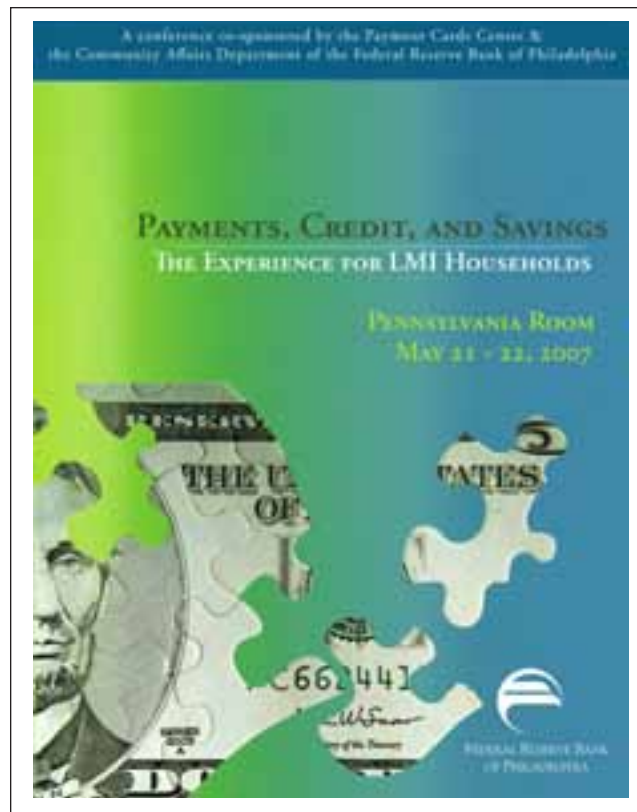


## CONFERENCE SUMMARY



# Payments, Credit, and Savings:

The Experience for LMI Households

May 21 - 22, 2007



FEDERAL RESERVE BANK OF PHILADELPHIA



# Payments, Credit, and Savings:

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## The Experience for LMI Households\*

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### Summary

The Payment Cards Center and the Community Affairs Department invited Michael Barr, University of Michigan Law School and faculty investigator for the 2005-2006 Detroit Area Study (DAS), to collaborate in organizing a conference, "Payments, Credit, and Savings: The Experience for LMI Households," held May 21-22, 2007, at the Federal Reserve Bank of Philadelphia. This year's DAS survey was designed to gain a better understanding of 1) how and why LMI households use a wide array of financial services as well as the costs and benefits of such services and 2) how LMI households would respond to new types of cost-effective financial products specifically tailored to their needs. This conference brought together viewpoints from the financial services industry, academic community, consumer and community development organizations, and federal and state regulatory agencies to consider data and early findings from the 2005-2006 DAS in three main areas: making payments, accessing credit, and accumulating savings. The conference discussion emphasized both the challenges and opportunities for consumers, private-sector financial services providers, and regulators in moving toward a more inclusive financial system.

*\* The views expressed here are not necessarily those of this Reserve Bank or of the Federal Reserve System.*



**TABLE OF  
CONTENTS**

I. Introduction.....	5
II. Banking into the Financial Mainstream: Barriers Faced by the Underserved.....	6
III. Conference Sessions .....	9
a. Setting the Stage: 2005-2006 DAS: Methodology and Objectives .....	9
b. Driving Payment and Transactional Banking Choices: Product Attributes Valued by LMI Households.....	10
c. Access to Credit: Payday Lending and Alternative Credit Products .....	13
d. Encouraging Personal Savings: Challenges and Opportunities.....	16
IV. Conclusion .....	19
Exhibit 1: Conference Agenda .....	21
Exhibit 2: Institutions Represented at the Conference .....	23



## I. Introduction

In the United States, over 50 million low- and moderate-income (LMI) households<sup>1</sup> make daily financial decisions that determine how purchases are made, bills get paid, money is borrowed, and savings set aside. However, the approach LMI households take when making financial choices is far from clear. To explore this topic, the Payment Cards Center and the Community Affairs Department of the Federal Reserve Bank of Philadelphia invited Professor Michael Barr, of the University of Michigan Law School, to collaborate in organizing a conference titled “Payments, Credit, and Savings: The Experience for LMI Households,” which was held May 21-22, 2007.

In 2005, Barr made the keynote remarks at a Payment Cards Center conference examining the role of payment cards in serving the financial needs of unbanked and underserved consumers.<sup>2</sup> At the time, he was just beginning work on survey research in the Detroit metropolitan area. He had been selected to serve as faculty investigator for the 2005-2006 Detroit Area Household Financial Services Study, more simply called the Detroit Area Study (DAS).<sup>3</sup> The DAS has been conducted for over 50 years under the auspices of the University of Michigan’s Institute for Social Research, Survey Research Center. Each year survey researchers explore a different topic. The 2005-2006 study was designed to gain a better understanding of 1) how and why LMI households use a wide array of financial services as well as the costs and benefits of such services

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<sup>1</sup> Low income is defined as income less than 50 percent of the median family income for the metropolitan area. Similarly, moderate income is defined as family income greater than 50 percent of the median family income for the area but less than 80 percent of the median family income for the area.

<sup>2</sup> The conference was titled “Payment Cards and the Unbanked: Prospects and Challenges.” A summary of Barr’s remarks can be found in the conference summary at [www.philadelphiafed.org/pcc/conferences/2005/PaymentCardsandtheUnbankedSummary.pdf](http://www.philadelphiafed.org/pcc/conferences/2005/PaymentCardsandtheUnbankedSummary.pdf).

<sup>3</sup> The DAS was supported by the Ford Foundation, the Fannie Mae Foundation, the MacArthur Foundation, the Mott Foundation, the Annie E. Casey Foundation, the Community Foundation of Southeast Michigan, the National Poverty Center, CLOSUP, and the Provost, Vice President for Research, and Law School of the University of Michigan. Professor Barr would like to thank these institutions for their support. Results and analysis are those of the authors alone and do not represent the views of the study’s sponsors.

and 2) how LMI households would respond to new types of cost-effective financial products specifically tailored to their needs.<sup>4</sup> Through this survey, Barr and his fellow researchers hoped to develop a more complete understanding of the financial behaviors and motivations of LMI households and the related constraints on their use of traditional and emerging financial products and services.

As Barr and his colleagues began to analyze the survey data and to organize their findings, it seemed like an opportune time to gather a group of subject matter experts from the financial services industry, academic community, consumer and community development organizations, and federal and state regulatory agencies to share experiences and insights using Barr’s research as a platform for discussion. To this end, conference discussion was organized into three main sessions that focused on financial activities addressed in the survey: making payments, accessing credit, and accumulating savings. To introduce these sessions, Barr provided participants with a sense of the 2005-2006 research objectives and methodology. Then, in each area — payments, credit, and savings — Barr or one of his co-authors shared data and preliminary findings from the 2005-2006 DAS, after which panelists with varied expertise on the topics added their reactions and comments.

Delivering the keynote remarks, Sandra Braunstein, director of the division of Consumer and Community Affairs at the Federal Reserve Board of Governors, set the context for the day’s discussion. She pointed to technological advances, payment innovations, and the entrance of alternative providers as critical new forces providing a greater range of choices and opportunities to improve the delivery of financial services to LMI households. At the same time, she argued that these changing dynamics are also presenting challenges for consumers, providers, and regulators in moving toward a more inclusive financial system. Nevertheless, she challenged conference participants to help define market-based solutions that meet the sometimes different needs of LMI consumers. She characterized the financial services market for LMI consumers as

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<sup>4</sup> For more information on the survey methodology, see section III.a. Also, visit Michael Barr’s website, [www-personal.umich.edu/~msbarr/detroit.html](http://www-personal.umich.edu/~msbarr/detroit.html), for a detailed overview of the 2005-2006 DAS.

representing a profitable opportunity for providers able to design products better suited to the needs of LMI households while still meeting internal cost and regulatory requirements.

