

Financial Services, Saving, & Borrowing Among Low- and Moderate-Income Households



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Detroit Area Household Financial Services Survey

- Survey of 1,003 households in Detroit metro area conducted with Survey Research Center
- Random, stratified sample. HH area median = \$49,000 (census definitions)
 - 0-60% of area median (up to \$29,000)
 - 61-80% of area median (\$29,000-\$39,000)
 - 81-120% of area median (\$39,000-59,000)
- Over sample low-income census tracts
- 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

- 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
- 29% are unbanked

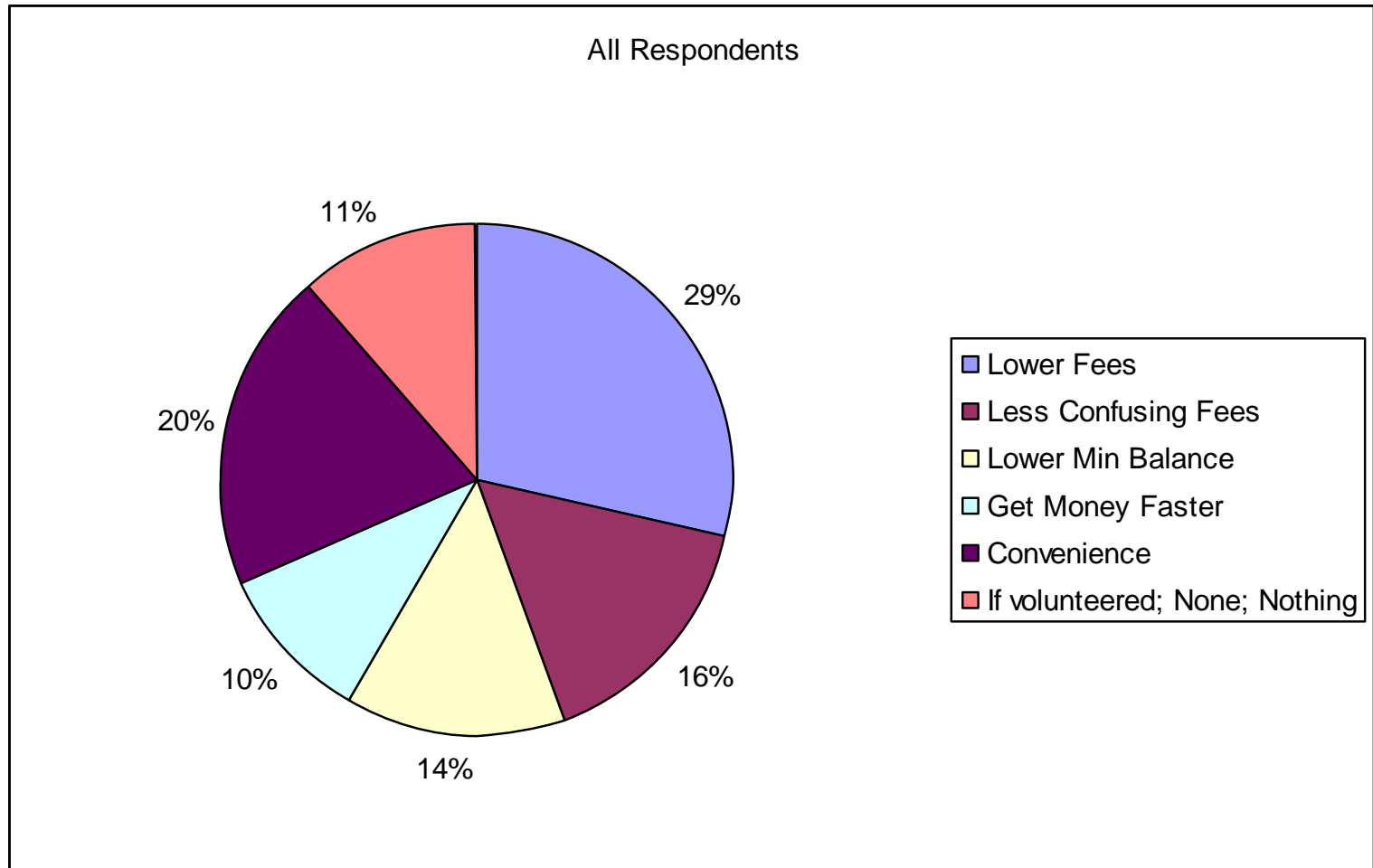
Overview

- 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

Financial Services & LMI Households

- The financial services lives of low- and moderate-income households—living on the financial edge.
- The financial system is not designed to serve low- and moderate income households
 - Supply: High bank fees, minimum balances, overdraft & NSF fees, check-writing delays, Chexsystem
