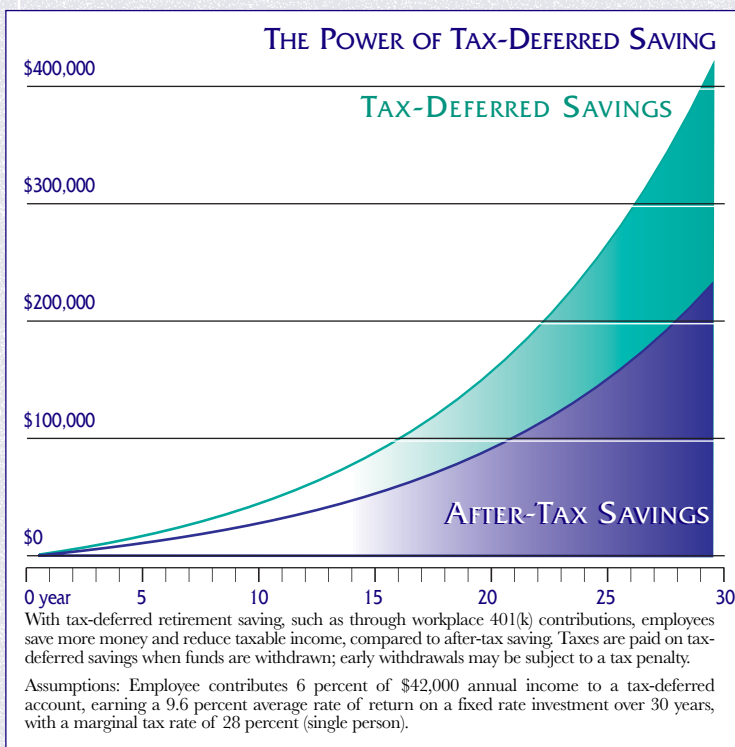
better chance of success when employees are financially educated says Parry. He emphasizes these are messages that apply to all consumers because the economy will continue to change and grow more complex. "This requires employees and consumers to make long-term commitments to learning about financial issues for their personal well-being." Parry says ultimately this personal commitment translates to national well-being and a more productive economy.

seminars with another valuable financial tool for Federal Reserve employees: a benefits Web site that helps employees plan for retirement and other financial goals. A frequently used feature of the site allows employees to input various financial and timeframe criteria for their retirement and other goals to model the financial implications of their choices. A quarterly personal finance newsletter for employees augments the Web site.

Based on the success of the initial seminar, the Federal Reserve is developing financial planning seminars for all employees to assist them in reaching their goals at various stages in their lives. "These programs are intended to help employees establish and achieve financial goals such as saving for a child's education, building an emergency fund, investing wisely, and retirement planning," says Todd Glissman, group vice president of District Human Resources. The seminars also will help employees understand tax implications, insurance options, and lifetime planning issues such as wills and trusts.

Glissman says the workplace is a logical venue for financial education. "Given that employees have more responsibility for planning their financial futures and have very busy lives, we believe it's important to make sure they have the information and tools necessary to make sound decisions."

Salt Lake City Branch employee Chris Matsen was another participant in the Fed's inaugural financial education seminar. Matsen joined the seminar via a Web conference. "I wanted to increase my knowledge of the benefits that will be available to me as a retiree." Matsen and other Federal Reserve employees supplement knowledge gained at the



Homeownership, savings, and small business ownership are the primary means for families to build wealth. Yet U.S. Treasury estimates indicate that approximately 35 million American households are without checking or savings accounts, the starting points for asset accumulation. During 2002 Senior Community Affairs Specialist Craig Nolte played an instrumental role in bringing Individual Development Account (IDA) savings programs to Utah and Idaho for the first time. "IDA programs financially empower and build wealth for individuals and families by providing them with often first-time opportunities to open savings accounts tied to financial goals," says Nolte. Nolte and Community Affairs Specialist John Olson held meetings in Utah and Idaho bringing lenders and nonprofits together to learn about the benefits of IDAs. Salt Lake Neighborhood Housing Services, a workshop attendee, is the first organization in Utah to offer IDAs.

## IDA Savings Programs

### Salt Lake Neighborhood Housing Services

In 2002 Salt Lake Neighborhood Housing Services (NHS) launched Utah's first Individual Development Account (IDA)

with a primary mission of revitalizing neighborhoods and creating affordable housing and homeownership opportunities for the community it serves in Salt Lake City, Utah. "IDAs are an important component of our asset-building strategy to promote economic independence for low- and moderate-income families and individuals in our community," says Maria Garcia, the nonprofit's executive director. "By fostering self-sufficiency, IDAs contribute to long-term financial solutions to empower these groups and revitalize our neighborhoods."