During the day's discussion, several common themes emerged. Barr introduced one of the themes early on when he observed that a "financial services mismatch" exists between the undifferentiated value propositions delivered to LMI households by traditional financial institutions and the more distinct needs for features, functionality, and pricing demanded by this market segment. He suggested that the increasing prevalence of alternative financial services providers is, in part, due to their responsiveness in delivering customized products and services better suited to LMI consumers' needs.

When considering this concept of a financial services mismatch, several speakers, including the social science and behavioral academics, argued a second point: Simple, straightforward, and cost-conscious value propositions are fundamental to successfully tailoring financial products and encouraging their adoption among LMI households. Other participants stressed that transactions completed in the alternative financial sector are, by nature, less complex because they are grounded in transactional behavior rather than in the context of a banking relationship. Participants debated the question of whether this model provides greater value than the traditional relationship model. Finally, participants by and large agreed that the DAS data suggest that LMI consumers, in many cases, seem to be making logical financial decisions based on the alternatives available to them. This observation led to a further question about the importance of financial education in a market where available alternatives are often far from optimum.

## **II. Banking into the Financial Mainstream: Barriers Faced by the Underserved**

During her career with the Federal Reserve, Sandra Braunstein has closely observed the progression of efforts to provide financial services for LMI consumers. Against this historical context, she observed that the current U.S. banking system finds itself at a crossroads with respect to its dealings with LMI households, in large part because of recent technical advances and

the growth in alternative nonbank financial services providers. In a way, how this market continues to evolve may hinge on whether the delivery of financial services to LMI households ends up being less about having a banking relationship with access to payment, credit, and savings products all in one place and more about consumer convenience and choice to select the best provider for a particular transaction. Braunstein noted these alternative paths when discussing challenges for consumers, traditional and nonbank financial services providers, and bank regulatory agencies as progress continues toward a banking system that is more inclusive and better able to serve the financial needs of LMI households while still supporting and encouraging desirable financial behaviors.

Braunstein opened her remarks by reflecting on the title of the conference — "Payments, Credit, and Savings: The Experience for LMI Households," noting that 30 years ago each of these activities — making payments, accessing credit, and accumulating savings — required a relationship with a regulated depository institution. As a result, many of the challenges to inclusiveness revolved around making sure people were able to physically visit a bank. Braunstein pointed to recent developments, such as the increasing adoption of electronic payments and the number of nonbanks providing specialized financial services to LMI households, that have changed the way we think about access. Today, ensuring access to financial products and services is less about supporting physical contact with a bank and more about issues related to fairness in pricing and to the types of providers and the variety of products. Braunstein suggested that contemporary discussions about access may need to consider new implications in an era of relatively easy access and a dynamic financial marketplace.

Furthermore, Braunstein noted that unlike the traditional banking model where services tend to be bundled around a demand deposit account relationship, alternative financial services providers make it easier for LMI consumers to meet their transactional needs on a one-by-one basis, often via multiple service providers. For example, an individual may cash his payroll check at a local check casher and, later, purchase money orders or pay bills by visiting a local grocery or a Wal-Mart. As a result, Braunstein observed, these changes have, in some ways, actually made it easier for individuals to be unbanked because there are more providers offering a particular set of financial alternatives that, in



the end, are often seen as easier to access.

While such flexibility has led to remarkable developments in consumer choice and convenience, Braunstein cautioned that it also presents potential challenges for LMI households. The disassociation of consumption-based transactions from saving or asset-building mechanisms weakens, or even eliminates, the traditional relationship between consumers and financial institutions, which, Braunstein argued, can play a key role in encouraging constructive financial behaviors, such as saving. Not having access to savings programs in the same place where transactions are conducted, Braunstein suggested, may lead to a lesser focus on savings by LMI households and, in the end, make them more susceptible to shocks related to job loss, health crises, and other unpredictable events. Moreover, consumers who rely on the alternative financial sector for their transactional needs may face difficulties in building credit histories and a reputation with a single institution as a way to establish their creditworthiness. As a result, their ability to access more affordable mainstream credit will also be limited.

To examine these market dynamics further, Braunstein shared data from the Federal Reserve's 2004 Survey of Consumer Finances (SCF)<sup>5</sup> to shed light on what it means to be unbanked. Interestingly, according to the 2004 SCF, being unbanked didn't necessarily mean that an individual had never had a relationship with a bank. In fact, 52 percent of families without a checking account had held such an account at some point in the past.<sup>6</sup> Therefore, in her view, the important policy issue may not involve focusing on getting someone into the financial mainstream but rather keeping them there.

She noted that the 2004 SCF also explored the reasons given for exiting an account relationship by those who were currently unbanked but who had previously held a checking account. The top three reasons were: 1) didn't write enough checks to make it

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<sup>5</sup> As described on the Federal Reserve Board's website, the Survey of Consumer Finances (SCF) "is a triennial survey of the balance sheet, pension, income, and other demographic characteristics of U.S. families." For more information, see [www.federalreserve.gov/pubs/oss/oss2/scfindex.html](http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html).

<sup>6</sup> In the DAS, survey results showed that 70 percent of currently unbanked households had had a relationship with a bank at some point in the past.

worthwhile; 2) didn't like dealing with banks; and 3) didn't have enough money. Two of these three reasons, Braunstein observed, seem to point to cost factors as contributing to survey respondents' choice to be unbanked. Braunstein suggested that, in fact, traditional account fee structures may not be best matched to the needs of an unbanked or underbanked population. Rather, to be successful, account-based products may require different structures, depending on the consumer segment and how and for what purposes consumers use the account. She acknowledged that developing new account structures requires traditional financial institutions to make investments in such processes. To do so, providers must have economic incentives.

The strength of these incentives weighed against the investment costs, she suggested, ties back to the crossroads analogy for LMI financial markets. If mainstream financial institutions are not motivated by economics to serve these consumer segments, LMI households may continue to use, and more deeply rely on, in many cases, higher cost options available to them in the alternative financial sector. They may also potentially suffer from the aforementioned consequences of being outside the financial mainstream.

To consider the question of incentives, Braunstein shared data estimating the potential size and value of the financial services market for unbanked and underserved consumers. As a general observation, she noted that, until recently, researchers tended to focus on estimating the number of people or households that were unbanked or underserved. Today, researchers are focusing more on also understanding the economic power of financially underserved households. Offering one example of such efforts, she cited a collaborative study by Bearing Point and Visa, which found that approximately 84 million people are underserved and many still receive payroll or benefits in the form of a paper check. Of these, the researchers estimated that 45 million were underbanked or used a mix of traditional and alternative providers, 28 million individuals were unbanked, and 11 million individuals were unbanked, unregistered immigrants. Notably, the study estimated that these people represent a combined annual income of \$1.1 trillion in wages and benefits.<sup>7</sup> Braunstein observed that from the perspective of either an alternative

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<sup>7</sup> "The Unbanked Cross Multiple Demographics," *Cards and Payments*, 19 (August 2006), p. 22.

services provider or a traditional financial institution, these very large numbers represent a significant opportunity for the right financial services provider.

