Remarks by
FDIC Chairman Sheila C. Bair
to the
Operation HOPE Financial Forum
Financial Literacy in the Backdrop
of the
Global Economic Crisis
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I am honored to be here today for Operation Hope's public forum. This is Financial Literacy Month, and I can think of no better way to mark it.

This has been a season of challenges for the banking industry and our economy. It has also been a season of challenges for consumers as they cope with protecting their money, hanging on to their homes, and trying to decide what to do next with their hard-earned cash. Financial literacy is vital in meeting those challenges. As President Obama has said: "... education is no longer just a pathway to success. It's a prerequisite to success." That could not be more true for a financial education, made all the more urgent by the economic challenges we face today.

Consumer Protection

There were many factors that led to the economic crisis. We had a financial system that was dependent on huge short-term gains from using complex loans that were packaged together and resold as securities to investors. Many of the underlying loans had irrational features that led to the wide scale foreclosures that we're seeing today. Consumers across the country were often misled and steered into these mortgages that they never should have been offered.

Many lenders made these loans without documenting income to make sure that the borrower could afford to make the payments over the life of the mortgage. They offered low, introductory "teaser rates" to entice consumers. After two or three years into the loan, the rates would jump, sometimes doubling or tripling monthly payments, making them unaffordable to many homeowners. Making matters worse, there often were prepayment penalties if a consumer wanted to refinance out of a bad loan.

Part of the problem is that there have been so many new financial products and services to choose from. Consumers generally benefit from having lots of choices. But when it comes to complex financial products, especially those that sound "too good to be true," a wrong decision can be very costly, with serious consequences. And it can take months or years to recover from these consequences. Many consumers did not understand the consequences of their subprime and nontraditional mortgages, and they are now paying a high price as foreclosures mount.

Many of the worst lending practices were initiated outside the banking sector, in essentially unregulated markets. This opened the door for rampant fraud and targeting of low income and minority communities. When standards are not uniform, and consumers are not well informed, there will always be a race to the bottom. There are no winners in this kind of race. Consumer protections are a fundamental part of our regulatory infrastructure. The market cannot function efficiently without them. We need strong rules that apply – and that are enforced – across the board for banks and nonbanks alike.

Saving more, spending less

This crisis is the culmination of a decades-long process where national policies have skewed economic activity away from savings and toward consumption, away from investment in our industrial base and public infrastructure and toward housing, and away from the real sectors of our economy and toward the financial sector.

We as a society need to examine both public and private policies and practices from a long-term view and ask whether they create the incentives that will lead to a sustainable, higher standard of living. For example, what role did relatively easy access to revolving debt for many consumers play in encouraging spending over saving?

Properly balancing income and expenses, and saving money is good for the economy. As demonstrated recently, it harms the entire economy – not just the individual consumer – when people spend beyond their means financed by debt that they cannot afford to repay. For working families, a savings cushion to fall back on might be the only thing that keeps them from bouncing a check, or turning to a payday lender for help. The more we can encourage people to save, the better off they'll be.

Stepping back more broadly, our financial system also has opportunities to become more financially inclusive. Having a bank account is an absolutely essential first step for the underserved to build savings for the future. After all, there is no safer place in the world to save money than a federally insured bank.

Unfortunately, according to our recent landmark study, more than one-in-four American households – or some 60 million adults - are underserved. We also learned that certain racial and ethnic groups are more likely to be underserved than the population as a whole. For example, here in the Atlanta Metropolitan area, nearly one-in-four of all households are underserved. But for Black and Hispanic households, one-in-two households are underserved. We need to change that. We've got to turn those numbers around.

Overdraft protection

One way we can do it is by expanding access to "safe accounts." By that I mean accounts that are federally-insured, affordable, easy to understand and free of hidden or unfair fees. We all know how high-cost alternative financial services can prevent underserved consumers from building wealth and savings. But we also need to make sure that people who use mainstream banking services can do so effectively.

For example, the total number of consumer complaints about overdraft programs has nearly doubled. Repeat overdraft users are of particular concern. Our 2008 survey of overdraft programs showed that customers with over 10 NSF transactions in a year accounted for a whopping 84 percent of the reported fees. This indicates that many of these customers aren't simply covering inadvertent overdrafts, but are borrowing to cover cash shortfalls ... and may be lacking a basic financial education.

