Remarks by Assistant Secretary for Financial Institutions Michael S. Barr

Financial Literacy Research Consortium
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New Insights and Advances in Financial Literacy:
Translation, Dissemination, Change

As Prepared for Delivery

Good afternoon, it is great to be here with all of you and to see so many familiar faces. Thank you to Annamaria Lusardi, the RAND Corporation and the Social Security Administration for inviting me to speak here today. I would like to commend the Social Security Administration for its leadership in establishing the Financial Literacy Research Consortium, which, based on research, will develop materials and programs to help enhance the financial capability of Americans at different stages of their lives. And thank you to all the people in this room who are working every day to expand our knowledge of financial literacy and exploring the implications for financial education efforts and public policy.

When President Obama came into office a little more than 18 months ago, our financial markets were frozen, our economy was shrinking, and we were facing the worst economic crisis our country has endured since Franklin Roosevelt came into office. Our nation was losing nearly 800,000 jobs a month. Small businesses were closing their doors. And home prices were in free fall. President Obama moved quickly. His actions stabilized the financial markets, reduced the widespread harm brought on by the failed policies of the past, and restarted economic growth. Had he not taken such decisive action undoubtedly the recession--as brutal as it has been--would have been far, far worse.

Although the economy is now showing signs of improvement, and many employers have begun to hire again, considerable challenges remain.

Through it all, we have remained focused on the urgent obligation to fix the failures in our financial system that helped trigger the recent economic crisis and the recession that has cost American families and small businesses so dearly. The passage of the Dodd-Frank Act[1] provides a strong foundation on which we must now carefully build a more stable system--a system that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial markets.

To be sure, the failures that lead to the 2008 crisis had many causes – some here in Washington, others on Wall Street and on Main Street. Regulators did not protect consumers to the full extent of their authorities, which led to unchecked predatory lending that trapped so many families. Firms and investors took on risks they did not fully understand. Legal loopholes and regulatory gaps allowed large parts of the financial industry to operate without oversight, transparency, or restraint. Many
Americans took on more debt than they could afford and many firms encouraged them to do just that.

For the 1 in 7 Americans who live in poverty, or the millions of Americans who live in constant fear of falling out of the middle class, these times have been particularly devastating. These families were the least prepared to handle the shock of the recession. They had little or no savings to fall back on; and stood one medical emergency, or one major unexpected car malfunction, away from a personal economic crisis.

When the music stopped in 2008, families found themselves overleveraged and underresourced. What we know, is that going forward American families will need to try to save a larger share of income and to borrow more responsibly.

Today, many Americans are rediscovering the importance of living within their means. They’re building assets by saving more and paying down debt. And they’re growing more careful about how they borrow and how they invest. These changes are necessary and healthy. And, ultimately, they will build economic security for American families and make our economy stronger and more resilient.

The Treasury Department has taken seriously our obligation to help bring new ideas, new models and new frameworks to bear on solving the intractable challenges faced daily by families who are trying to build enough savings to afford just a little peace of mind. We have begun several initiatives which, as part of the broader consumer protection reforms, will help families save for a more secure future. Savings strategies will not solve all the problems that weigh heavily on struggling families, but they will allow families to invest in their future by helping them save for retirement, save for an education, or save to buy a home.

One of the critical ways we can help promote economic security is by making consumer financial markets work better for America families. Thanks to researchers like you, we are learning more and more about the dynamics of these markets, including about financial literacy, individual psychology and behavior, and the role of financial firms as they react to individual capabilities and psychologies. As policymakers, we must draw on this growing body of empirical and theoretical work to design policies that improve outcomes for consumers. And as researchers we must continue to expand this repository.

**Using a Behavioral Framework**

The evidence on consumer fallibility and on how firms behave in light of this fallibility suggests a framework for understanding which types of mechanisms will work best in particular markets.[2] It is helpful to divide consumer financial markets into two buckets: those where firms are neutral towards or have incentives for overcoming consumer fallibility; and those where firms have incentives to exacerbate consumer biases.
For example, providers of bank accounts have incentives to help individuals overcome the behavioral barriers to savings. Lenders, on the other hand, may have incentives to exploit biases that lead consumers to over-borrow. And providers of all kinds have incentives to charge fees that are less salient for consumers or that take advantage of consumers’ errors in predicting their own future product usage—such as late fees, over-the-limit fees, and overdraft fees. The implications for policymaking in each of these two cases are different.