One example of an innovative solution serving the market for unbanked workers is payroll cards, which, Braunstein noted, are increasingly being used by LMI households. To emphasize the market potential presented by payroll cards, she shared estimates that unbanked workers are paid \$200 billion in salary and benefits every year.<sup>8</sup> She suggested that if these workers paid check cashers a 2 percent fee to cash their checks, these outlets potentially earn \$4 billion in check-cashing fees annually; other providers could be earning these fees instead by offering an attractive alternative. She noted that payroll cards already seem to be making inroads as such an alternative and, according to most estimates, have been experiencing impressive growth rates in recent years. Research from the Mercator Advisory Group, for example, shows that \$10 billion was loaded to payroll cards in 2005, representing a growth rate of 65 percent over 2004.<sup>9</sup> Braunstein noted that payroll cards also offer a mechanism for capturing payment history and, potentially, in the future to leverage such histories in lending decisions.<sup>10</sup>

Returning to the question of incentives, she argued that the opportunity represented by this market is motivating not only alternative but also mainstream providers to invest in developing products to serve the unique needs of LMI households in a cost-effective way. In fact, she noted that there is recent evidence that mainstream financial institutions are doing just that.<sup>11</sup>

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<sup>8</sup>James C. McGrath, "General-Use Prepaid Cards: The Path to Gaining Mainstream Acceptance," Payment Cards Center (March 2007), p. 15.

<sup>9</sup>Braunstein noted that while she chose two examples of research related to the financial services market for underserved consumers, others exist. For example, she pointed to recent research by the Aite Group, LLC, which examined the global remittance market. This study estimated that global workers' remittances will reach \$369 billion in 2007, generating \$14.4 billion in revenue for service providers. These figures were expected to increase to \$456 billion and \$18.3 billion, respectively, by 2010. Again, this research concluded that significant revenues may exist for those who provide such services to traditionally underserved consumer segments. For more information on the Aite Group, LLC, report, visit [www.aitegroup.com/reports/200703261.php](http://www.aitegroup.com/reports/200703261.php).

<sup>10</sup>For more information, see Katy Jacob and Rachel Schneider, "Market Interest in Alternative Data Sources and Credit Scoring," Center for Financial Services Innovation (December 2006).

In addition to payroll cards, Braunstein discussed several other examples of mainstream innovations driven by these market incentives, such as Bank of America's "Keep the Change" program,<sup>12</sup> discussed in more detail in a later session.

Braunstein acknowledged that even with attractive market prospects and increasing provider interest, challenges remain for federal banking agencies in their efforts to balance support of innovation with ensuring consumer protections for products and services offered not only by traditional financial institutions but also by the growing number of nonbank alternative service providers. To this end, Braunstein stressed the importance of the rule-writing process. She noted that, in the last year, the Conference of State Bank Supervisors (CSBS) has been providing input into the Federal Financial Institutions Examination Council's (FFIEC)<sup>13</sup> rule-writing process, with the objective of improving coordination and promulgating rules that apply to practices of both federal- and state-supervised entities,

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<sup>11</sup>On August 7, 2007, Capital One Financial Corporation announced its acquisition of NetSpend Corporation. On its website, [www.netspend.com/info/corp/corp\\_company.shtml](http://www.netspend.com/info/corp/corp_company.shtml), NetSpend describes its mission as enabling "the 80 million U.S. citizens who lack or choose not to have a traditional bank account to become full participants in mainstream economic life. Traditionally labeled as 'unbanked' or 'underbanked,' this population receives over \$1 trillion in payments from employers, states and government entities, and holds enormous spending power. NetSpend's customers range from people who don't have the credit histories or minimum account balances that banks require, to people who want to avoid confusing fee structures and statements, to casual users such as teens managing their allowance and travelers who want to protect their cash on the go." This acquisition is an example of a mainstream financial institution acquiring an alternative financial services provider specializing in serving the needs of an unbanked or underserved population.

<sup>12</sup>Bank of America's "Keep the Change" program is described in more detail in section III.d. For more information, visit Bank of America's website, [www.bankofamerica.com/deposits/checksave/index.cfm?template=keep\\_change&adlink=000302027g850000c336](http://www.bankofamerica.com/deposits/checksave/index.cfm?template=keep_change&adlink=000302027g850000c336).

<sup>13</sup>As described on the FFIEC's website, [www.ffiec.gov](http://www.ffiec.gov), the council "is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS), and to make recommendations to promote uniformity in the supervision of financial institutions."

including many providers in the alternative financial sector.

In closing, Braunstein considered the topic of financial education and raised a concern that was echoed several times during the remainder of the day: Moving toward a more inclusive financial system is, perhaps, about matching the right products to the needs of LMI households rather than about relying too heavily on efforts to better educate these consumers. She noted that, in many cases, LMI households are making reasonable decisions about which financial products and services and which providers best meet their needs. In the end, she suggested that financial education should not be considered a panacea but rather an essential companion to innovations in our financial markets.

### III. Conference Sessions

#### a. Setting the Stage: 2005-2006 DAS: Methodology and Objectives

As the faculty investigator for the 2005-2006 Detroit Area Study, Michael Barr designed the survey to explore how and why LMI households use a wide variety of financial services as well as the costs and benefits of such services and how these consumers would respond to new types of cost-effective financial products specifically tailored to their needs. While the survey addressed a range of financial activities, as previously noted, the conference focused on three: payments, credit, and savings. Barr described several related questions that he hoped the research would be helpful in addressing: Why are some LMI households unbanked? What features of bank accounts and payment cards do LMI households want? Are mainstream and alternative credit products complements or substitutes? Why do LMI households use refund anticipation loans and payday loans? Do LMI households save? How and why do they save? And do LMI households use the tax withholding system as a pre-commitment device to save?

Barr described the 2005-2006 Detroit Area Study as a survey of 1,003 low- and moderate-income (LMI) households living in the Detroit metropolitan area. Interviews were done in person and were extensive, averaging 76 minutes. The sample was randomly drawn and stratified across three income segments — low, moderate, and median — with oversampling in the low-income census tracts.<sup>14</sup> The resulting survey population was more socioeconomically disadvantaged than the average U.S. household, with 33 percent living

below the federal poverty line. These households were mostly black, two-thirds female, and predominantly unmarried. Furthermore, 30 percent had less than a high school diploma or GED, 56 percent were employed, 29 percent did not have a bank account, and 45 percent owned their home. Focusing in more detail on the 29 percent who were unbanked, Barr noted that the survey data showed these consumers to be generally younger, less educated, less employed, and poorer than banked individuals. Interestingly, 70 percent had previously had a bank account, and the majority of those households closed the account for reasons associated with moving, high fees, or insufficient funds. When survey participants were asked what would make them open an account, their responses generally centered on lower and less confusing fees and more convenience. These findings created a picture of people who would like to be banked if they were offered a product that better matched their situation.

This insight, in part, led Barr to characterize the existing banking system, as represented by mainstream financial institutions, as unsuited to serving the unique needs of LMI households. He argued that a “financial services mismatch” exists between those products supplied to the market by mainstream financial institutions and those services or functionality and price points demanded by LMI households to meet their everyday financial needs. Filling this void, Barr noted, alternative nonbank service providers, such as check cashers and payday lenders, were continuing to gain acceptance and were shown in the data to be increasingly popular alternatives to traditional bank relationships.

Barr highlighted the seemingly strong desire, indicated in the data, among LMI households to open a bank account; in the aggregate, over 50 percent of survey respondents *wanted* to open an account and almost 25 percent *had taken steps* to look into opening an account. As a result, Barr sees opportunities for mainstream providers through innovation and product development to deliver a more finely matched, fee-sensitive mix of services, products, and delivery mechanisms to an underserved consumer segment that, as Braunstein

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<sup>14</sup> Low income was defined as those households making 0 to 60 percent of the Detroit metropolitan area median income of \$49,000. Moderate income was defined as 61-80 percent of the area's median income, and middle income was defined as 81-120 percent of the area's median income.

noted earlier, represents a potentially untapped and profitable market for traditional financial institutions.