 - Demand: Low income, low savings, immediate needs
- Alternative financial services sector serves poor
 - Check cashers, money orders, payday lenders, refund anticipation lenders, pawnshops, title loans, etc.
 - Often costly, inefficient & dead-end
- Fluidity Across formal & informal sectors
 - Many unbanked used to be banked (70%)
 - Many banked use AFS & bank services
 - Many unbanked use bank & AFS services

What would make you open an account?

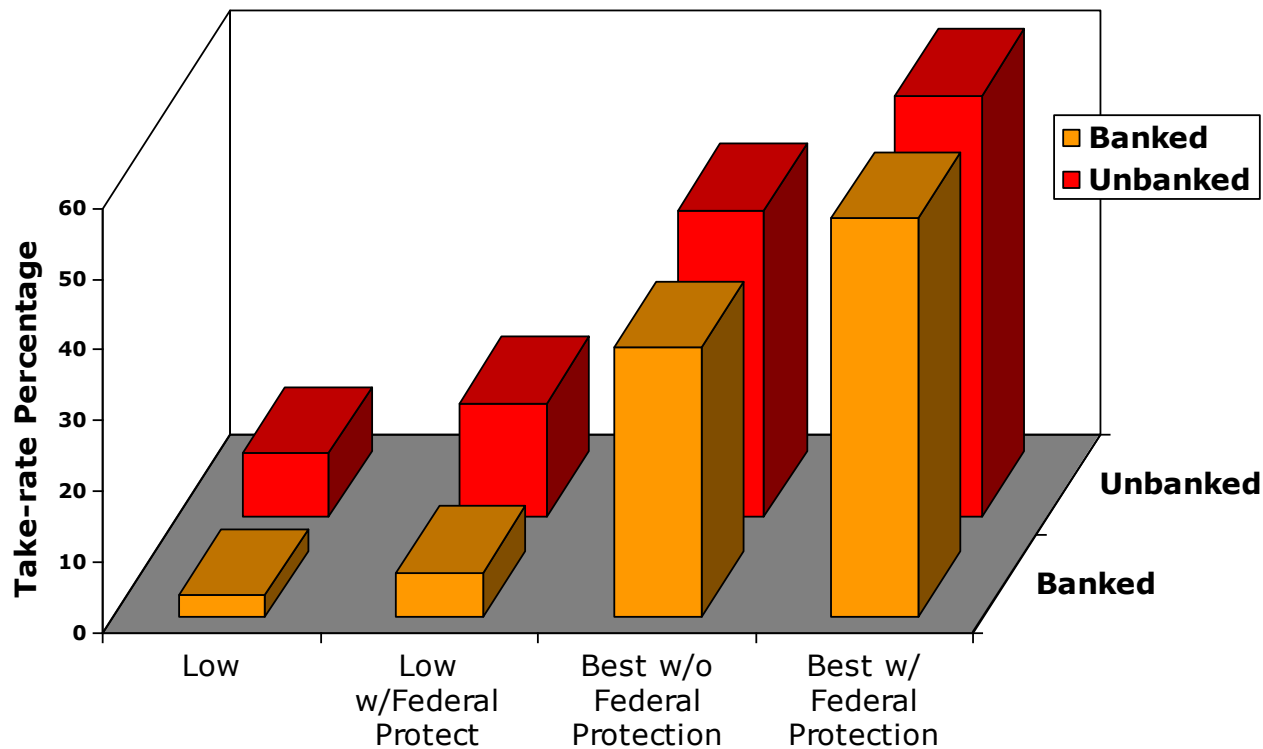


Banking and Payment Cards

- ❑ Checking accounts don't work for LMI households
- ❑ Payment cards (debit & prepaid) are a potentially attractive financial product for LMI households and for financial institutions: a win-win.
- ❑ Conjoint analysis tests what features different LMI households find attractive
 - Many unbanked HH would like a bank & payment cards
 - LMI HH's value low monthly cost & federal protection
 - Automatic savings plan positive

Preference by Banked Status

- Unbanked prefer even the lowest value cards, which Federal Protection makes twice as attractive.