It is also helpful to think about potential market interventions as falling into two different categories: changing the "rules" of the game and changing the "scoring." Changing the rules means changing what market participants must do or are allowed to do; while changing the scoring means changing the incentives—costs or benefits—of market participants to adopt one consumer practice over another.

Interventions that change the rules and change the scoring can be useful in both types of market contexts—where firm incentives are to overcome consumer fallibility and where those incentives are to exploit such fallibility. However, the two scenarios may require different approaches. In the scenario where firms are neutral to or have incentives to overcome consumer biases, rule-changing may be highly effective on its own. The success in promoting retirement savings through the use of smart defaults is a well-known example. In this case, employers were at worst indifferent to and at best inclined to increase employee participation in defined-contribution plans.

In cases where firms have incentives to exacerbate biases, changing the rules may not be enough. In these cases firms will have incentives to work around the rules and render them less effective. For example, firms may comply with the letter of disclosure laws, but act to undermine them by discouraging consumers from focusing on and understanding their content. In such cases, it may be necessary to change the way the game is scored to make a real difference for consumers.

This behavioral framework has profound implications as we think about how best to promote financial access and consumer protection. Defaults in the defined-contribution plan world serve as a prominent example of how behaviorally-informed innovation can have a significant impact on the lives of everyday Americans. But there is a need for a lot more innovation that is informed by the interplay of consumer psychologies and firm incentives in market-specific contexts.

**A Three-Legged Stool**

There are three primary ways to improve consumer financial outcomes for American families: first, enhancing individuals' financial literacy and capabilities; second, promoting access to financial products that meet consumers' needs; and third, establishing strong protections for consumers. Basic financial literacy is the necessary foundation for informed consumer decision-making. But to be effective, financial literacy must be combined with improved access to suitable financial products and strong consumer protections.
And, importantly, efforts in all three areas must be driven by well-considered evidence on how consumers and firms behave in the real world.

**Financial Literacy**

This Administration is committed to promoting strong, evidence-based financial literacy efforts that help level the playing field for consumers and promote better consumer decision-making. The Treasury Department, in conjunction with the Financial Literacy and Education Commission, is currently working on two initiatives related to financial capability. First, the development and implementation of a National Strategy for Financial Literacy. And second, the dissemination of widely agreed-to core financial competencies.

The Strategy, which was created through a process that included conversations with a broad range of stakeholders, will set strategic direction for policy, education, practice, research, and coordination in the financial literacy and education field in the U.S.

The development of core competencies, which is another goal of the Strategy, is particularly important in establishing a baseline for financial literacy. This is crucial for both individuals and providers of financial education. Establishing a baseline by which program success is measured, will help address the current lack of consistency in financial literacy programs. We are hoping to make these core competencies user-friendly and accessible to the public.

We will also be working closely with the President’s Advisory Council on Financial Capability. The President appointed a highly qualified group of men and women from the private and non-profit sectors to advise us on how to maximize the effectiveness of existing private and public sector efforts and identify new approaches to increase financial capability.

In addition to promoting financial literacy, it is also critical to expand financial access and establish strong consumer protection. In particular, I want to talk about how behavioral insights can help inform efforts in these two areas. Research—including by many individuals in this room—has shown that consumers have predictable psychological and behavioral biases that may lead them to make sub-optimal financial decisions. Financial firms can, and regularly do, identify and exploit these biases—sometimes in ways that help consumers—but too often in ways that harm them. The persistence of consumer biases and of firm usage of these mistakes creates the need for mechanisms to de-bias consumer markets.