In addition to this existing mismatch and the opportunities it presents in the private sector, Barr also spent some time discussing the role of the public sector and creative policymaking in helping to bring LMI households into the financial mainstream. As one example, Barr examined the use of the tax system by LMI households as a form of pre-commitment savings. He noted that 73 percent of survey respondents filed a tax return in 2004 for the calendar year 2003. Of these, 82 percent received a refund, averaging \$2,008. Moreover, the survey results showed that 66 percent of LMI households used a paid preparer to file their tax returns and, of these, about 38 percent obtained a refund anticipation loan (RAL).<sup>15</sup> Proportionally, more unbanked individuals obtained an RAL than did others: 51 percent compared to 31 percent.

Given these findings, Barr imagined the possibility for policy initiatives that leveraged this existing behavior. For example, he envisioned a federally sponsored tax credit program whereby financial institutions could receive a tax credit for offering low-cost, electronic-based private accounts to tax filers who did not have direct deposit. Accounts could be funded using quarterly tax withholding, could include savings-match incentives, and, with performance over time, could offer a credit feature. Barr also suggested that Congress could enact a new initiative under which the IRS would directly deposit unbanked tax filers' refunds into a new bank account set up in their name at the time a refund is issued. The IRS (or its fiscal agent) would draw from a roster of privately offered, debit-card-based low-cost bank accounts to set up direct deposit on behalf of low- and moderate-income tax filers who are currently unbanked.

Whether private-sector or public policy initiatives are involved, Barr emphasized that a key to successfully helping LMI consumers to become banked, to save, and, eventually, to gain access to affordable credit resides in designing programs that leverage existing

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<sup>15</sup> A refund anticipation loan (RAL) is offered by tax-preparation firms as a form of cash advance secured by an individual's refund. For an RAL, the tax preparer charges a loan fee and, sometimes, an application fee as well as an electronic filing fee. For tax filers who can't get their refund by direct deposit, RALs give them quicker access to the funds than a paper check.

behaviors, are simple and straightforward, and are cost sensitive.

In closing, Barr warned of the societal costs associated with financial exclusion. Specifically, many people end up paying higher costs for financial products and services, the country suffers from national dis-savings, and, ultimately, these effects are manifested in an inefficient national economy. It is the societal costs of financial exclusion that are focusing policymakers' attention and that are motivating research such as the Detroit Area Study.

## **b. Driving Payment and Transactional Banking Choices: Product Attributes Valued by LMI Households**

Moderator Jennifer Tescher, of the Center for Financial Services Innovation, introduced the first session and the panelists: Bob Bucceri, Chaddsford Planning Associates, LLC; Patricia Hasson, Consumer Credit Counseling Service of Delaware Valley (CCCSDV); and Jonathan Zinman, Dartmouth College. In all of the remaining panel discussions, Michael Barr or one of his co-authors — in this case, Ed Bachelder, of Dove Consulting — presented DAS data and researchers' relevant findings. Panelists then shared insights based on their experiences and their perspectives on how such data may be helpful in addressing the session's framing questions, which included:

- What do LMI households want from their banking and payment products?
- What are the consequences of limited or inefficient payment alternatives?
- Are payment cards a useful complement, substitute, or path to becoming banked?
- What can be done to provide better payment products for this consumer segment?

In introducing the survey data related to payment behaviors and preferences, Ed Bachelder focused on the results related to payment cards and the researchers' analysis of consumer preferences. The DAS researchers employed a conjoint tool as a way to illuminate LMI consumer preferences pertaining to a particular set of payment card features. The researchers used a repeated measures technique, which methodically varied combinations of nine product attributes in order to make inferences about the features' relative importance to survey respondents.

A detailed description of the nine payment



Attributes		Levels	
1	Credit Check	A	No Credit Check
		B	Favorable Credit Report
2	Card Type	A	ATM Card
		B	Payroll Card
		C	MasterCard Prepaid Debit Card
3	Protections	A	Federal Protection
		B	No Protection
4	Funding	A	Direct Deposit
		B	Employer Load
		C	Cash and Load for \$2.95
5	Savings	A	Automatic Savings Plan
		B	No Automatic Savings Plan
6	Bill Payment	A	Buy Money Orders with Card
		B	Automatic Bill Payment Available
		C	Pay Bills in Person with Card
		D	Pay Bills by Phone or Internet with Card
7	Cash Access	A	ATMs, Bank Tellers and Stores
		B	Cash at ATMS, and Stores
8	Cash Access Fees	A	4 Free at the Card Issuers; Then \$2 Each
		B	\$1.50 per Withdrawal
		C	\$2.50 per Withdrawal
9	Monthly Cost	A	No Monthly Fees with Direct Deposit
		B	\$2.95 per Month Fee
		C	\$5.95 per Month Fee
		D	\$9.95 per Month Fee

card features and the variations tested within each category is presented in the chart above.

The analysis showed that, of these payment card features, monthly cost, federal protections,<sup>16</sup> and funding method were the most important, and bill payment and cash access were the least important to the LMI survey respondents when selecting a payment card. Tescher and several others suggested that the importance of these preferences may be very dependent on an LMI consumer's individual situation. For example, someone who is unbanked and transient may, in fact, have preferences very different from those of someone who is making a moderate income and has a bank account.

Bachelder agreed and noted that to explore these potential variations, the research also examined

consumer preferences for these nine features across four LMI consumer segments: banked, unbanked, credit card holder, and not a credit card holder. He found that all segments identified monthly fees as most important and federal protection as highly important when selecting a payment card. Several conference participants wondered whether this consistent finding implied something about how consumers seemingly less familiar with payment cards were evaluating the costs and benefits associated with these products — that is, in ways similar to consumers who are banked or who have a credit card and, presumably, are more knowledgeable about payment card products in general.

To further explore the apparent importance of federal protections to LMI consumers, Bachelder employed a discrete-choice model using multinomial logistical regression to generate take-rates for particular combinations of product features. With this model, he built a low-valued and high-valued hypothetical payment card alternative and then varied whether these

<sup>16</sup> Federal protection was defined as consumer liability limited to \$50 for lost or stolen cards if reported to the issuer within 48 hours.

products included federal protection. Next, he considered whether and to what degree take-rates were affected by federal protection when overlaid with differences in age, income, and banked status. He found that, generally, as people get older, they are less likely to take any one of these products, but at every age group, the addition of federal protection increased take-rates. The same held true across income segments and banked status.

More generally, Bachelder suggested that both public sponsors<sup>17</sup> and private issuers of payment card programs may have an opportunity to better match existing offerings to the needs of LMI consumers by using the DAS conjoint model to test how certain trade-offs in the combination of features affect take-rates.

Bob Bucceri, of Chaddsford Planning Associates, LLC, cautioned that any alterations to standard bank product offerings may result in significant additional costs. He described his own experiences with electronic benefit transfer (EBT) programs administered by state governments. There is much interest in modifying these programs to add other government benefits, such as TANF, but these efforts are often blocked because of the costly infrastructure changes that would be required. Another issue is that for federally funded programs, the Office of Management and Budget has strict guidelines on how start-up and development costs can be allocated among programs. For example, development costs cannot be allocated based on program caseload. This makes it difficult for programs that wish to provide a joint payment application to share the cost of producing that product. Again, focusing primarily on government EBT programs, Bucceri noted that any such innovations would likely be delayed until long-term contracts with current providers expire. In summary, he emphasized that while the conjoint analysis tool may be useful for improving product design, costs and other bureaucratic and organizational limitations can often frustrate the process.

Emphasizing the preliminary nature of the analysis, Bachelder described one seemingly counterintuitive observation. The unbanked and noncredit-

card-holder segments strongly preferred direct deposit of wages to a bank account rather than cashing checks or having an employer load value to prepaid cards. Given that unbanked consumers do not have access to direct deposit, the ensuing discussion suggested that the researchers consider whether this preference is related more to privacy concerns — for example, employers having access to personal financial information — rather than to preferred funding methods. The other two segments, banked and credit card holders, also expressed a preference for direct deposit, and, in this instance, most participants agreed that the response may be more driven by perceptions of convenience. In any case, participants cautioned that the similarity in funding preferences across these segments, while interesting, may also be telling different stories with regard to motivations behind LMI survey responses.

