

# **FINANCIAL COUNSELING: A MEANINGFUL STRATEGY FOR BUILDING WEALTH IN THE LATINO COMMUNITY**

By Beatriz Ibarra\*

## **INTRODUCTION**

In recent years, the goal of increasing the nation's collective financial literacy has gained prominence among policy-makers. In May 2005, President Bush introduced a new initiative to improve financial literacy in the Hispanic\*\* community. Earlier this year, members of Congress passed legislation to designate April as Financial Literacy Month. Others have proposed legislation that would create broad-based financial literacy programs in schools and in the workplace. These efforts stem from several underlying factors. For instance, some lawmakers have sought to advance policy measures that represent the elements of a new ownership society. Others want to give low-income families the tools to make wise financial decisions and to understand fundamental principles of saving and investing.

These financial literacy policy efforts have had limited scope and impact on low-income families. Despite the breadth of activity in this area, little has been done to provide practical financial advice and information to them in a meaningful way. Increasing financial knowledge among low-income Hispanic families is especially important given their limited experience with financial tools and the growing number of financial choices they must make. Instead of improving access to financial counseling services, efforts have resulted in the production of an arguably excessive amount of financial education materials. Ostensibly, these tools are designed to improve personal financial knowledge as well as individual financial security. Production and consumption of generic financial information, however, does not necessarily result in better financial decision-making on the part of individuals. For this reason, financial counseling is much more valuable than broad financial education in building wealth for Latinos.

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\*\*The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.



But access to financial counselors\* is not an option for many low-income individuals. The current structure of the market for financial advice ensures that only those who can afford it may access good-quality information and counseling. Because Latinos tend both to be asset-poor and to have lower comparative incomes, many are barred from accessing the best financial advice that the market can provide. Policy-makers have yet to address the structural barriers that inhibit access to financial advice and to provide meaningful solutions to the problem.

This white paper provides an overview of national efforts to increase financial literacy among the U.S. population and specifically examines financial education initiatives and legislation that target low-income families. The paper also explores the important role that financial advisors or counselors play in transmitting critical information on personal finance and how such services can reach low-income families more effectively. Finally, the paper examines challenges in accessing certified financial counselors for low-income families and includes policy recommendations for creating a financial counseling infrastructure at the community level.

## **BACKGROUND**

For Hispanic families in particular, lack of access to quality financial information and advice is a roadblock to purchasing and preserving assets as well as building wealth. Studies show that there is a sizable Latino-White wealth gap in the U.S. The median net worth of Hispanic households in 2002 was \$7,932, compared to \$88,651 for White households.<sup>1</sup> In 2002, 25% of Latino households did not own any assets other than a vehicle or held unsecured liabilities (e.g., credit card debt), compared to only 6% of White households.<sup>2</sup> According to a Pew Hispanic Center survey, more than 35% of Latinos surveyed reported that they did not have a bank account, and that number rises to 42% for foreign-born Latinos.<sup>3</sup> As a result, Latinos often pay too much for check-cashing, remittances, auto loans,\*\* and other financial services, and many are enticed into predatory or high-cost loans with exorbitant interest rates or fees.

The National Council of La Raza (NCLR) analyzed a broad range of initiatives and programmatic efforts under way in the field of financial education in a report entitled *Financial Education in Latino Communities: An Analysis of Programs, Products, and Results/Effects*. The report found that most financial education programs consist of broad, generic information in the form of classroom-style lectures, workbooks,

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\* Financial counselors/planners: There is no universal definition. For the purpose of this paper, a financial counselor is an individual who advises individuals or families on a broad range of financial issues. The ideal planner is fee-based and certified by a nationally recognized trade organization.

\*\* Reports show that Latinos and African Americans are often the victims of discrimination in auto financing. Dealers are more likely to “mark up” finance rates on loans for minority car buyers, regardless of their creditworthiness. Suits against Nissan Motor Acceptance Corporation, General Motors Acceptance Corporation, WFS Financial, and American Honda Finance Corporation have been settled. Actions were filed against Toyota Motor Credit Corporation, Ford Motor Credit Corporation, and Primus Financial Services; these cases are currently in litigation.

Internet-based seminars, and financial literacy outreach campaigns.<sup>4</sup> Although these efforts are important for increasing awareness, there is no evidence to suggest that these methods are helping low-income Latino families accumulate assets and build wealth.

The experience of providing one-on-one homeownership counseling to low-income families suggests that counseling is a meaningful and effective tool for both building financial knowledge and improving wealth levels.\* In 1994, Congress allocated funding to the U.S. Department of Housing and Urban Development (HUD) to establish a network of organizations to provide pre-purchase homeownership counseling to low-income families. Since 1997, the NCLR Homeownership Network has helped more than 17,140 families from predominantly low-income Latino neighborhoods to purchase homes of their own.