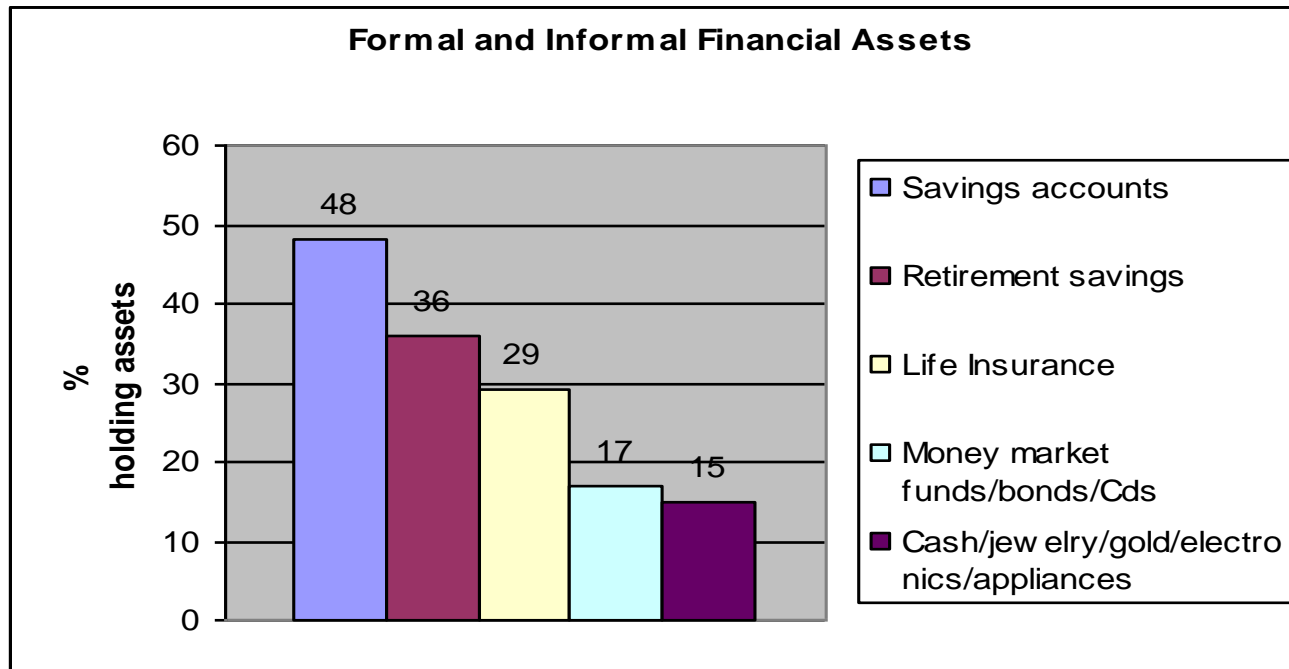


Saving

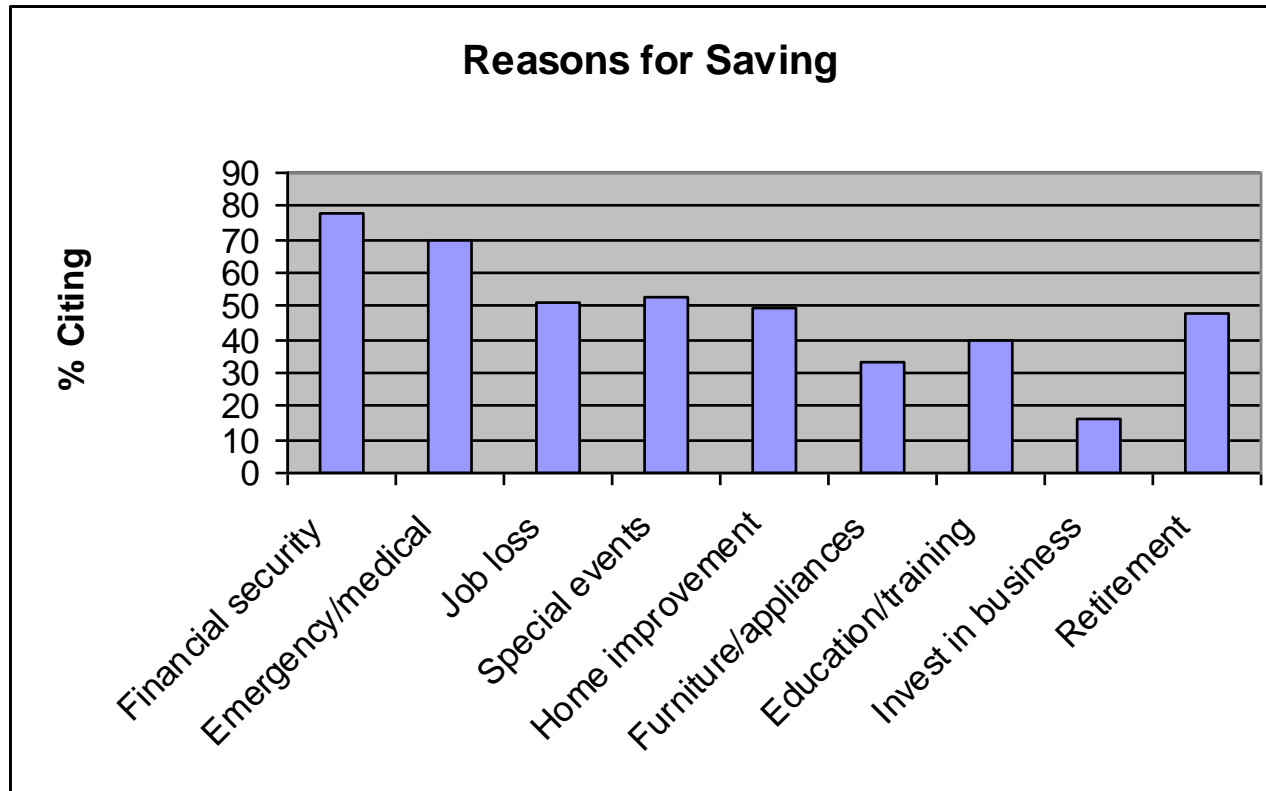
- Diversity in how regularly LMI HH's save
 - Frequency of contributing to financial savings:
 - At least every month – 32%
 - Once or twice – 11%
 - Never – 42%
 - Contributions last year to financial savings (among those w/+ contribution):
 - Mean = \$2628; Median = \$1000
