

Remarks by Vice Chairman Roger W. Ferguson, Jr.
Before the Pittsburgh Community Reinvestment Group, Pittsburgh, Pennsylvania
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Financial Education: The Next Chapter in Community Development

Thank you for inviting me to participate in your annual celebration of the innovative partnerships that are contributing to the economic revitalization of Pittsburgh's lower-income neighborhoods. These collaborations, like others before them, place Pittsburgh in the forefront of community development and will serve as models for others who tackle the challenge of creating opportunities in their neighborhoods. In rebuilding your communities, you are leading by example and contributing to the revitalization of other neighborhoods in need, much as the Neighborhood Housing Services of Pittsburgh has done in pioneering a concept three decades ago that became the model for community-based housing initiatives throughout the country.

Similarly, the PCRG, serving as a local umbrella organization for its twenty-seven members, offers community development groups an example of how coordination among organizations with complementary objectives is an effective means for accomplishing the global mission of an industry while achieving the specific goals of individual groups. As a conduit between community groups, local governments, and financial institutions, the PCRG has helped facilitate the development of mutually beneficial business relationships among its partners by providing a forum for bringing community developers and lenders together to creatively fund projects that may otherwise not have been considered financially viable. Through these strategic alliances, more than \$4 billion has been reinvested in Pittsburgh's inner-city neighborhoods during the past twelve years, and more than \$40 million in community development loans have been sold in the secondary mortgage market, increasing local lenders' capacity to extend more credit. More specifically, as an affiliate of the National Training and Information Center, the PCRG assisted Fannie Mae, lenders, and community groups in four other cities to design and implement the Low Down Payment Home Mortgage, a \$50 million underwriting experiment designed to increase access to mortgage loans for low-income borrowers. Another aspect of this collaboration was a commitment by Fannie Mae to purchase or securitize \$100 million in seasoned loans originated by partnering financial institutions. Locally, the PCRG led this alliance of lenders, community groups, and the secondary market in the development of a loan product that offers eligible homebuyers a mortgage loan with flexible underwriting criteria and homebuyer education. In the Pittsburgh area, this partnership has resulted in the origination of \$1 million of new mortgage loans and the sale of \$54 million of seasoned, CRA-qualified mortgage loans on the secondary market in the past three years. Furthermore, just as Pittsburgh has benefited from its effective partnerships between nonprofit development groups and the banking community, this strategic approach to creating a product to respond to the credit needs of lower-income households has been successful in all five of the pilot cities, with Fannie Mae investing a total of \$1.5 billion in loans through this program--ten times its original goal of \$150 million for the project.

The Federal Reserve's Interest

Strategic collaborations to innovate products and services that increase access to credit are of great interest to the Federal Reserve, from our perspectives as both economists and bank regulators. As economists, our principal purpose is to conduct monetary policy to contribute as best we can to foster the fastest economic growth sustainable over time and the highest possible standard of living for all Americans. In our role as banking regulators, we strive to craft and enforce regulations designed to ensure safety and soundness while also promoting equality in the delivery of credit through the banking system. Each of these functions is distinct in its role in supporting this robust economy, the longest uninterrupted economic expansion in this country's history.

However, while we intend for our policies and regulations to enable all markets, these are blunt tools that cannot be calibrated to exempt a particular segment of our economy. We realize that there are areas of market inefficiencies and that some communities remain distressed despite the growth and development occurring around them. For a myriad of reasons, the challenges confronting these neighborhoods require strategies that are more precise in their execution, such as the initiatives being highlighted today. Your programs illustrate how unique and localized partnerships can help ensure that low-income communities also benefit from good economic conditions and become vibrant markets that offer safe, decent, and affordable housing, as well as small business development and employment opportunities, for their residents.