Like IDA programs around the country, Salt Lake NHS offers participants who meet enrollment criteria a matched-savings account to fund higher education, purchase a home, or establish a small business. Typically nonprofits such as Salt Lake NHS administer IDA programs with matching funds obtained through contributions, grants, or

Maria Garcia greets David Brown, president and CEO of First Utah Bank. First Utah and other financial institutions contributed resources to launch the IDA program.

program when four participants made initial deposits into their savings accounts at a local bank.

Established in 1977, Salt Lake NHS is a nonprofit, community-based organization



foundations. Local financial institutions provide the savings accounts. For the Salt Lake program, participants' monthly deposits of \$35 are matched at a four-to-one ratio for a year. Matched funds are withdrawn if participants do not meet their financial commitments.

Creating homeownership opportunities is a direct outcome of the IDA program and an important part of the Salt Lake NHS asset-building strategy according to Garciaz. "We set up the IDA program with homeownership in mind because of the tremendous potential for homeownership to build wealth and stability for families and neighborhoods."

Garciaz says financial education is an equally important component of the IDA program. Participants complete a Financial Fitness workshop covering issues such as credit, budgeting, and saving to qualify for the program. Attendees also learn how to cope with a financial emergency and how to make informed decisions to avoid becoming victims of predatory lending practices.

Once qualified, participants attend additional training related to their goals. Those saving for higher education must enroll in an eligible institution.

Potential homeowners participate in a homeownership-counseling program. Prospective small business owners must open their businesses within the nonprofit's



A participant in the Salt Lake NHS IDA program signs papers to open his savings account.

service area and must attend courses provided by a small business development center before opening their doors.

The first four participants in the Salt Lake NHS IDA program are saving with the goal of funding higher education. Illustrating the exponential benefits of IDA programs, one participant already is thinking about the next step, opening a small business in his local community.

One premise that underlies all financial education studies is the importance of beginning the learning process early in life. A 2001 report by the U.S. General Accounting Office supports this. According to that report, more than 33 percent of surveyed students had a credit card before they entered college; another 46 percent said they acquired a credit card in their freshman year of college. Used wisely, credit cards can help students establish good financial habits and a positive credit history. However, students who lack solid financial knowledge may make poor decisions that can take years to overcome.

During 2002 Lorraine Thayer, a public information specialist at the Portland Federal Reserve Branch, stepped into the classroom to teach the basics of financial education to teens participating in a series of workshops sponsored by Sabin Community Development Corporation. "Much of the program's success is due to relationship building, spending time with the teens," says Thayer. She adds that once they link financial education to their goals, the students are excited about learning more.

## Financial Education for Teens

### Sabin Community Development Corporation

**W**hen talking with Craig Fondren, economic empowerment manager at Sabin Community Development

programs. Founded in 1991, Sabin CDC is a community-based organization whose mission is to stabilize and improve the viability of the culturally diverse neighborhoods it serves in North/Northeast Portland, Oregon. Sabin CDC works to achieve its goals by creating affordable housing, homeownership, and business development opportunities for neighborhood residents. Recognizing that just providing a roof for a family is not enough, Sabin CDC's Executive Director Felicia Allender-Brant also has established venues to help teens, adults, and seniors in the nonprofit's neighborhoods build developmental life skills such as financial literacy and technology training. Partnerships with business, government, and community groups are integral to the success of the nonprofit's programs.

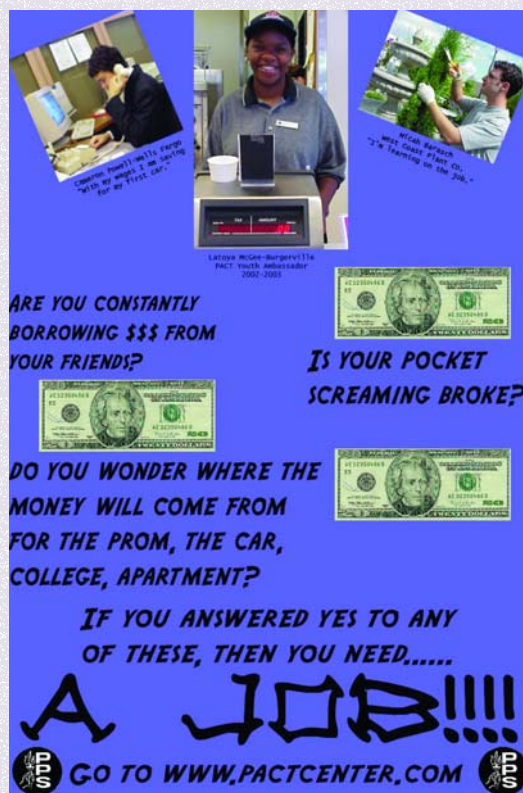


Sabin CDC teens prepare to shoot a video about financial education with help from mentors (left to right) Craig Fondren, Felicia Allender-Brant, Denise Boston, and Lorraine Thayer.