Bachelder described another area of similarity among survey respondents: All preferred having a savings feature associated with their payment card. Tescher commented that mainstream institutions are showing increased interest in linking savings to card programs, often as a means to build customer loyalty. In her view, the addition of a savings option is positioned more as a rewards program or benefit tied to the relationship rather than as an asset-building mechanism. Hasson noted that whatever the motivation, it is still a positive development when traditional financial institutions are incorporating savings opportunities into their card programs aimed at LMI consumers. By doing so, financial institutions not only encourage constructive financial behaviors, but they also gain more value from their relationships with LMI consumers.

As a social scientist working in the field of behavioral economics, Jonathan Zinman, of Dartmouth College, noted that what academics, practitioners, and policymakers need in working together to improve financial decision-making, and, ultimately, policy-making, is more research to help them better understand what information consumers have and don't have, what information they use and don't use when they have it, and, perhaps most important, what biases LMI consumers are prone to reveal in their financial decision-making. He observed that studying payment choices made by consumers every day, in the way the DAS was designed to do, can be very helpful in shedding light on how and why LMI consumers make financial decisions.

Zinman argued that the insights provided by the DAS research and those gained through similarly

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<sup>17</sup> Public sponsors of payment card programs may include state governments (EBT programs), Department of Homeland Security (disaster relief prepaid card programs), or the U.S. Department of the Treasury (other benefits card programs, such as disbursement of Social Security payments).

inclined natural and field experiments can assist financial providers in designing products for this consumer segment and help policymakers in evaluating whether interventions are needed. He suggested that a process be established to support partnerships between researchers and firms and the government to, in essence, “systematize” innovation in payments. Building experimentation into the day-to-day operations of businesses looking to innovate or government agencies considering changes to existing policy or creating new policy initiatives can, he argued, improve outcomes. Hasson noted that such a partnership could be useful to her organization, Consumer Credit Counseling Service of Delaware Valley, since CCCSDV has developed a pre-paid card application for its consumer constituency. For example, she had not envisioned highlighting federal protections as a key part of the marketing materials, but after learning of the DAS research, she may change the way CCCSDV markets this product. Above all, Zinman stressed that recent social science research indicates that simplicity with regard to both function and price is of paramount importance in helping to improve financial decision-making and, ultimately, the well-being of LMI consumers.

Braunstein responded that policymakers are also moving toward incorporating this sort of experimentation into their rule-making process. For example, she cited the proposed rules changes, which at the time of the conference were pending, to credit card disclosures.<sup>18</sup> The Federal Reserve went through a process that benefited from feedback not only from consumer groups and industry representatives through the traditional comment process but also from focus groups, which allowed regulators to hear directly from consumers. The insights gained from these focus groups, such as confusion about certain terms, were incorporated, as appropriate, into the proposed rule changes.<sup>19</sup>

On a final note, several panelists addressed the role of financial education in helping to improve LMI households’ decision-making. Agreeing with Braunstein’s earlier remarks, most emphasized the importance of financial education in helping consumers to better

<sup>18</sup> For additional reference, see Mark Furletti, “Federal Consumer Protection Regulation: Disclosures and Beyond,” Payment Cards Center Conference Summary (June 10, 2005).

<sup>19</sup> See the Federal Reserve Board of Governors’ Notice of Proposed Rulemaking and Request for Public Comment on changes to Regulation Z at 72 Fed. Reg. p. 32948 (June 14, 2007). Also see the Board of Governors’ website, [www.federalreserve.gov/boarddocs/Press/bcreg/2007/20070523/default.htm](http://www.federalreserve.gov/boarddocs/Press/bcreg/2007/20070523/default.htm).

understand the benefits, risks, and costs associated with new and existing financial products and services. They also acknowledged that such programs alone cannot move society toward a more inclusive banking system.

### c. Access to Credit: Payday Lending and Alternative Credit Products

The next session focused on LMI households’ access to credit with a special examination of the payday lending market. Moderator Michael Barr introduced the panelists: Ronald Mann, University of Texas School of Law;<sup>20</sup> Joe Smith, Commissioner of Banks of North Carolina; and Alan White, Valparaiso University School of Law and formerly of Community Legal Services, Inc. In his opening remarks, Barr said that the session’s goal was to address three key questions:

- Are creditworthy LMI borrowers being denied access to credit or paying too high a price?
- What are the consequences of insufficient or too-costly access to credit?
- What can be done about it?

Barr noted that, in recent years, researchers and others have focused attention on the payday lending market as such loans have become increasingly popular among LMI households that need access to short-term credit. The 2005-2006 Detroit Area Study has added to the existing literature by providing insights into how and why and under what circumstances LMI households choose to obtain loans from payday lenders, either instead of or in addition to other credit alternatives. Barr set the stage for discussion by defining payday loans, describing the economics of such loans, and highlighting several relevant survey findings. After Barr’s remarks, the panelists shared their perspectives on the dynamics of the payday lending market and on the questions Barr posed at the session’s start.

As described by Barr, payday loans are generally small-dollar, short-term unsecured loans made against the expectation of a borrower’s future, regularly scheduled income payment.<sup>21</sup> By their nature, payday loans require applicants to be employed or have a regular income stream and to have a bank account.

<sup>20</sup> On August 8, 2007, Columbia University announced that Ronald Mann had joined its law school faculty. For more detail, visit [www.law.columbia.edu/media\\_inquiries/news\\_events/2007/august07/new\\_faculty](http://www.law.columbia.edu/media_inquiries/news_events/2007/august07/new_faculty).

Therefore, Barr emphasized that payday loan users are, to some extent, already part of the financial mainstream. Key questions addressed in the DAS were how, why, and to what degree these borrowers rely on payday loans. In particular, the DAS was designed to explore whether payday loans are used primarily to smooth consumption or if they represent something more insidious, such as repetitive “frivolous” overspending encouraged by easy, albeit expensive, access to credit.

As background, Barr provided data on the growth of the payday lending industry and the attributes of a typical payday loan: its size, fees, annual percentage rate (APR), and other characteristics. The number of payday lending outlets has increased dramatically since the early 1990s, growing from almost none in 1990 to 22,000 locations in 2004. Moreover, total loan volume was estimated to have reached \$40 billion in 2003.<sup>22</sup> Barr characterized a typical payday loan as being about \$300, extended for a two-week period, with fees ranging from \$15 to \$20 per \$100 loaned, or, on average, about \$45 to \$60. These fees translate into APRs of approximately 390 percent to 520 percent,<sup>23</sup> and borrowers can incur additional fees if the loan is rolled over for subsequent periods. Barr emphasized that key concerns for consumer advocates and policymakers alike are the apparent high costs associated with payday loans and the potential “debt trap” that may ensue for those who make consecutive rollovers.

Turning to the DAS research, Barr noted that 4.4 percent of respondents stated that they had looked into getting a payday loan of \$100 or more in the last three years, with 90 percent of these respondents requesting or applying for the loan.<sup>24</sup> Of these, 67 percent received the loan they requested, 10 percent received a smaller loan, and 20 percent were denied their loan request. If we look at a shorter horizon, 3.4 percent

of the survey population took out a payday loan in the last 12 months, including 40 percent who rolled over their loan and an additional 14 percent who borrowed from one payday lender to pay another. The results also showed that, on average, payday loans were rolled over four times.<sup>25</sup>

Examining the profile of a typical payday loan user in the DAS sample, Barr noted that LMI respondents who had borrowed from a payday lender, compared to nonborrowers, were more likely to be employed, working age (25-60), African-American, and educated beyond high school, and to rent their home. Of these payday loan recipients, 60 percent stated that their payday loans were used to pay for necessary living expenses such as food, gasoline, or regular bills; 11 percent said the loans were used to pay credit card or bank debts; 10 percent specified car or transportation expenses; 8 percent identified education expenses; and 6 percent noted medical or dental expenses. The DAS researchers suggested that only 9.6 percent of the reasons given for taking out a payday loan could arguably be classified as “frivolous.” Barr concluded that most payday loans were employed as a means to smooth households’ monthly cash flow, particularly when households were confronted with unexpected expenditures, such as medical, dental, or transportation costs.

