

Presentation by Sally Parker, Senior Vice President for Creditor Relations, National Foundation for Credit Counseling, Inc. at a meeting of the Financial Education Network of Southeastern Pennsylvania on June 29, 2006

I would like to start by thanking the Federal Reserve Bank of Philadelphia and the Financial Education Network of Southeastern Pennsylvania for holding this meeting to discuss financial education. Looking over the landscape today, it is troubling to see the deplorable level of financial literacy in this country, yet at the same time it is heartening to see how topical the issue has become.

A recent study conducted by the Jump\$tart Coalition for Personal Financial Literacy found that high school seniors were only able to answer correctly half of the questions on a 30-question financial survey. And just the other day, Fed Chairman Ben Bernanke said that improving financial literacy is vital to the future of our economy.

That lack of financial literacy is evident almost everywhere in society. Let's consider this country's current financial environment for consumers that is creating a burgeoning real need for credit counseling services.

Americans like to spend money — in many cases, more money than they earn. You know the ominous statistics. U.S. credit card debt exceeds \$800 billion; total consumer debt stands at

over two trillion dollars and climbing. Easy credit has helped fuel a spree that has contributed to these excessive amounts of debt.

There has been much concern that the recent increase by credit card issuers of the minimum payment due will create the tipping point that will drive significant numbers of over-extended consumers into financial delinquency. Currently, there is no clear evidence that this has occurred. Certainly, our members hear anecdotally that this is the proverbial straw for some of their clients.

On the other hand, issuers have told us that outstanding balances have been liquidating and delinquency levels have generally not spiked as higher payments have rolled out. As with rising energy prices, this is one factor that needs to be watched closely over the coming months.

I believe that there is another, more significant crisis that will exacerbate these statistics, and it surrounds the issue of consumer mortgage-related debt.

Consider the following:

- Consumers owe a whopping \$9 trillion in mortgage debt;
- In 2005, U.S. foreclosures jumped 25 percent to a total of 846,982 foreclosures reported during the year;

- Fifty percent of mortgages written over the last two years have been adjustable rate mortgages and many buyers qualified for these loans because of low “teaser rates”;
- Over the last two years, \$2 trillion of adjustable rate mortgages were written—and are scheduled to reset this year and next to much higher interest rates, making them much less affordable; and.
- Sub-prime mortgage lending has reached \$700 billion, or 12 percent of total mortgages.

These statistics are a matter of great concern for the American consumer. At the National Foundation for Credit Counseling (NFCC), we’ve been contacted by policymakers from the public and private sectors wanting to address what they perceive is a growing problem: that consumers are over-extended with their mortgages and many will be at risk with rising interest rates because they initially subscribed for products they didn’t understand. These policymakers recognize that a lack of financial education or literacy is as big an issue as easy access to credit and a go-go spending culture.

Over the next few years, more and more of our agencies will be focused on educating consumers about their mortgage loans and saving their homes.

NFCC housing services have been growing. To give you a sense of NFCC’s housing reach, during the 2004-05 program year **NFCC-member agencies** conducted 99,884 housing

counseling sessions. In addition, the NFCC conducted approximately 480,000 general counseling sessions; about 20 percent involved discussion of housing issues.

We believe that as NFCC-member housing services increase over the next few years, much strategic thinking, service development and counselor training will be dedicated to this service segment. And NFCC members are ready for this challenge.

Look at what has been accomplished in just one year since the NFCC assumed from the American Association of Retired Persons the role of providing national home equity conversion mortgage (HECM) counseling **required by the U.S. Department of Housing and Urban Development (HUD).**

From June 2005 to May 2006, the NFCC expanded its HUD-supported HECM network from 11 agencies to 44, and from 45 counselors to 238, as of May 12, 2006. The NFCC network alone now has enough theoretical capacity to meet the entire projected nationwide demand for HECM counseling for next year based on informal projections by the National Reverse Mortgage Lenders Association (NRMLA) and industry leaders.

During NFCC's tenure as the sole HECM intermediary, counseling queues have been eliminated and consumer wait times from initial contact to counseling have been reduced to less than 10 business days. At the same time, network counseling continues to meet the highest standards established by the AARP Reverse Mortgage Education Project. This has occurred simultaneously with the ramp-up and delivery of bankruptcy counseling services.

Of course, bankruptcy reform is the proverbial 800-pound gorilla in the room. In the weeks and months following October 17 when the reforms went into effect, so much was written about bankruptcy, its implications, its effects, and its consequences that it was difficult to separate fact from fiction. To that end, the NFCC surveyed its members in early March to find out for itself just what the new bankruptcy landscape looked like after the first five months.

The findings of that survey were the subject of our report, *Meeting the Mandate*, which is available on the NFCC's web site, at www.nfcc.org.

The survey found that the total debt of individuals receiving pre-filing counseling substantially exceeded their annual income and that the top three reasons consumers find themselves facing bankruptcy are poor money management, loss of income, and medical expenses. These dovetail with the reasons cited in regular budget and credit counseling.

According to those agencies that provided debt and income data, individuals who received pre-filing counseling had average unsecured debt of \$40,673 and average income of just \$31,255. The average unsecured debt for those who sought regular counseling was about half as large at an average of \$20,997.

Even more interesting was the channel mix of how services were delivered. Just over 60 per cent of pre-filing counseling sessions took place over the telephone. Internet counseling

accounted for 26 percent. Only slightly more than 1 in 10 of pre-filing sessions provided by NFCC-member agencies involved face-to-face counseling. Although some agencies still provide nearly all sessions in person, others have virtually eliminated face-to-face bankruptcy counseling because of the cost of providing in-person services.