- 74% saving to make purchase or spend this year or next year
- Challenges: low income, income volatility, many needs, hardships, credit/insurance market imperfections, lack of saving mechanisms

Asset Holdings

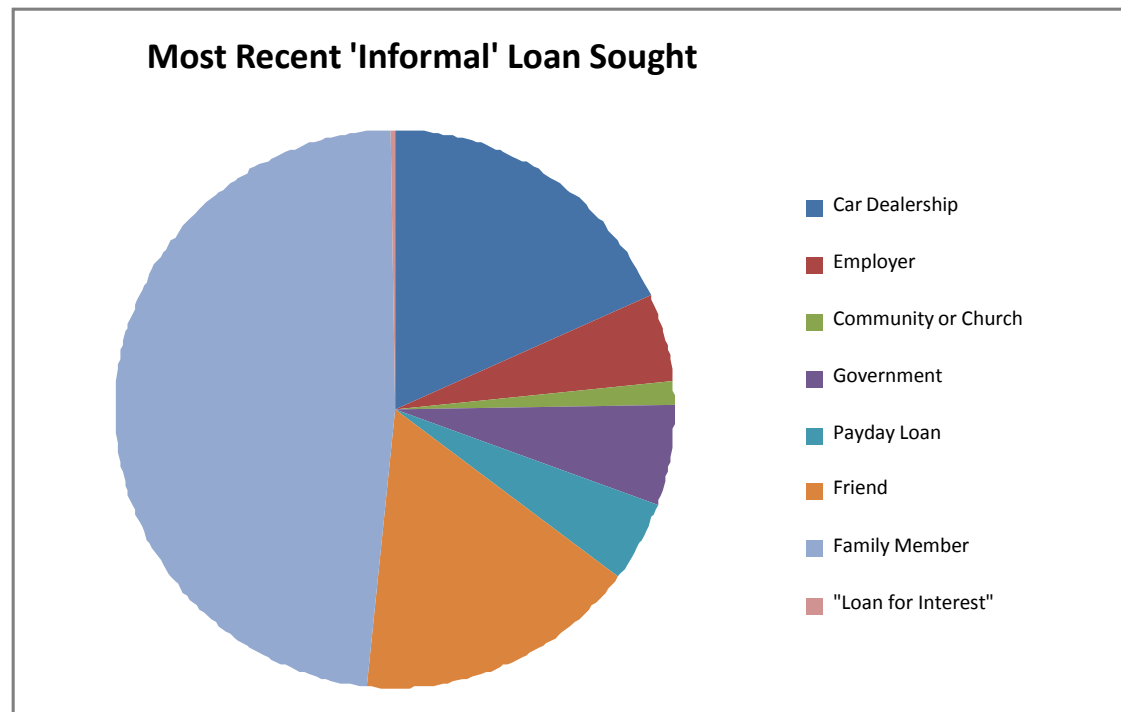
- 90% of LMI HH's in DAHFS accumulate formal & informal, financial &/or physical assets
 - 75% have formal or informal financial assets
 - 73% own car
 - 45% own home