The DAS was also designed to provide insights into why these LMI consumers would choose a payday lender over other types of credit providers. The top three reasons were convenience and after-hours avail-

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<sup>21</sup> A payday loan borrower endorses a post-dated check for his or her next payday, usually a two-week period. The check is made in the amount of the loan plus the fee and can be either deposited by the payday lender on the date written on the check or returned to the borrower in exchange for cash on that day. The borrower may also roll over or extend the loan for an additional period by paying a fee.

<sup>22</sup> Mark Flannery and Katherine Samolyk, “Payday Lending: Do the Costs Justify the Price?,” FDIC Center for Financial Research, Working Paper 2005-09 (June 2005), p. 2.

<sup>23</sup> The APR is calculated by multiplying the fee (\$15 to \$20) by 365 days and dividing by the number of days in the loan, assumed to be 14 in this case.

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<sup>24</sup> Barr emphasized that payday loans were not the most popular source of credit for his survey population. Respondents attempted to access credit in greater proportions from numerous other sources, including both traditional providers as well as other alternative providers. As examples, Barr noted that in the last three years, 22 percent of respondents said that they had looked into getting a loan from a bank and 14 percent had specified a finance or mortgage company. With regard to alternative sources of credit, 32 percent had looked for a loan from a family member, 22 percent from a friend, and 4.4 percent from a payday lender. Almost three times the number of applications were denied, as a group, by traditional providers than by alternative providers.

<sup>25</sup> Other sources report higher annual average rollovers per borrower. For example, a report by the Center for Responsible Lending showed that payday borrowers, on average, receive between eight to 13 payday loans a year. For more detail, see Keith Ernst, Kevin Farris, and Uriah King, “Quantifying the Economic Cost of Predatory Payday Lending,” Center for Responsible Lending (December 18, 2003; revised February 24, 2004).



ability, an expectation of loan approval, and a need for a small loan to pay an existing bill. Barr suggested that payday loan users seem to be making rational borrowing decisions that allow them to smooth their cash flow with a product that most flexibly and conveniently meets their needs. At the same time, Barr strongly believes that LMI households were paying too high a price, at APRs of 390 to 520 percent, for such flexibility and convenience.

While Mann agreed that payday loans were too costly, he also suggested that payday borrowers may be making good decisions at the moment they choose such a loan over mainstream alternatives. Again, the DAS found that payday borrowers highlighted convenience, expected loan approval, and small loan amounts as key reasons for choosing a payday loan over other alternatives, including bank products. Mann noted that a customer can walk into a payday loan office with proof of identification, evidence of employment, and recent bank statements and, in most cases, walk out with a loan. In contrast, bank loan products cannot match the immediacy of the payday transaction. Moreover, Mann noted that small-dollar bank loans are much less prevalent in mainstream lending markets: Whereas the typical payday loan is \$300, large banks rarely make personal loans in amounts less than \$3,000 or \$4,000 other than via credit cards, an avenue that may not be available to many LMI households.

Mann also highlighted the simplicity, even the transparency, of the payday loan product: a fee in exchange for a small loan to be repaid in two weeks. In comparison, bank products such as credit cards and checking accounts tend to be much more complex, both with regard to the value proposition and the product's pricing. To underline this point, Mann referred to the conjoint analysis, discussed in the previous session, where survey participants evaluated nine payment card features, many more than associated with the typical payday loan. Turning to pricing complexities, Mann noted that credit card program fees include not only an interest rate component but also fees for late payments and borrowing above the assigned credit limit. Similar pricing complexity can be found with checking accounts, where fees are incurred by account holders who overdraw their accounts. Mann stressed that both credit cards and checking accounts on which the lender assesses fixed penalty fees in the range of \$25 to \$40 become at least as expensive as, if not more expensive than, a small-dollar payday loan. Therefore, given the

convenience and pricing simplicity of payday loans compared to more "traditional" options, LMI consumers may indeed be selecting the loan product that best meets their immediate needs.<sup>26</sup>

Mann introduced another issue when he cautioned that LMI households may be paying higher costs than they expected in their initial analysis of credit alternatives because they never anticipate paying a credit card bill late, overdrawing their checking account, or having to roll over their payday loan. Hence, he suggested that LMI households' payment choices in the short term may suffer from overconfidence in their ability to make ends meet in the future.

Alan White, of Valparaiso University School of Law, responded that, in his view, examples of irrationality in LMI financial decision-making remain, even when considering a short horizon. He cited the refund anticipation loan (RAL) as one such area. In White's experience, it is not unusual for LMI consumers entitled to an earned income tax credit (EITC) to forgo this credit. EITCs are calculated automatically as part of an employer's payroll process, and the savings are reflected in the recipient's paycheck. By opting out of the EITC program, these consumers essentially postpone consumption today that could have been financed by their EITC and, instead, receive a lump-sum refund payment at tax time. In effect, many of these consumers wait all year to receive their tax refund but, rather than wait a few additional weeks to receive their tax return check, choose instead to obtain an RAL. By doing so, these consumers pay a high price to get their money just a little sooner, a short-term-financial decision that, White argued, could be characterized as unsound.

Mann returned to one of the key questions posed to the panel: Are creditworthy people paying too high a price? In each of the cases he described earlier, Mann believes the answer is yes. At the same time, he acknowledged that payday lenders are obviously addressing an unmet need in our credit markets. Therefore, he agrees with Barr's earlier comment that there appears to be a financial services mismatch, or in his words, a "broken market," with regard to the mainstream credit products available to LMI households and the loan attributes demanded by this consumer segment.

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<sup>26</sup> For more detail regarding Mann's analysis, see Ronald J. Mann and Jim Hawkins, "Just Until Payday," *University of California at Los Angeles Law Review*, 54 (April 2007), pp. 855-912.

Joe Smith, commissioner of banks of North Carolina, emphasized the policy debate underway: On one side are consumer advocates, who say that payday lenders charge exorbitant rates and take advantage of consumers' fallibility (or who, in the current jargon, engage in predatory lending). On the other side are payday lenders, who argue that the fees are necessary because of the high level of risk these types of loans entail and the costs associated with making them. Smith argued that there must be some middle ground between the high fees charged by payday lenders and the return on capital requirements of traditional financial institutions that still provides a sufficient incentive for mainstream providers to enter this lending market.

This debate is taking shape against the backdrop of a market experiencing significant growth. Moreover, agreeing with earlier speakers, Smith noted that payday lending seems to be uniquely meeting consumer credit needs related to convenience, pricing, and simplicity. As a result, he asserted, policymakers are challenged to balance consumer protection considerations against potentially restrictive policy that may have the unintended effect of pushing these borrowers toward less desirable forms of credit offered by less regulated or even shady markets, such as loan sharking.

White urged conference participants to look beyond observed consumer behaviors. He asserted that just because LMI households are using payday lending does not necessarily mean that such lending is serving the real needs of this consumer group. If payday lending is primarily a means to pay for everyday expenses, it may simply imply that these households don't have enough money to make ends meet on a regular basis. He suggested that policymakers should focus on broader questions such as ensuring that LMI households have access to adequate unemployment insurance, health-care coverage, and a living wage.