**Financial Access**

One area where more innovation is sorely needed is in expanding access to financial services that meet the needs of low-and-moderate-income Americans. A growing body of research has revealed that the financial access gap in our country is sizeable. The FDIC has estimated that 9 million American households are unbanked and another 21
million are underbanked, meaning they have a checking or savings account but are not well-served by these accounts and rely on costly alternative financial services, such as check-cashing and money orders, to meet their financial needs. [3]

One challenge we face in expanding financial access for low-and-moderate-income Americans is promoting savings and the use of low-cost electronic payment mechanisms, such as debit cards. Defaults--changing the "rules"--may help in this context because the providers of savings and transaction accounts have incentives to alleviate consumer biases, for example, with respect to procrastination, to gather deposits. However, defaults maybe less effective on their own in this market as they are in the retirement context. The reason is that the cost to serve individuals with very small balances can discourage firms from serving low-and-moderate income populations.

In this context, a combination approach is needed. It may be necessary to change the "scoring" as well as the rules, such as by designing creative solutions that help firms serve these populations with sustainable product economics.

Treasury is taking an innovative approach to direct federal benefits payments that relates to the insights I've been discussing. Treasury is responsible for making ongoing payments to 70 million individuals for direct federal benefits, including Social Security, Supplemental Security Income, and Veterans, Railroad Retirement, and Office of Personnel Management benefits. Fifteen percent of these individuals still receive their benefits by paper check.

Individuals who have accounts can use Direct Deposit. Individuals who are unbanked, or who prefer not to use Direct Deposit, receive payments on the "Direct Express" card. Direct Express is a debit-card account platform offered by a bank according to requirements established by Treasury. There are currently 1.4 million federal benefits recipients who have opted into receiving benefits on Direct Express, which was launched in 2008. Customers report 95% satisfaction with the card's features.

When benefits recipients use Direct Deposit or the Direct Express card to receive their benefits, they enjoy the advantages of electronic payments, including enhanced safety, convenience, and control. In addition, those who might otherwise cash their benefits checks now have a more convenient way to save. They can also avoid alternative financial services fees that can take a toll on their benefits amounts, such as check-cashing.

Direct Express is an example of how government can help make serving low-and-moderate income customers more sustainable for providers. In this case the government is bundling many customers' accounts together, allowing for a more favorable scale of operations for the provider.

Treasury is simultaneously undertaking other efforts to improve the electronic delivery of federal benefits payments. For example, Treasury is establishing rules that better protect federal benefits payments from bank account garnishment. And Treasury is
enhancing requirements on the types of accounts that are eligible to receive benefits payments, including prohibiting benefits from being deposited into accounts set up for payday loan-type arrangements.

This tax season Treasury will be piloting an initiative to improve tax administration by offering selected low-and-moderate income households an opportunity to receive their tax refund on a debit card.

Electronic benefits payments are part of a broader set of efforts by Treasury to promote financial access. One major element of these efforts is an initiative called "Bank on USA." The President requested $50 million dollars in the FY 2011 budget to launch a national initiative built on the local "Bank On" movement, made up of local coalitions dedicated to promoting access to mainstream financial products. Our goal is to support and enhance these local efforts as well as to promote innovations that will expand access to appropriate, affordable products that better meet consumers' needs.

**Consumer Protection**

So we need to educate consumers. And we need to improve access. Now we also need consumer protection. In an environment of weak and ineffective regulation, the tendency of some consumer financial markets to end up in "races to the bottom"--as we saw in the housing market--are not likely to be overcome solely by consumer education and access.

The CARD Act[4], which President Obama championed and signed into law in May 2009, is an example of regulation written for a market and product in which the provider has a strong incentive to usher consumers to suboptimal choices--to rack-up lots of late fees and to make only the minimum payment each month. Last year, nearly 80 percent of American families had a credit card, and 44 percent of families carried a balance on their cards. Americans were paying roughly $15 billion, annually, in penalty fees.

The CARD Act was well crafted legislation that combined a requirement of common sense disclosures with protections from practices designed to make use of consumer fallibility for the benefit of the credit card issuer and the detriment of the consumer.

For example, the Act banned unfair rate increases, including rate increases on existing balances due to "universal default" clauses, and severely restricted retroactive rate increases due to late payment. It banned unfair fee traps, including weekend due dates, or due dates that change each month, or payment deadlines in the middle of the day. And it ended the confusing and unfair practice of so called "double cycle" billing.

