

And Banking for All?  
Mainstream and Alternative Financial Services  
Usage of LMI Households



Saving Strategies and Innovations for Low-Income Households  
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## Disclaimer:

The views presented here are my own and do not necessarily reflect those of the Federal Reserve System, its Board of Governors, the CFPB, or the Treasury Department.



# Detroit Area Household Financial Services Survey

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- Survey of 1,003 households in Detroit metro area conducted with Survey Research Center
- Random, stratified sample
  - Over sample low-income census tracts (0-80% median)
- Ask randomly selected individual from household about own & household's financial service use
- In-person, computer assisted. Average interview length 76 minutes. Production hrs/interview: 8.8
- 65% response rate

# Description of Sample

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- Mostly black, 2/3 female, mostly unmarried
- \$20,000 median household income
- 33% live below federal poverty line
- 30% have less than a HS Diploma or GED
- 56% currently employed
- 27% are unbanked

# Overview

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- ❑ LMI households need range of transaction services to receive income, store it & pay bills
- ❑ LMI HH need opportunities for saving
  - Short-term (emergencies, asset purchase)
  - Longer-term (housing, education)
- ❑ LMI HH are underinsured for key events
- ❑ LMI HH often pay high costs to borrow
- ❑ The financial services system is not well organized to serve LMI HH
- ❑ Unbanked are particularly vulnerable

# Who are the unbanked?

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- In our sample, the unbanked are
  - Much younger
  - More likely to be non-white
  - Less likely to be married
  - Less educated
  - Less likely to be employed
  
- 51% live below the poverty line
  - Compared to 26% of the banked
  
- In sum, less economically active

# Transaction Services (in past month)

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- Only 44% receive income through direct deposit
  - Compared to 70% nationally
  
- Cash checks
  - 83% of unbanked used a bank to cash check
  - 33% of banked used a grocery/liquor store
  - 21% of banked used a check casher
  
- Pay bills
  - 52% used a money order, 44% personal check
  - 48% of banked used a money order
  
- 23% used a non-bank wire transfer

# Credit Product Usage (in past 3 years)

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- 28% used a Refund Anticipation Loan (RAL)
  - 37% banked, 24% unbanked
- 20% used overdraft
  - 24% banked, 11% unbanked
- 11% used pawn shop
  - 7% banked, 21% unbanked
- Other sources
  - Cash advance, pension, rent-to-own, payday loan, title loan
- Credit cards are uncommon
  - 53% banked, 12% unbanked

# Annual Outlays

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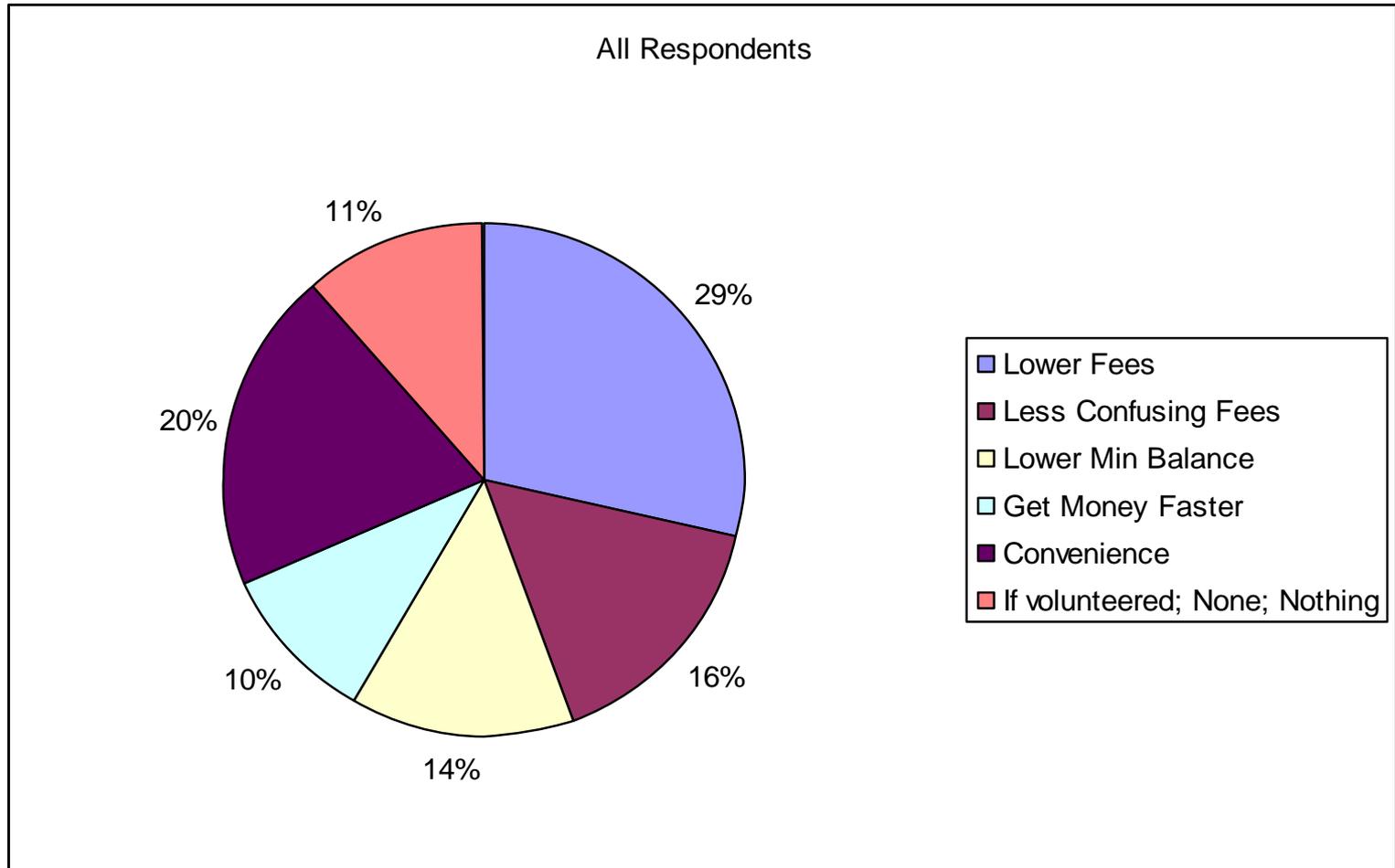
- Median total outlays: Only \$179 (1% income)
  - 50% of outlays on AFS
  - 30% of outlays on AFS for banked, 86% unbanked
  - 90<sup>th</sup> percentile: \$614
  