In closing, Barr acknowledged that broader policy questions are constructive, particularly given the purposes for which LMI households are borrowing from payday lenders: for everyday expenses, education, transportation, and health care. At the same time, fair and affordable access to credit is a cornerstone of asset building and, ultimately, wealth creation. Saving is also fundamental to such efforts. To achieve the societal benefits of financial inclusion, we need policies and markets that support both fair and affordable access to credit and savings, Barr concluded.

#### **d. Encouraging Personal Savings: Challenges and Opportunities**

The final session examined the role that savings can play in the financial situation of LMI households and in the financial choices they make. Moderator Stephen Brobeck, of the Consumer Federation of America, introduced Jane Dokko, of the Federal Reserve Board of Governors, one of Michael Barr's co-authors, whose remarks focused on aspects of the DAS research related to personal savings. Dokko shared preliminary findings from the DAS to set the stage for broader discussion of this topic by the remaining panelists: Patrick Kelly, of Bank of America, and Eldar Shafir, of Princeton University. As moderator, Brobeck noted that the session's structure was based on the following questions:

- What do LMI households need to save for?
- What are the tools used to save?
- What are the consequences of insufficient savings?
- What can we do about it?

To set a baseline, Dokko introduced the research by first describing how she and her co-authors defined savings. In economists' view, she noted, savings occurs when current consumption is less than current income. Moreover, if we take a life-cycle view, saving should occur when income is high, and dis-saving or borrowing should occur when income is low. This view, she emphasized, differs from the more conventional belief that saving is always good and borrowing is always bad. Over time, continued saving leads to asset accumulation and, in essence, allows consumers to trade current consumption for future consumption.

Dokko shared results about how often and in what amounts survey respondents indicated that they set aside savings. She noted that there was considerable diversity in the regularity with which the LMI households saved: For example, 32 percent saved some amount every month; 11 percent saved once or twice in the last year; and 42 percent never saved. Contributions made to savings in the last year averaged \$2,628, with a median contribution of \$1,000. Most survey respondents – 74 percent – indicated that they were saving to make a purchase either this year or next, suggesting a relatively short horizon for shifting consumption.

Given that LMI households are saving, Dokko also examined the types of assets held by DAS survey respondents. She noted that many specified having

both financial and physical assets. Three-fourths of respondents had either formal or informal financial assets: Almost half had a savings account, over one-third had retirement savings, and others held savings in life insurance policies, money markets, bonds, certificates of deposit, cash, jewelry, gold, appliances, or electronics. With regard to physical assets, almost three-fourths owned a car and close to half were homeowners. The median value of financial assets alone was \$2,500; when including physical assets, the median value rose to \$68,209.<sup>27</sup> Dokko noted that one challenge for researchers with these and other data is to develop a sense as to whether these savings are adequate and, as important, whether these LMI households are making good decisions about when and how to save and when to borrow, given their current circumstances.

To explore these questions, Dokko shared respondents' reasons for saving and the challenges they faced in doing so. The most common motivation for saving, she found, was as a precautionary measure, allowing these households to feel more secure in general or to insure against emergency costs, medical expenses, or job loss. Other reasons for saving included paying for future consumption (for example, a wedding or vacation), funding home improvements, or investing in education or additional training. Almost half of the respondents saved in order to make payments on an existing debt. Dokko suggested that this high percentage may mean that people think of saving as a regular part of their monthly budgeting process and they set aside some income from a current paycheck to pay monthly bills as they come due.

Despite the reasons to save, LMI households identified several challenges to saving. Not surprisingly, respondents emphasized that having a low income presents a real obstacle to accumulating savings; in fact, 29 percent of respondents stated that their monthly expenses exceeded their income during most of the last year. To make up this difference, 50 percent relied on borrowing from family and friends; 23 percent spent their assets; and 13 percent borrowed from a bank or credit card account. Forty-five percent of these LMI households were able to cover their expenses by using

one of these credit options or some other one. In addition to low income, LMI households specified that their many needs strain their ability to save. For example, 86 percent of respondents found it hard to save because most of their money was allocated to paying for basic necessities. Additionally, 37 percent expected to face a big expense in the next five to 10 years, maybe to purchase a home or pay for education. Finally, many respondents faced unexpected problems such as job loss or major illness in the past year, and these expenses were affecting their ability to save. Together, these short-term consumption demands added to the difficulties LMI households faced in accumulating assets or savings over time.

Dokko also considered the role of self-control in LMI households' saving patterns. She suggested that such issues may compound challenges to both saving and asset building. To give an example of where self-control issues seem to affect behavior, she returned to Barr's earlier example of LMI households' use of tax withholding for pre-commitment savings. The DAS research revealed that 76 percent of respondents saved some or all of their refund once it was received; 24 percent spent all of their refund and, of these, 79 percent used some portion of their refund to pay bills or other existing debt. Dokko noted that participation by LMI households in this form of formal savings may actually be a way for them to address issues of self-control. Along with Barr, Dokko also suggested that this behavior may reveal an opportunity for policymakers to leverage LMI households' existing use of the tax system to encourage saving while helping to address self-control concerns.

In closing, Dokko suggested that future research address whether and when to encourage saving, in what circumstances saving should be encouraged, and, finally, what types of saving should be encouraged: liquid vs. illiquid, short term vs. long term, or account-based vs. physical assets. Echoing earlier remarks by Zinman and Mann, Dokko noted that success may hinge on making the process of saving part of something that these households already do normally, combined with a simple and straightforward value proposition.

Patrick Kelly, of Bank of America, pointed to the bank's "Keep the Change" program as a product that is following these principles and experiencing some success in the marketplace. Under this program, debit card purchases are rounded up to the nearest dollar

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<sup>27</sup> The term "saving" refers to the act of putting money aside over a period of time (in technical terms, "saving" is a flow). The term "assets" (stock) refers to the amount of money that someone has saved at a fixed point in time.

for those customers who have enrolled. This amount is then transferred to the customer's savings account. For example, if an enrollee buys \$100.01 in groceries with his or her debit card, \$.99 will be transferred to that customer's savings account on the same day. Bank of America matches these transfer dollars 100 percent for the first three months the person is enrolled in the program and 5 percent thereafter, up to \$250 annually. The match is in addition to the interest earned on the account. The program does not require participants to do anything differently than they would normally do when using their debit card to make purchases and it imposes no additional fees on the cardholder. As described by Kelly, the program is a simple way for Bank of America to encourage both saving and account ownership.

Since the program's launch, 4.6 million accounts have been enrolled in "Keep the Change," and these customers have saved over \$400 million.<sup>28</sup> Kelly also shared some socioeconomic data related to program enrollees. Household income is in the moderate range (and includes LMI segments), with, for example, 15 percent making less than \$15,000; 25 percent making between \$15,000 and \$29,000; 26 percent making between \$30,000 and \$49,000; and only 6 percent making \$100,000 or more. As incomes rose, enrollments decreased. Therefore, LMI households are more heavily represented in the program. Participants are also generally younger, with an average age of 35 years. Enrollees typically have completed high school, and some have a college education.<sup>29</sup> Additionally, about half of the enrollees have some retirement savings, either in an IRA or a 401K program.

Eldar Shafir, of Princeton University, observed that the "Keep the Change" program is built on a key insight of behavioral economics: Simplicity and ease of use can significantly influence the success of a particular endeavor. In this case, Shafir said that "the *Keep the Change* enrollee has nothing to do, think about, or change...saving simply happens."

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<sup>28</sup> For further reference, see Erin Mierzwa, "Bank of America Wants Customers to Keep Their Change," *Cascade* (Winter 2007) available at [www.philadelphiafed.org/cca/capubs/cascade/64/winter07\\_08.html](http://www.philadelphiafed.org/cca/capubs/cascade/64/winter07_08.html).