The NFCC estimates that across all three channels the average counseling session costs an agency \$50.96. The average fee that an agency receives from the consumer for that session is \$37.71. This leaves, on average, a shortfall of \$13.25. In view of most debtors' inability to pay higher fees, as well as the requirement and NFCC membership standard that agencies provide bankruptcy counseling without regard for the debtor's ability to pay, agencies have little or no ability to raise fees to a level that fully covers costs.

The survey also found that, because of this "counseling funding gap," some member agencies have been diverting resources from other counseling services and financial education programs to fulfill bankruptcy counseling obligations. Others report that waiting times have grown for non-bankruptcy counseling sessions.

For example, one agency was forced to delay the start of a new financial empowerment program because "the labor and financial resources needed to implement this program had to be redirected to provide bankruptcy counseling and education." Another agency reported that "lack of funding and the high volume prohibits available appointments for traditional credit counseling." For a time, another agency shifted appointments from face-to-face to phone

counseling to handle demand; the agency said that “lack of funding to put in place counselors” was a factor.

It is this combination of resource diversion and the counseling funding gap that is especially troubling and bears close monitoring in the months to come.

As if the continued challenge of bankruptcy reform weren't enough, the Internal Revenue Service has stepped up its regulatory oversight of the credit counseling industry. This is not to say that the NFCC views these efforts as a bad thing. On the contrary, we welcome the scrutiny as a way to weed out the bad apples and leave standing the good actors — those dedicated to a mission of providing consumers with financial education.

The U.S. Senate included in the Charitable Title of its version of the Tax Reconciliation bill, known as S. 2020, additional **requirements** for credit counseling agencies in order to obtain and maintain nonprofit status under Section 501(c)(3) of the Internal Revenue Code. While several of the provisions of S.2020 would have been acceptable with some modifications, the cornerstone of the provisions was a cap on debt management **plan** (DMP) activity.

The debate around DMP caps, designed to take the “DMP mills” head-on via federal legislation, is really “fair share,” not DMPs. The fair share model is “the (other) elephant in the room” that has improperly provided incentive for behavior and services resulting in egregious abuses to consumers and it must be redesigned.

While the final bill that was signed into law by President Bush did NOT contain any provisions related to credit counseling, this issue is not yet over as both the House and Senate are continuing to work on a second bill that may include credit counseling provisions.

What needs to be made clear is that nonprofit and for-profit organizations are not the same. By virtue of their status under IRC 501(c)(3), legitimate nonprofit counseling agencies must provide holistic, comprehensive financial counseling, and educational assistance. **For-profit entities have no such requirements and by their very nature have profit as a priority.**

One topic which has been discussed in great detail today has been low- and moderate-income individuals and the unbanked. As this is an issue that is frequently encountered in the credit counseling sector, I would like to provide some additional perspectives.

As we all know, a substantial number of Americans — perhaps as many as 56 million — operate largely outside the credit system. Their credit files are too “thin” to generate a credit score or they don’t have files at all. This is an astounding number. In effect, our country now has two parallel economic systems — a credit-based system that helps individuals acquire assets and build wealth and a cash-based system that allows people to meet their basic needs, but does not help them accumulate wealth.

Indeed, many NFCC agencies’ clients include the unbanked and the under-banked. We work with individuals who are unable to access the credit system because of thin files. And quite

frankly we work with many, many people who have a very limited understanding of the financial system and who are desperately in need of financial education.

The division between those with credit and those without is growing and tends to be self-perpetuating. If you are operating in the cash economy, it's hard to move out. Individuals find themselves locked out from credit — robbed of hope of making life better for themselves and their families. Obviously, some people do overcome the obstacles and move up.

However, this pattern undercuts the fundamental American belief in possibilities — that any person who works hard enough can improve his or her lot in life. In other words, social mobility is already out of reach for some and may become an impossible dream for millions more if solutions aren't found.

Take the example of Hispanic Americans, a large percentage of whom are unbanked and outside the credit system. Many in this community have a number of issues to overcome before they can even get started. This includes not only the language barrier; but issues around family identity sharing (sharing with social security numbers) and a culture which values similarity of names. Hispanic Americans are not alone. The challenge is that barriers to entry are different for Americans of ethnicity, and the barriers are different for Hispanics, than they are for Asian Americans, and the barriers are different still for African Americans.

It is important that we recognize these distinctions and provide the necessary specific education so more consumers can participate in the “credit-based system” and fulfill their hopes for a better future.

Here in the Philadelphia area there is, sadly, no shortage of consumers hoping to fulfill that hope for a better financial future. The NFCC-member agency in this area, Consumer Credit Counseling Service of Delaware Valley, reports that its volume of bankruptcy counseling remains high. Specifically, pre-filing counseling sessions are fully booked and can often be difficult to schedule because of demand. A recent pre-discharge class was so well-attended that people were sitting on the floor and standing in the hallway because the room was so full. It will be interesting to watch whether this trend continues for the balance of the year.

For the credit counseling sector, bankruptcy, and financial education, the view from the mountaintop is one of challenge and opportunity. We like to think that because of increased IRS scrutiny the bad actors will be weeded out of credit counseling. In turn, the future for those of us who are dedicated to genuine credit counseling — with an emphasis on helping the consumer through financial education — can only be a bright one. At the same time, we are not even a year into bankruptcy reform and there will no doubt be many twists and turns to that journey before it is over.

Going back briefly to the findings from the NFCC's bankruptcy report, it is worth keeping in mind the consequences of shifting resources from financial education efforts to meet bankruptcy volume. Will financial education efforts today prevent a bankruptcy filing tomorrow? I think there is very little doubt of the benefits of all of us acting early and in unison to educate consumers in this country and provide them with financial education tools for a lifetime. That truly is our biggest challenge and ultimate opportunity.