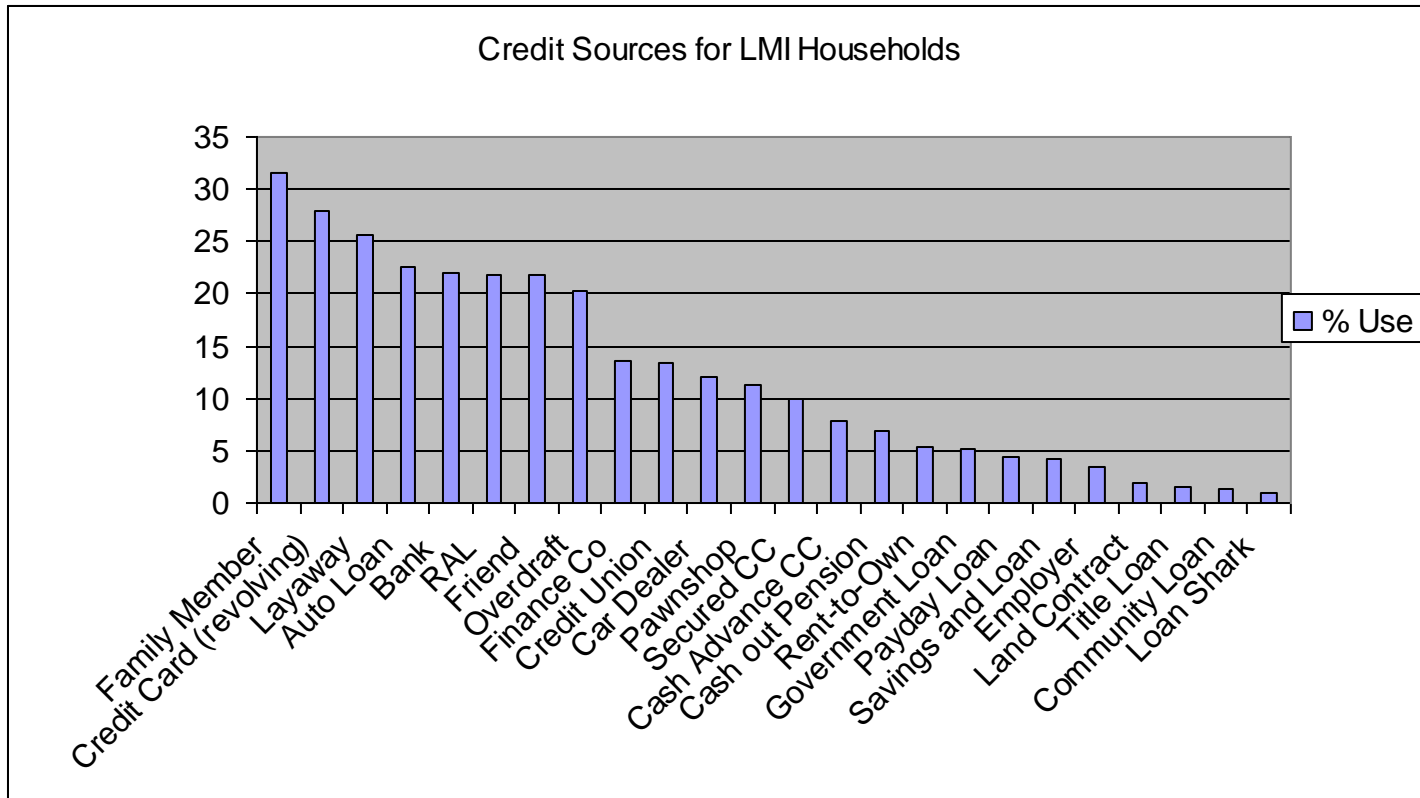
Reasons for Saving



Informal Borrowing



Credit Sources for LMI Households



Quick Highlights: Tax Prep & RALs

- 66% of low- and moderate-income tax filers used a paid preparer to file.
- About 38% of all LMI taxpayers using a paid preparer took out a RAL.
- 51% of unbanked use RAL vs. 31% others
- 50% of EITC filers use RAL vs. 14% others
- RAL users paid \$177 for tax preparation & RALs, which represents 7% of the average refund of such households (\$2,505).

Quick Highlights: Home Mortgages

- Broker Usage
 - 58% used a mortgage broker
 - Of those using a broker, only 33% were offered loans from more than one lender

- 29% paid points or fees up front
 - Blacks pay 2.5-3 times the points & fees whites pay

- “High Cost” mortgages held by 55% of HH
 - Include high APR, balloon payment, prepayment penalty
 - 63% for blacks, 46% for whites

- When “high cost” mortgages also include ARM, 62% of LMI HH hold such mortgages
 - 70% for blacks, 51% for whites

Quick Highlights: Home Mortgages (2)

- Roughly 13% of LMI HH have “D” class subprime loans (APR = 10% or greater).

- 29% have ARMs
 - 32% of blacks and 22% of whites

- 23% face prepayment penalty
 - 29% blacks face prepayment penalty but only 13% of whites
 - Median APR on loans with prepayment penalty higher than loans without penalty (7% vs. 6.5%).

- 11% have balloon payment
 - 15% blacks, 5% whites

Quick Highlights: Payday loans

- 3.4% of LMI HH used payday loan in last year.
- Why? 60% to pay for everyday expenses, 11% to pay down credit card or bank debt, 8% for transportation expenses.