<sup>29</sup> Kelly noted that 4 percent of program participants have some high school education, 22 percent have graduated from high school, 32 percent have some college education, and 26 percent have graduated from college.

Echoing earlier comments by participants, Shafir also suggested that attempts to increase financial literacy to change people's behavior — for example, to induce them to save more — will be less effective than designing programs that leverage existing consumer behaviors, as is the case with the "Keep the Change" program. To illustrate his point, he used the analogy of an individual who has been taught that walking is better for him than driving. The person will likely walk when he can, but not always, and more education is not going to make this person walk more. Instead, Shafir suggested, making it easy for the person to walk will be a much more effective strategy. For example, when designing business parks, planners may encourage walking by placing parking lots further from buildings. In this way, a simple architectural change can help motivate the beneficial behavior.

In comparing LMI consumers to upper-income households, Shafir noted that differences in financial management are less indicative of what these consumers know and understand and are more suggestive of the circumstances in which they live. For example, higher net worth individuals are more likely to be able to request e-mailed bill payment reminders, to have access to employer-reviewed 401K and retirement plans, and to afford financial planning advice. On the other hand, LMI households often don't have access to these tools to help them in making the best financial decisions. Shafir emphasized that he did not want to imply that education is unimportant but rather that it is also important to examine how to better design financial systems and products to encourage better financial behavior.

As another example of a program that is encouraging saving within an existing context, he described the premise behind the Save More Tomorrow (SMarT) program as described in research by Shlomo Benartzi and Richard H. Thaler.<sup>30</sup> In essence, the program gets employees to commit a portion of future pay raises to savings. Therefore, individuals do not sacrifice anything today but, instead, receive lower incremental salaries than they would have otherwise. Once people register for the program, Shafir said, they tend not to

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<sup>30</sup> For more information on the SMarT program, see Shlomo Benartzi and Richard H. Thaler, "Save More Tomorrow: Using Behavioral Economics to Increase Employee Savings," *Journal of Political Economy*, 112 (February 2004), pp. S164-87.



think about it again and do not take advantage of opt-out provisions. He noted that, to date, data show that people who enrolled in the program have saved twice as much as those who did not.

In closing, Shafir acknowledged that there must be incentives for financial institutions, employers, and others to modify their “architecture” in ways that make it easy for consumers to make better financial decisions. For such efforts to be successful, he believes that policymakers must play a key role in encouraging such innovative financial structures.

Stephen Brobeck, of the Consumer Federation of America, shared his recent research on emergency savings needs. To assess these needs, he compared household data on unexpected expenditures with those on liquid financial resources. After noting and suggesting an explanation as to why these expenditures were far less than the three to six months of emergency savings recommended by most experts, he suggested that these data reveal a significant “emergency savings gap” for low- and moderate-income households. He then presented other data showing that, for this population, there is a strong inverse relationship between emergency savings and negative financial experiences such as having difficulty making mortgage or rent payments, bouncing checks, and taking out payday loans. He concluded his remarks by suggesting that banking institutions can play an important role in reducing the emergency savings gap by effectively marketing automatic savings with low or no minimums. He also noted that reducing the emergency savings gap is an important goal of the America Saves program, which his organization helps manage.

## IV. Conclusion

LMI households were, at one time, generally perceived to be an unprofitable segment requiring high-cost servicing with low returns. The evolution of electronic payments has resulted in cost efficiencies that have changed the traditional economics related to serving these consumers. Moreover, recent research has shown significant earning potential among these households. As Michael Barr noted, to date, the market for financial products and services for LMI households has evolved mainly outside the financial mainstream. These consumers frequently use alternatives, such as check cashers and payday lenders, in order to pay bills,

cash checks, and access credit. Although traditional financial institutions seem to be motivated by the opportunities in this market, Barr emphasized that banks are still struggling with how to leverage their existing products and payment infrastructures to cost-effectively serve consumers who may be intimidated by bank branches, who have a mistrust of banks, or who feel that bank products are too complex and costly and lack convenience.

The 2005-2006 Detroit Area Study was designed to help researchers, policymakers, and private-sector providers better understand these consumers’ attitudes, preferences, and choices when it comes to making a variety of financial decisions. Barr hopes that this better understanding may lead to better products and delivery mechanisms to help bring more LMI households into the financial mainstream. Participants contributed a number of insights that may also assist in such efforts, including keeping value propositions simple, leveraging existing behaviors rather than requiring consumers to do things differently, and more appropriately matching products and services to the specific needs of low- and moderate-income consumers. There is increasing recognition that LMI consumers represent a potentially lucrative and mostly untapped market for financial institutions. However, while progress is certainly being made, altering traditional business models to best meet the demands of these consumer segments, in ways that remain profitable for providers and cost-effective for consumers, is not simple or straightforward.

Returning to Braunstein’s crossroads analogy, an open question remains as to how the financial services market for LMI households will evolve: Will traditional relationship-based solutions accommodate these households’ needs? Or will the transaction-based approach of alternative financial services providers be favored? Ultimately, participants generally believe that the path toward financial inclusion will be built on some combination of these alternatives.



## **Exhibit 1: Conference Agenda**

*Monday, May 21, 2007*

**Welcome Reception**

*Tuesday, May 22, 2007*

**Setting the Stage: 2005-2006 DAS Methodology and Objectives**

Michael Barr, University of Michigan Law School

**Banking into the Financial Mainstream: Barriers Faced by the Underserved**

Sandra Braunstein, Board of Governors of the Federal Reserve System

**Driving Payment and Transactional Banking Choices: Product Attributes Valued by LMI Households**

Moderator: Jennifer Tescher, Center for Financial Services Innovation

Panelists: Ed Bachelder, Dove Consulting, a Division of Hitachi Consulting

Bob Bucceri, Chaddsford Planning Associates, LLC

Patricia Hasson, Consumer Credit Counseling Service of Delaware Valley

Jonathan Zinman, Dartmouth College

**Access to Credit: Payday Lending and Alternative Credit Products**

Moderator: Michael Barr, University of Michigan Law School

Panelists: Ronald Mann, University of Texas School of Law

Joe Smith, Commissioner of Banks of North Carolina

Alan White, Valparaiso University School of Law

(formerly of Community Legal Services, Inc.)

**Encouraging Personal Savings: Challenges and Opportunities**

Moderator: Stephen Brobeck, Consumer Federation of America

Panelists: Jane Dokko, Board of Governors of the Federal Reserve System

Patrick Kelly, Bank of America

Eldar Shafir, Princeton University





## Exhibit 2: Institutions Represented at the Conference

Bank of America	Federal Reserve Bank of Philadelphia
Brooklyn Law School	Federal Reserve Board of Governors
Capital One Financial	Fordham Law School
Consumer Credit Counseling Service of Delaware Valley, Inc.	New America Foundation
Center for Financial Services Innovation	North Carolina Office of the Commissioner of Banks
CFED	Office of the Comptroller of the Currency
Chaddsford Planning Associates, LLC	Princeton University
Consumer Federation of America	Stevens & Lee, P.C.
Dartmouth College	The Pew Charitable Trusts
Dove Consulting, a division of Hitachi Consulting	University of Michigan
Electronic Funds Transfer Association	University of Michigan Law School
Federal Deposit Insurance Corporation	University of Texas School of Law
Federal Reserve Bank of Chicago	U.S. Department of the Treasury
Federal Reserve Bank of New York	Valparaiso University School of Law
	Wachovia Corporation



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The Payment Cards Center was established to serve as a source of knowledge and expertise on consumer credit and payments; this includes the study of credit cards, debit cards, prepaid cards, smart cards, and similar payment vehicles. Consumers' and businesses' evolving use of electronic payments to effect transactions in the economy has potential implications for the structure of the financial system, for the way that monetary policy affects the economy, and for the efficiency of the payments system.