The Role of Community Developers

Throughout the past three decades, community developers have been dedicated to, and have been quite successful at, the physical revitalization of neighborhoods by rehabilitating homes, redeveloping brownfields, and constructing commercial properties. And rightly so, as the character of these bricks-and-mortar structures define the identity of neighborhoods and stimulate civic pride and investment. These homes and businesses embody the hard-won campaigns that have been waged by community developers to resurrect distressed communities. Now, to preserve these gains, we must fortify the strength of the physical infrastructure of these communities with the development of their intellectual infrastructure by improving the financial acumen of the families who live there. As community developers and lenders, you have worked diligently with your constituencies to coach them on how to improve their credit histories, reduce debt, and create household budgets in order to qualify for a mortgage. In conjunction with your partnering institutions, you have leveraged funding resources in order to provide affordable mortgages, knowing that home ownership is the key to stable neighborhoods. In creating homeowners, you also established new consumers of mortgage loans, the most important credit instrument in the financial services industry, and made investors of these families as they began to build equity in their homes. You have helped these families to begin the process of asset accumulation through home ownership. Now they must become knowledgeable in managing and preserving their investment by obtaining and using the financial tools that can improve their economic future.

One strategy that has been employed in recent years to provide a foundation for asset accumulation among low-income households is the Individual Development Account (IDA). This vehicle, with its funds-matching and educational components, provides families with a framework for the cumulative benefit that saving provides because withdrawals from these accounts can be applied only to long-term capital investments, such as purchasing a home, starting a business, or continuing education. By structuring the program to require the owner to make regular deposits as a condition of receiving matched funds from the sponsoring

organization, IDAs create a mechanism that motivates and rewards wealth building, thereby instilling commitment to the program and to saving. While academics are currently studying empirical data to determine the efficacy of IDAs, anecdotal information indicates, in a very compelling way, that this is a very successful model. Here in Pittsburgh, one of the PCRG's community partners, Garfield Jubilee Association, reports that of the 118 IDAs that it has opened in the past two years, four have become home owners, including one person who had been homeless for five years. These are people who did not believe that they had enough resources to live, let alone to save. They are now building new lives and setting concrete goals for their future. Another important benefit of IDAs is that they often serve as the first step for very low-income individuals in establishing a banking relationship and engaging in deliberate financial planning.

Insight into Consumers' Financial Relationships

The Federal Reserve has gained a better understanding of the issues related to family financial management through its Survey of Consumer Finances, a study of 4,500 households that is undertaken every three years. From our most recent survey, conducted in 1998, we learned that approximately 13.5 percent of all families surveyed do not maintain a transaction account with traditional financial institutions, with nearly 83 percent of these households reporting annual incomes of less than \$25,000. When asked why they did not maintain a checking account, 28.4 percent stated that they "do not write enough checks to make it worthwhile." Another 18.5 percent of the survey respondents in this group indicated that they "do not like dealing with banks", and 7 percent replied that they "cannot manage or balance a checking account." Also noteworthy is that only 1 percent indicated that banking locations or hours of operation deterred them from maintaining a banking relationship.

Given this information, the Federal Reserve has conducted additional research to help us better understand how lower-income households use credit and savings products and to estimate the potential demand for these services. Through this study, we found that lower-income consumers rely on alternative financial service providers, such as check cashers and pawn brokers to conduct personal financial business, such as cashing checks, paying bills, and obtaining credit. This report cited studies indicating that check cashers charge four to six times more for their services than banks and that consumers relying on these facilities spend approximately \$500 annually to obtain services that would cost roughly \$60 a year at a bank. This research also noted surveys indicating that consumers who use alternate sources for credit are paying exorbitant interest rates and fees, citing evidence that loans from pawn shops are typically fifteen times more expensive than credit from banks. These data demonstrate how lower-income families are unnecessarily losing a substantial amount of money in conducting basic financial transactions, thereby reducing their capacity to save and ability to weather any financial shock, such as the loss of a job or a long-term illness of a family member. For these families, financial literacy could improve their ability to reduce expenses for financial services and increase savings capacity. The need for financial education is further evidenced by the fact that personal debt and bankruptcy rates are high, saving is at its lowest level in seventy years, and the existence of abusive lending tactics is undermining the work that has been done to bring economic promise to disadvantaged families and neighborhoods.