- Why payday lender? Convenient hours/locations (24%), expected to be approved for loan (22%), needed a small amount to pay a bill (19%).

Quick Highlights: Payday loans (2)

- Common risks associated with payday loans are to delay/rollover payment, which 40% did.
- On average, borrowers rolled over 4 times.
- 14% took a loan from one payday lender to pay back a loan to another payday lender.
- Payday borrowers have lower asset levels (especially homes) than non-borrowers

AFS Complementary Products

Among those using other AFS/not using other AFS,
what % use payday?

AFS	What % of users use payday?	What % of non-users use payday?
Pawnshop*	16%	3%
Cash Advance*	14%	4%
RAL*	9%	3%
Rent-to-Own*	16%	4%
Cash out Pension*	12%	4%
Overdraft*	13%	2%

*Significant difference at 10% level after controlling for age, race, gender, and income

Credit Card Behaviors and Payday Use

Among those with noted credit card behavior, what % use payday?

Late Fee	No Late Fee
9.2%	3.4%
Never pay off balance	Always pay off balance
8%	3.6%
Pay minimum*	Pay More
12.5%	3.8%
Secured CC*	Credit Card
17.4%	3.3%

* Significant difference at 10% level after controlling for age, race, gender, and income

Financial Hardships & Payday Loans

Among those using/not using payday loans, what % experienced hardship in last 12 months?

	Payday Users	Non-Users
Bankruptcy*	11%	4%
Eviction*	12%	6%
Phone cut-off*	38%	17%
Utilities shut-off*	26%	9%
Major medical illness/expense	30%	27%
Turned down for mainstream loan	39%	28%

*Significant difference at 10% level after controlling for age, race, gender, and income

Financial Hardships & Payday Loans

Among those experiencing hardship, what % used payday loan?

