Commentary on Financial Education Papers Delivered at The Federal Reserve System Research Conference

Stephen Brobeck, Executive Director, Consumer Federation of America

I appreciate the opportunity to participate in this important conference and to comment on the papers presented by Angela Lyons and Richard Todd. While the first paper focuses on consumer participation in the mainstream banking system and the second on consumer credit management, both assess the impact of financial education programs.

This general subject is an important one. In the area of financial services, consumer laws mainly require sellers to abstain from grossly unfair sales practices and to provide buyers with important product information. However, to obtain good value in their purchases, buyers must undertake product searches that use this and other information. The key role of financial education is to help consumers understand and effectively use available product information in these searches.

In the past several years, there has been increased emphasis placed on this education for several reasons. The financial services marketplace has grown more complex and dynamic. The increasing availability of credit, sometimes at a very high price, has resulted in millions of Americans taking on unsustainable debts. And financial services providers and policymakers who do not favor greater government intervention have argued that financial education is the preferred solution to growing consumer concerns and problems. These and other factors help explain why the financial services industry, and regulators, educators, and advocates have recently stressed the importance of this education.

Unfortunately, despite growing interest by researchers, which is heartening, we still know relatively little about effective financial education. Typically, in both schools and communities, this education emphasizes the communication of knowledge through classroom instruction, materials, and web sites. But researchers have not systematically studied the impact of this education on consumer skill levels and behavior. They have not compared the effectiveness of different financial education curricula. And they have rarely examined the effectiveness of more experiential learning provided by simulations or actual marketplace experiences.

It is in this context that I will comment on these two papers. The research by Lyons and Scherpf investigates the effect of financial education on the decision of individuals to participate in the mainstream banking system. The authors acknowledge the limits of their study: from a fairly small and probably self-selected sample to an exclusive focus on attitude — namely, perceived usefulness of the Money Smart program and declared intention to open a checking or saving account — rather than on behavior — actual decisions to open or not open such accounts.

If they continue their important and challenging research, the authors might consider several options for assessing skill levels and behavioral change. The simplest would be to ask, in the post-test, what participants specifically learned, or failed to learn, that would be useful to them in their purchase and use of checking or savings accounts. Did they learn, for example, about the importance of minimum balance requirements, the costs of bounced checks and overdraft loans, and payment alternatives to checking?

A second option would be, in both pre- and post-tests, to assess actual gains in problem-solving skills. One could ask, for example, what are the most cost-effective options for someone, with a certain personal and financial profile, to make payments or to save.

A third option, which could be combined with either of the first two, would be to study the impact of making available a checking or savings account as part of the financial education program. In America Saves, at the end of the motivational workshop, we have started to experiment with offering to sign participants up for a no- or low-balance savings account; we have a representative of a participating financial institution present as well. In IDA programs, participants are encouraged to agree to make deposits to savings accounts to which they have limited access. In programs such as these, researchers could study why participants chose to purchase or not purchase accounts.

The other suggestion I would make to the authors is that they consider differentiating key behavioral outcomes. They, like most researchers, consider opening a checking account to be functionally equivalent to opening a savings account. While they usefully discuss the potential risks and costs of checking, they should explicitly acknowledge that the costs of a savings account are far lower and the benefits are often much greater. It is hard to imagine a consumer who would not benefit from maintaining a savings account whose deposits could be used to pay for emergency expenditures. Certainly, those who did would seem to have less need for high-cost credit such as payday loans and RALs.

Largely because of the participation of major lenders, Gartner and Todd's research was more ambitious that that of Lyons and Scherpf. They were able to study the impact of financial education and counseling on the consumer credit usage and behavior of several samples of consumers. While it encountered various difficulties, this research did draw the important tentative conclusion that education and counseling are more effective when offered preventively, well before cardholders near delinquency. This is also the belief of several lenders with whom I've spoken.

My main comment on this paper has to do with the benefits and costs of collaboration with lenders. Let me begin by saying that my organization believes that researcher-lender partnerships can be extremely productive, and we have engaged in many, most recently with Visa on the financial status of young women, with Providian Financial on consumer knowledge of credit scores, and with Amex and Mike Staten on the effectiveness of financial education delivered by credit counseling agencies. Such partnerships frequently allow access not only to new, huge rich data sets but also to resources that cover the expense of thoroughly examining these data sets.

However, our experience with these partnerships has not been uniformly favorable. That is most likely the case when the corporate partner strongly desires a particular research outcome, especially if that outcome could influence a relevant debate about public policy. In these instances, the industry group might try to bias the selection of issues studied and the way these findings are reported. Of course, consumer groups may also strongly desire certain research outcomes. That is why a consumer-corporate partnership that uses an independent researcher may tend to minimize all biases.

We at CFA have tried to be flexible in considering the selection of issues studied, as long as those that remain have significance for consumers and would not have the potential to mislead — for example, a study of the benefits but not the costs of a financial services product, or research on the costs but not the benefits of financial services regulation. But we are never willing to compromise on the way findings are reported.

To the credit of Visa, Wells Fargo, U.S. Bank, and Target Financial Services — and, of course, the researchers — there was no evidence (I detected) of corporate bias in the research. While it did assess the impact on lenders as well as consumers, both subjects are of interest to many outside the industry. And the research seems to have been carried out rigorously with an unbiased reporting of findings.

My one suggestion to researchers in this area, especially those with a corporate partner, is to study the impact of a wide variety of financial services curricula and materials. It is particularly important not to rely exclusively on those produced by companies or their associations. Creditor curricula, for example, are unlikely to stress essential knowledge about credit cards: the most sensible way to use a credit card is as a charge card, try to pay off all balances in full each month and thereby avoid all charges. Or to avoid late charges, it is usually important to make your credit card payment within a week or 10 days after receiving your monthly statement. Or maintaining large balances on credit cards will lower your credit scores.

So, my one suggestion to both sets of researchers is to consider not only carefully evaluating the content of financial education curricula but also varying the content of these curricula and the way they are delivered, then testing the resulting differences. While not always easy, I believe that this approach offers great promise for improving the effectiveness of financial education programs.