The Fed's Efforts in Community Development and Financial Literacy

In addition to our concern with the economic well-being of families, the Fed is also distressed by the practices of abusive, and in some cases fraudulent, creditors that prey on vulnerable homeowners. Throughout the summer, the Federal Reserve conducted a series of public meetings across the country to learn more about the issues surrounding predatory

lending. We are currently analyzing the information provided at these meetings and other data to determine how we can revise our regulations to help monitor and enforce mortgage lending so that it is beneficial to homeowners and the economy. In addition to suggesting actions that the Fed could take to contribute to the resolution of this issue, community groups at each of the meetings were consistent in acknowledging their role in providing comprehensive consumer education on fundamental banking services to help stem the economic devastation that families and communities experience when they become the victims of predatory lenders or make poor choices in the use of credit. Through their local partnerships and networks, neighborhood organizations are best positioned to expand on these lessons to teach the members of their communities how to identify and use appropriate financial instruments to the betterment of their financial future.

In this time of constant change and greater options in the products, delivery mechanisms, and providers in the financial services industry, the need for concentrated efforts to increase financial literacy is greater than ever. This challenge requires a coordinated response among the private and public-sector organizations that are committed to this mission. The Federal Reserve is engaged in several activities to contribute to the body of knowledge and resources on this issue. Besides collecting and analyzing data on small businesses and consumers, the Federal Reserve is actively involved with the National Partners for Financial Empowerment (NPFE). This nonpartisan coalition, launched by Treasury Secretary Lawrence Summers in April 2000, is a public-private partnership that seeks to promote the development of personal financial skills. To raise public awareness of the critical importance of financial literacy and to reinforce the many creative initiatives to promote financial literacy already under way, the NPFE is engaging in a major campaign that will reach across the nation with the help of national and local leaders from the public and private sectors. Working with the NPFE, the Federal Reserve will seek to play a role in educating people on how to make informed choices for common financial transactions, including home mortgages, consumer credit, and basic banking services. In addition, the Federal Reserve Bank of Cleveland is actively engaged in "Cleveland Saves," a pilot program for a national campaign to encourage savings, particularly among lower-income populations. With respect to predatory lending, we are actively participating on a task force with our colleagues at the other banking agencies to explore strategies to curb unscrupulous lending practices and identify appropriate public information resources. The Federal Reserve also has a significant track record in sponsoring programs to encourage community economic development in low- and moderate-income areas. Through our Community Affairs programs at each of the twelve Federal Reserve Banks, we conduct ongoing outreach and educational activities and give hands-on technical assistance to help banks, their customers, and communities understand and address community credit and banking needs. This is no small commitment. The Federal Reserve Board and the twelve Reserve Banks combined devote more than 100 full-time staff members to help institutions understand and participate in community development.

In all of these activities, groups such as the PCRG, with specialized knowledge of communities, are valuable partners, as they understand the needs of lower income families and serve as a critical link in the development and implementation of products and educational initiatives designed to help them stabilize finances and build wealth. In Pittsburgh, you have already formed relationships with families who would benefit from such programs. Through these associations, you can help to dissolve their apprehensions in using mainstream financial institutions and assist them in establishing banking relationships that would reduce their reliance on alternate sources for financial services, improve access to and availability of credit from regulated banks, and provide consumer protection and restitution through regulatory agencies.

Conclusion

Let me conclude by emphasizing that, like you, the Federal Reserve is interested in the financial health and literacy of all Americans. Through effective monetary policy, our goal is to help maintain price stability and create conditions for sustainable growth that provide continuing opportunities for families to flourish. Sustainable growth also helps many of our citizens to enter the job market, obtaining important skills that can be life transforming. By creating conditions conducive to maximum sustainable growth, the Federal Reserve can best do its part to make sure that all Americans have the chance to ensure their financial well-being. Through our supervision of banks, we continue to monitor financial institutions' compliance with laws requiring them to offer credit fairly and impartially as well as fostering a safe and sound banking system. And we will continue to conduct research on consumer finance and to promote financial literacy in partnership with national, as well as local, agencies and nonprofit organizations. In fact, we will be sponsoring a major research conference next April that will feature two panel presentations of studies on these topics. One session will be devoted to discussing the delivery of financial services by banks and nonbanks in low-income communities, while a separate panel of experts will analyze wealth-building strategies for lower-income households. Through these efforts we, like you, are working to ensure that our current economic gain enables the construction of a solid platform for enhanced job opportunity, business growth, and wealth creation for all Americans.

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