Corporation (CDC), it is clear that financial education is the common ingredient in all of the nonprofit's youth

When Sabin CDC rolled out its first financial education program for high school students in 2002, it brought in the “home” team in the form of Steve Kerr and other starting lineup members of the Portland Trailblazers to deliver the training. “The Trailblazers really helped get the kids involved when we launched the program,” says Fondren. Called the Game of Life, the training followed a game show format and used financial education curriculum developed by Federal Reserve Banks and Fannie Mae to reach 154 high school students. Students learned financial basics such as budgeting and saving. They also learned to distinguish between “needs” and “wants” and to create decision-making strategies to reach their financial goals.

Fondren notes that many students who completed the Game of Life also participate in Sabin’s Youth Tech Corps, which includes a financial education component like all of Sabin’s teen programs. Along with improving their own



technology skills to develop financial spreadsheets and research financial information on the Internet, the teens go into Sabin’s targeted neighborhoods during their third year in the program to teach adults similar computer and financial skills. Adults who have specific financial goals are provided with computers in their homes.

When asked about the results he sees from the teen programs, Fondren points to Cameron Powell and La Toya McGee, both the Game of Life graduates and Tech Corps members. Using skills learned at Sabin CDC and through a partnership with the Portland Public School’s Portland Area Training Center, the two created a financial literacy and job preparedness section for the center’s employment Web site for high school students. McGee also is the center’s 2002/2003 Youth Ambassador. Carrying their skills into the workplace, the two have opened savings accounts and are depositing one-third of their paychecks to save for future financial goals.

By almost any economic indicator, Native Americans lag far behind the rest of the population. According to 2000 Census data, 26 percent of Native Americans are impoverished—more than twice the national average. Only 30 percent of Native Americans on tribal lands are homeowners, compared to 67 percent of the national population.

As part of an ongoing effort to increase access to capital and credit for Native Americans, the San Francisco Reserve Bank's Community Affairs unit partnered with First Nations Development Institute to bring personal financial education to Indian communities in 2002. "First Nations needed assistance rolling out their curriculum developed especially for Native communities," says Senior Community Affairs Specialist Craig Nolte. Nolte, with the support of colleagues such as Community Affairs Specialist Lena Robinson, conceived and spearheaded a strategy to market and deliver eight "train the trainer" workshops to approximately 300 tribal representatives and community development organizations that work with tribes throughout the Twelfth Federal Reserve District.

### Building Native Communities:

## Financial Skills for Families

### First Nations Development Institute

**W**hen First Nations Development Institute looked toward developing a financial education curriculum to enhance

foundation. Established in 1980, First Nations is a nonprofit organization whose mission is to assist Native communities in controlling and leveraging their financial assets and in building their capacity to direct their economic future in ways that reflect tribal culture and goals. The ultimate goal is to build self-reliant communities. Through its subsidiary, Oweesta Corporation, and with funding provided by Fannie Mae, First Nations developed *Building Native Communities: Financial Skills for Families*, a culturally based curriculum designed to help Native people take control of their financial futures.

"There is an inextricable link between the vitality of the reservation economy and the well-being of individual members," says Elsie Meeks, executive director of



Barbara Holman and Craig Nolte lead a discussion among recent graduates of the Umatilla Tribe's financial education program.

the economic well-being of its Native communities, the nonprofit found its own ancestral history provided the best

Oweesta. Meeks says the *Building Native Communities* curriculum starts with the premise that self-reliance in Native communities begins with personal financial skills.

Tribes throughout North America and Hawaii have been practicing resource management skills for generations, ensuring the survival of their people.

Recognizing the wisdom and success of traditional resource management, *Building Native Communities*

draws from historical examples of saving, budgeting, and adapting new tools to benefit Native communities. Topics include developing and using a spending plan, managing money with checking and savings accounts, understanding credit and credit reports, and applying for a loan.

The Umatilla Tribe of Pendleton, Oregon, is one of numerous tribes seeing positive results from the training. Barbara Holman, the tribe's homeownership counselor, has trained more than 60 tribal members with the *Building Native Communities*

curriculum. Holman says the weekly two-hour classes are intentionally kept small—no more than ten—to allow ample time for attendees to have their specific issues addressed. She reports there already have been several positive results. Workshop

participants have been able to refinance auto loans from double- to single-digit interest rates, pay off debts and collections, dispute incorrect information on credit reports, increase credit scores up to 100 points within a

year, and establish savings for the first time. The Umatilla experience illustrates the tremendous potential for personal financial education to bring about behavior change, which is the first step to greater self-reliance for tribal members and their communities.