Hardship	What % experienced used payday?	What % didn't experience Used payday?
Bankruptcy*	13%	4%
Eviction*	9%	4%
Phone cut-off*	9%	3%
Utilities shut-off*	12%	4%
Major medical illness/expense	5%	4%
Turned down for mainstream loan	10%	7%

*Significant difference at 10% level after controlling for age, race, gender, and income

Other Outstanding Loans

- 47% borrowed to buy a car
 - Median outstanding=\$4,000
- 28% have unpaid medical bills, median=\$1,046
- 23% have student loans, median=\$6,000
- 3% have unpaid legal bills, median=\$2,000
- 1% used title loan, median=\$5,000
- 16% have “other” loans, median=\$4,300

Loans From Traditional Sources

- In the last three years, looked into loan:
 - 22% from a bank
 - 14% from a finance or mortgage company
 - 13% from a credit union
 - 4% from a savings and loan
- 29% were turned down for a loan
 - 7% were approved but given smaller amount
- 36% compared lenders (median=3)
- Median APR was 7.5%

Loans from Other Sources

- In the last three years, looked into loan
 - 32% from a family member
 - 22% from a friend
 - 12% from car dealership
 - 5% from government loan fund
 - 4% from payday lender
 - 3% from employer
 - 1% from community or church loan fund
 - <1% from a loan shark
- 9% of these loan requests were turned down

Alternative Credit Options

- 8% used cash advance from a credit card
- 7% borrowed against/cashed out a pension
- 26% bought something on layaway
- 11% pawned something at a pawn shop
- 22% received a refund anticipation loan (RAL)
- 5% rented using rent-to-own
- 20% used overdraft in their bank account
- 2% obtained a land contract for their home
- 8% looked for a loan online

Credit Cards

- 41% of the sample has a credit card
 - 53% of whites, 35% of blacks
- 21% of those without a CC want one but cannot get one
- 46% of those without a CC have had one in the past
- 9% of credit cards are secured
- Median # of cards = 2 (mean=2.8)
- 2/3 know their APR, median=13%
- 27% pay an annual fee
- 22% paid a late fee
- The interest rate changed for 35% of the sample
 - 61% knew that the rate could change
- 15% have transferred a balance from one card to another

Credit Card Payments

- 31% pay off the entire balance every month
- 29% never pay off the entire balance
- 18% usually pay the minimum amount
- Median amount owed = \$1,000, mean=\$3,233
- We asked: if you only pay the minimum due, would the amount you owe
 - Go down: 25%
 - Stay the same: 29%
 - Go up: 46%
- 15% of the sample has declared bankruptcy at some point
- 4% have declared in the past 12 months

Credit Policy

- Savings cushions
 - Direct deposit programs
 - Automatic savings plans
 - Tax refund savings programs
- Short-term loan alternatives
 - Direct debit, longer-term, self-amortizing consumer loans provided by banks
- Disclosure across formal & informal credit markets
 - Overdraft protection under TILA
 - Disclosure of actual time to pay off actual CC balance
 - Behavioral research re: comparability across sectors
- Regulation of mortgage markets
 - Broker registration & licensing, ability to pay, etc.
 - Disclosure standards (in addition to TILA rules)
 - Supervision, examination, enforcement
- Develop “opt-out” policies for credit cards & mortgages

Financial Services Policy

- Encourage low-cost, electronically-based bank accounts with a new tax credit for depository institutions
 - Pay for performance, fixed cost per account
 - Administered by IRS & FMS using adjustments to quarterly withholding payments
 - Can include incentive for matched savings plans provided by financial institutions, funded by Treasury
 - Can include option of self-amortizing, 6 month credit product with direct debit after seasoning period
 - No overdraft, no check-writing, no chexsystem screen
- IRS should deposit tax refund to opt-out, privately offered e-bank accounts for the unbanked
- State EBT to move beneficiaries into banking system
- Federal Reserve role in sponsoring payments system improvements (as in Directo a Mexico)

Savings Policy

- Universal opportunity to access a bank account that makes sense for financial lives

- Inclusive asset-building programs
 - Savings for Working Families Act

- Employer-based savings plans
 - Make Saver's Credit Refundable (Orszag & Greenstein)
 - Universal, portable pensions (Iwry)
 - Direct deposit payroll savings plans (Barr)

- Inclusive National Savings Plan
 - Universal, progressive, earned by working, in addition to Social Security
 - Possibility of children's accounts, as in UK

Conclusion

- Financial Services Ill-Serve LMI Households
 - The financial services system is not well designed to serve low- and moderate-income households.

- Costs of Financial Exclusion
 - Inefficient for national economy
 - 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