- Median transaction outlays: \$98
  - \$105 for banked, \$71 for unbanked
  - 90<sup>th</sup> percentile: \$307
  
- Median credit outlays: \$41
  - \$57 for banked, \$0 for unbanked
  - 90<sup>th</sup> percentile: \$398
  
- Tail of distribution is where the costs are
  - 57% of credit outlays are in top 10% of households

# Non-pecuniary Costs

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- For 30% of respondents, check casher or grocery liquor store is most convenient location
  - 17% for banked, 62% for unbanked
  - 90<sup>th</sup> percentile: \$614
  
- Among renters, only 55% of landlords accept personal checks
  
- 37% of respondents use bill payment centers
  - 35% of banked, 45% of unbanked
  
- Estimates of annual outlays exclude these types of costs even though they may be non-trivial

# What would make you open an account?



# Conclusions

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- ❑ Annual outlays are around 1% of annual income for most respondents
- ❑ Low outlays because of avoiding usage and/or economic inactivity
- ❑ Having a bank account does not preclude use of AFS, while being unbanked doesn't exclude households from using mainstream services
- ❑ Other costs (search, waiting in lines) may be extremely high
- ❑ Our results cannot directly tell us about predatory practices or poor disclosure

# Thoughts on Policy

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- Financial Services Ill-Serve LMI Households
  - The financial services system is not well designed to serve low- and moderate-income households.
    - Low income, low savings, immediate needs
  
- Costs of Financial Exclusion
  - Inefficient
  - Costly for low-income households
  - Promotes dis-saving
  
- Need for Inclusive Financial Policy
  - Low-cost banking & payment systems reforms
  - Regulation & opt-out systems in credit policy
  - Inclusive national savings policy
  - New ideas, such as...

# Prize-Linked Savings (Tufano et al.)

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- Win a cash prize in proportion to savings
  - Popular abroad: Britain's Premium Bonds, Latin America
- Two features make them particularly attractive
  - Skewed distribution of returns (upside risk)
  - Entertainment of a lottery
- Why would it work?
  - \$60 billion in lotteries (\$540 per household)
  - 2 Demonstration Projects (IN, MI) showed especially appealing to groups with low levels of formal saving
- Legal barriers: No private lotteries, Nat'l Bank Act
  - Federal alternative as in UK?
  - Experience in South Africa: State lotteries won't like it

# Funders & Advisory Board of the DAHFS

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## □ Funders

- Ford Foundation
- Fannie Mae Foundation
- MacArthur Foundation
- Mott Foundation
- Casey Foundation
- Community Foundation of Southeast Michigan
- National Poverty Center
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## □ For further information

- see <http://www-personal.umich.edu/~msbarr/> and click on "Detroit Area Study"