The CARD Act also used a de-biasing approach, by requiring *minimum balance warnings* that help to inform consumers of the consequences of their actions by displaying how long it would take to pay off an existing balance, if the consumer paid only the minimum payment each period; and the amount the consumer would need to pay each period to pay off the balance in 36 months. Credit card issuers know that the
impact of compound interest on credit balances is not necessarily intuitive to most consumers. The consumer may even, incorrectly, assume that the credit card issuer has a strong interest in the consumer paying down the balance sooner rather than later and therefore has set the minimum payment to an amount in line with that objective.

So imagine the shock that a consumer has when he or she learns that paying a minimum payment of $150 each month on a $7,000 credit card balance would take 22 years to pay off in full. Or the relief of learning--on that same page--that an extra $60 payment each month would reduce the time it took to pay off that balance from 22 years to 3 years and save more than $5,000 in interest payments along the way. That's meaningful disclosure. That's disclosure that empowers families to make choices that are right for them. And that's what we need to do wherever we can for consumer financial products.

The creation of the Consumer Financial Protection Bureau has provided a historic opportunity to build a successful regulatory structure for consumer protection; one that is designed to promote financial inclusion, preserve consumer choice, and provide for more efficient and innovative markets for consumer financial products--markets that operate on the competitive basis of price and quality, rather than hidden fees.

Before Dodd-Frank, our system was largely incapable of supporting a successful regulatory structure for consumer protection. Fragmentation of rule writing, supervision, and enforcement made it impossible to create a comprehensive and well calibrated consumer regulatory regime. Jurisdiction and authority for consumer protection was spread over many federal regulators, which had higher priorities than protecting consumers. Banks could choose the least restrictive supervisor among several different banking agencies. And a large number of non-bank providers escaped any meaningful supervision completely.

The CFPB will provide, for the first time, a consumer agency with necessary mission focus, market-wide coverage, and consolidated authority. It will be an agency that focuses not simply on more regulation, but smarter, more coherent and more effective regulation. Regulation that is designed and implemented with an understanding--and respect--of classical models, but is not blind to the compelling insights into consumer decisions derived from behavioral economics. Regulation that seeks to balance a consumer's ability to find the most suitable financial products from among many seemingly indistinguishable choices, on the one hand, and a product provider's incentives to hide that most suitable choice, on the other hand.

I have to admit, that what I find most curious about the voices of opposition to the CFPB--an agency, I remind you, whose primary principles are transparency, fairness and access--is that their logic rests on the premise that empowering consumers is somehow antithetical to free markets. They appear to be stuck in a debate that presumes that regulation and efficient and innovative markets are at odds. In fact, the opposite is true. Markets rely on good faith and on trust and fair dealing. Markets require transparency that reflects economic reality rather than distortions caused by
misleading sales pitches and hidden traps. And discipline of the market requires clear
rules.

At the Treasury Department, we have been working hard on the creation of this new
bureau. We are determining how to consolidate core authorities that are currently
spread across several agencies. We are working to ensure fairness and transparency
for mortgages, credit cards, and other consumer financial services. We are taking a
hard look at large nonbank providers of consumer financial services, such as credit
bureaus and debt collectors. We are planning for the provision of consumer assistance
and education nationwide, including literacy programs, online resources, and a
consumer complaints hotline. We are working to establish the offices that will focus on
protecting military families and seniors that will exist within the CFPB. In sum, we are
launching the Consumer Financial Protection Bureau to empower American families.

**Conclusion**

We appreciate the work that so many of you are doing to improve financial literacy and
financial capability. Together, we can prevent another crisis and rebuild our economy
on a stronger, more balanced foundation.

Thank you again for the opportunity to speak with you today. You are all amazing and
we look forward to working together with you to build a stronger America. An America
where working hard and playing by the rules means security for our families and hope
for our future. Where firms compete based on price and quality, not tricks and traps.
Where old fashioned values of thrift are rewarded. And where once again America
leads the world. Thank you very much.

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Informed Regulation*, in New Perspectives on Regulation 27-63 (David Moss & John
Cisternino eds., 2009).