Though homeownership is an unquestionably vital wealth-building pathway for Latinos, far too many low-income Hispanic families are not mortgage-ready. Studies show that about half of the Latino population is disconnected from mainstream financial institutions. For those families who are not ready to buy a home, financial advice on issues such as budgeting, banking, saving, retirement security, buying a car, and filing income tax returns is in high demand.

That said, current efforts to communicate information and provide advice about these issues to low-income families are largely ineffective. Moreover, the breadth of public policy responses to these challenges is minimal. Recent policy efforts include the following:

- In May 2002, the U.S. Treasury Department created the Office of Financial Education (OFE) to oversee the department's financial education policy and to increase access to financial education tools for all Americans. Since its creation three years ago, OFE has compiled educational materials from a number of federal agencies and presented them via a website.<sup>5</sup> Additionally, OFE coordinates the efforts of the Financial Literacy and Education Commission ("the Commission"). The Commission was established under the Fair and Accurate Credit Transactions Act (FACTA) of 2004 to help coordinate the various financial education efforts administered by federal agencies and to develop a national strategy.
- In February 2005, Representatives Rubén Hinojosa (D-TX) and Judy Biggert (R-IL) created the Financial and Economic Literacy Caucus to develop a financial education strategy and to provide members of Congress with an avenue to promote financial literacy. On April 6, the House approved a resolution sponsored by Representative Biggert declaring April Financial Literacy Month.
- On May 4, 2005, President Bush announced a new initiative to increase financial literacy within the Hispanic community. The initiative called for the Federal

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\* According to the Pew Hispanic Center report, *The Wealth of Hispanic Households*, home equity is a critical means of wealth-building for Latinos, accounting for two-thirds of the mean net worth of Hispanic households.

Deposit Insurance Corporation (FDIC), the U.S. Treasury Department, the Small Business Administration, and selected Latino organizations to coordinate their efforts to raise awareness about existing financial education programs. As part of this initiative, the FDIC launched a national Hispanic media campaign, including Spanish radio and print advertisements, to encourage consumers to call a toll-free number for information about a financial education curriculum, Money Smart, which the FDIC has translated into Spanish.<sup>6</sup>

More recently, several bills were introduced in an attempt to increase financial literacy and improve access to – and the quality of – financial education programs (see box below).

#### LEGISLATION

- **“Education for Retirement Security Act of 2005” (S. 924):** Introduced by Senator Jon S. Corzine (D-NJ), this bill would provide funds for both state agencies and nonprofit organizations to enhance the financial and retirement literacy of midlife and older Americans. The legislation also aims to reduce financial abuse and fraud. Representative Stephen F. Lynch (D-MA) introduced a companion bill in the House (H.R. 392).
- **“The Youth Financial Education Act” (S. 925):** Introduced by Senator Jon S. Corzine (D-NJ), the bill would provide funds to develop and integrate youth financial education programs for students in elementary and secondary schools.
- **“America Saving for Personal Investment, Retirement, and Education Act of 2005” (S. 868):** Introduced by Senator Rick Santorum (R-PA), the bill would create an account for every child born in the U.S., including a \$500 deposit, to encourage savings and expand opportunities for all. The bill also calls for the development of programs that increase financial literacy of children who hold these accounts.
- **“Pension Security and Transparency Act” (S. 1783):** Introduced by Senator Charles Grassley (R-IA), provisions in the bill would provide for investment advice and retirement planning to assist pension plan participants. Up to \$1,000 would be excluded from gross income for qualified retirement planning services.
- **“Pension Protection Act of 2005” (H.R. 2830):** Introduced by Representative John Boehner (R-OH), the bill would enable pension plan participants to receive financial advice about their investment options.

While targeted, customized, one-on-one financial counseling is a proven approach to building financial knowledge for low-income families, little is being done to grant families access to these services. One result of uneven access to financial advice is imbalanced participation in the mainstream financial marketplace. The likelihood of low-income consumers making disproportionately uninformed choices about credit and financial products creates significant market inefficiencies that only encourage more financial predators to enter the field. Consequently, low-income Latinos are likely to experience income and asset leakage in mainstream financial markets rather than enhanced wealth accumulation.