We want to focus renewed attention on the 2005 Joint Guidance on Overdraft Protection Programs and the Federal Reserve Board's November 2009 amendments to Regulation E. Banks have an obligation to monitor for excessive usage of overdraft protection. The 2005 Joint Guidance explicitly states that as a best practice, institutions should: "Monitor excessive usage, which may indicate a need for alternative credit arrangements or other services, and inform consumers of these options."

When they see this pattern, banks should contact their customers and advise them of lower-cost alternatives to deal with short-term credit needs ... including linked-deposit accounts and small-dollar loans. Our bank examiners will be verifying compliance to ensure that customers are not relying on overdrafts as a form of short-term, high-cost credit. Small-dollar loans are a good alternative to help consumers deal with short-term cash needs. And Main Street bankers who offer small-dollar loans can also make a profit.

Core financial education

I've made it a priority at the FDIC to bring more consumers into the mainstream financial system, and to protect them from unfair or deceptive practices. I believe that government regulation and enforcement play an equally important role with education. You need both – education and regulation – to build and maintain consumer confidence in our banking system. Ultimately, an educated consumer is our first line of defense. Because at the end of the day, it is the consumer who signs on the dotted line.

A consumer who knows the right questions to ask ... who understands economic fundamentals ... who has the confidence to challenge questionable products and practices ... is a regulator's ally in consumer protection. This is where you come in as financial educators.

As much as any bank regulator you can help prevent adults and young people from falling prey to costly overdraft fees, to unaffordable mortgages that can lead to financial ruin, or even to fraudsters. It's essential that people of all ages, and of all income levels, and from all walks of life learn to make informed and prudent financial decisions. Financial literacy is very effective in changing behavior.

As many of you know, the FDIC launched the Money Smart initiative in 2001. Since then, well over 2 million people have taken Money Smart. It's now available in seven languages. And versions are available for adults and young people, and for people to use on a computer or portable audio player. We now have more than 1,600 partnerships with national organizations, including Operation Hope, to use Money Smart.

Getting smart about money has measurable effects. We hired the Gallup polling organization to measure the impact of our Money Smart program on consumer behavior. We found that a majority of people who took Money Smart began to save more, had a better understanding of financial principles, and were more willing to comparison shop for financial services. What's more, up to a year after the training, consumers were still on track with good saving and spending habits.

Avoiding another crisis

This is a critical time for the American economy, and more and more people are going back to the basics, and learning why sound financial skills are so important. Many are taking action by saving more. And they're spending more wisely. More and more people – both young and old – are paying better attention to economic and financial matters. They want to know more. And all of us in this room have a critical role in helping them.

Let me now offer five ways that financial education can help us avoid another financial crisis.

First, financial education is a tool that empowers consumers. So it's essential that all consumers have access to safe accounts and services that are well-structured, easy to understand, and competitively priced. I know we can count on Operation Hope because your Hope Centers combine education with opportunities for consumers to manage their money.

Second, I hope we see people rediscovering the peace of mind of financial security that comes from: thinking before spending, using credit products wisely, and saving for a rainy day. I think we're already seeing a culture shift in this direction. Now we must make it a permanent shift.

Third, we need to think about what a "good financial education means." Just as we have standards of learning for reading, math and other skills, why can't we have a baseline for financial knowledge and skills?

Fourth, we cannot assume that a single lesson or one high school class will empower students to confront every challenge they will face in life. To be the most effective, lessons on money should be taught and reinforced in every grade, and incorporated into math, reading, and other core classes.

Finally, our "Financial-Ed" teachers must have a solid foundation in personal finance. Financial education is no different than any other academic subject. You have to master the fundamentals before you can teach others.

Conclusion

All of you are in the front lines, day-after-day. And all of you have a personal responsibility, whether you are a regulator, a banker, a financial educator or a community leader. Each one of you has the power to change the financial landscape, one consumer at a time. You can help people achieve a healthy balance between spending and saving. You can help people make prudent decisions and help them achieve their goals: paying their bills without borrowing, saving for an education, or buying a new car or the home of their dreams.

I believe very strongly that if we can arm consumers with enough knowledge about the benefits of long-term saving, if we can get them thinking and planning before spending, if we can get them looking to the future and working toward their personal goals, then we can create a better world for ourselves and for our children and grandchildren for generations to come.

Thank you very much.

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