Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

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Another Approach to Financial Literacy is Needed*

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The financial crisis demonstrates a need for a new approach to financial literacy. In the aftermath of the financial crisis, much attention has been devoted to the failure of some financial firms to employ sound risk management practices and the failure of regulators to step in and stop such practices. Less attention has been devoted to the fact that many consumers failed to appreciate the risks associated with some financial products, especially some mortgage instruments. Yet, the failure of consumers to appreciate those risks contributed to the depth of the financial crisis.

Financial literacy is addressed in the Dodd-Frank Wall Street Reform and Consumer Protection Act. However, the Act follows the same approach to financial literacy that preceded the crisis. The Act provides for the creation of an Office of Financial Education within the Bureau of Consumer Financial Protection. This Office is charged with “developing and implementing initiatives intended to educate and empower consumers to make better informed financial decisions” This Office will supplement the preexisting efforts of several Federal financial agencies (e.g., the FDIC’s Money Smart curriculum) as well as the activities of the federal Financial Literacy and Education Commission.

The creation of this Office is all well and good, but yet another publication, website, or voluntary curriculum will not make a difference in financial literacy. Such efforts did not succeed prior to the financial crisis and are unlikely to succeed going forward.

Three years ago, in testimony to the Financial Services Committee of the U.S. House of Representatives, I proposed a different approach. I recommended that the Federal Government and the states join in an effort to provide financial literacy training in the nation’s secondary school system. Such an approach to financial literacy would guarantee that every high

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school student receives training in financial literacy. It also would ensure that the training is provided in advance of when it must be put into practice.

A joint effort by the Federal Government and the states is needed because the challenges to the development and implementation of this approach are significant. While many states already have incorporated financial literacy as part of the high school curriculum, the existing state programs are not uniform, and a number of states have no such requirement. A uniform, national course of study must be developed. Teachers must be hired or retrained. The course of study would have to be incorporated into the existing schedule of classes. Funds would have to be found to cover all costs.

Funding this approach may be the least of the challenges. The most significant challenge may be fitting financial literacy into the existing high school curriculum. There are limited hours in a school day and the competition for course offerings already is intense. However, given the importance of the financial literacy to the general welfare of consumers and the economy as a whole, time should be found for this type of training.

As for covering the cost of this approach, Katie Wechsler, in our firm, has done a back of the envelop calculation based upon the amount the State of Virginia planned to spend on the development and implementation of a financial literacy program. That calculation came to around $5 billion in start up funding for a nation-wide program. On-going funding needs would be some percentage of this amount. Admittedly, this is not an insignificant amount, especially at a time when the federal budget is under increasing pressure. However, it is not an insurmountable sum, and some of the funding could come from reallocation of federal dollars already committed to financial literacy efforts. Additionally, it could be possible to have some of the costs covered voluntarily by the financial services industry. Banks, for example, could be given expanded credit under the Community Reinvestment Act if they provide financial support to the programs in the community or provide "adjunct faculty" to teach financial literacy classes.

In summary, traditional approaches to financial literacy have not worked. It is time to try a new approach. A uniform, national course of study in the nation's secondary schools is the better answer.

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