## CHALLENGES TO ACCESSING FINANCIAL COUNSELING

There are many reasons why low-income families do not seek the services of a financial counselor. For one, the financial planning market is not designed to serve low-income families. Specific factors are:

- **The lack of affordable, certified financial counselors in the marketplace.** Many financial counselors work for a commission and are more inclined to cater to individuals with large asset portfolios. Since many financial planners earn money by managing their clients' assets, serving low-income clients with little or no assets means earning significantly less income. Fee-only financial planners are more affordable, but their fees are often too high for low-income families. For a family earning below \$15,000 a year, a fee of \$200 an hour can be prohibitive.<sup>7</sup> Additionally, there are no pro bono requirements for certified financial planners. Although the number of hours varies from state to state, many states require attorneys to provide 50 hours of pro bono legal services each year.<sup>8</sup> While there has been an increase in the number of financial planners serving families with more modest means, NCLR's assessment of the field revealed that there are few Spanish-speaking, culturally-sensitive financial planners serving the Latino community.
- **The lack of explicit economic incentives for low-income families to connect to financial advisors and counselors.** For low-income families, there are no direct financial incentives to purchase the services of a financial planner. As previously stated, policy-makers encourage financial literacy but do little to facilitate access to certified financial counselors or to create incentives for low-income families to visit with them. In contrast, upper-income families who itemize their income taxes can claim the expense of the financial planner as a deduction.
- **The lack of federal resources for targeted, community-based, one-on-one financial counseling programs.** Although the demand for financial counseling is high, there is almost no corresponding investment by the government to support local, community-based financial counseling programs. By some estimates, there are approximately ten million U.S. households and 22 million families who do not have a basic checking or savings account.<sup>9</sup> Yet, the government invested \$25 million in Individual Development Account programs in 2004 to encourage savings

among low-income families.<sup>10</sup> Many low-income households are in need of free tax preparation services at the community level, but the government invested only \$7.5 million in matching grants to low-income taxpayer clinics in 2005.<sup>11</sup> Furthermore, at least 1.6 million households seek mortgages each year.<sup>12</sup> In 2004, the government invested \$42 million in the housing counseling program that HUD oversees. Millions more are in need of one-on-one financial counseling services, but the government invests zero dollars in such programs while providing more than \$350 billion in tax benefits to upper-income workers to save and invest their money.<sup>13</sup>

## **POLICY RECOMMENDATIONS**

As mentioned above, many low-income individuals lack a relationship with a mainstream financial institution. For immigrants, there are a number of additional barriers to accessing mainstream financial services, such as identification requirements and lack of English proficiency. These issues are barriers that financial counseling can help to overcome. To ensure that all families have an opportunity to improve their long-term economic status, NCLR recommends:

- **Creating new incentives for low-income families.** Congress should create a refundable federal income tax credit for low-income families to cover the cost of obtaining one-on-one financial counseling services. Policy-makers could determine the amount of the tax credit and require that recipients of the credit consult with a financial counselor who is certified by a nationally-recognized financial planning association. Additionally, policy-makers should ensure that *all* tax filers are eligible for the tax credit.

Congress may also choose to issue vouchers to low-income families to cover the cost of visiting with a financial planner. Through vouchers, families would have the opportunity to select the financial counselor of their choice and have more control over their finances. To avoid the inevitable complexities that arise with any voucher program, lawmakers should authorize pilot projects in a variety of U.S. cities to test whether or not vouchers could be a successful option in a financial counseling program.

- **Creating an infrastructure of community-based financial counselors.** Congress should authorize a program through the U.S. Department of Health and Human Services or HUD which would 1) manage grants to community-based organizations to support financial counseling services; 2) determine program eligibility; 3) manage and distribute resources to participating organizations; 4) develop personal finance case-management software; and 5) conduct program evaluations. Community-based organizations would use the resources to hire and train financial counselors, develop or obtain the necessary software to track client information, and build the capacity to expand the services they currently provide to include financial counseling services. NCLR estimates the initial cost of the program at \$100 million.

- **Increasing funds for low-income tax preparation sites to support a financial counseling component.** Congress should increase federal funding by \$50 million to support the expansion of important Internal Revenue Service initiatives aimed at low-income families, such as outreach regarding the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC). The receipt of tax returns presents an opportunity for low-income families to connect to financial services and products and learn about investments and savings. Linking tax preparation with savings and/or investment tools, such as Individual Development Accounts (IDAs), would increase asset-building knowledge. To meet these goals, tax preparers need resources to 1) hire and train counselors and 2) develop software to maintain client information. Policy-makers must more adequately fund and support the development of tax preparation sites and education efforts to identify families who qualify for such assistance and maximize potential income tax return benefits.

Access to independent financial counseling should also be part of any retirement savings package to enable workers to develop and leverage assets effectively. Policy-makers can take meaningful steps to close the wealth gap and increase ownership among Latinos. Financial counseling may be the linchpin of this strategy.

## ENDNOTES

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2. *Ibid.*
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5. <http://mymoney.gov>
6. Spanish radio and print advertising were featured in the following markets: Los Angeles, California; New York, New York; Miami and Ft. Lauderdale, Florida; Chicago, Illinois; Dallas, Austin, San Antonio, and McAllen, Texas; Denver, Colorado; Washington, DC; Boston, Massachusetts; Atlanta, Georgia; Kansas City, Missouri; and Puerto Rico.
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