

# Serving the Financial Needs of Low-Income Consumers

By

**James R. Wells, Jr.**

President, Wellspring Consulting International, Inc.

520 S.E. Fifth Avenue, Suite 1712

Fort Lauderdale, Florida 33301

+01.954-462-3430

## Introduction

The comment is often heard that it is difficult to serve the financial needs of low-income consumers, because those needs are difficult to ascertain. In reality, these needs are both basic and easy-to-identify. Low-income consumers, particularly immigrants and foreign-born nationals, share five basic needs:

1. Immediate liquidity for paper checks (paycheck, benefits check, etc.)
2. Pay bills, rent, etc., often at the last minute to avoid additional fees
3. Send money to relatives in other states and/or other countries
4. A safe place to keep whatever is left after the first 3 transactions
5. Access to small dollar value, short-term, unsecured credit for emergencies

Life in the modern economy gives rise to two additional needs:

6. Ability to build or rehabilitate credit histories
7. A form of digital currency to participate in the Internet economy

Low-income consumers need access to these services at times and locations that are convenient to them; and that suit non-traditional work schedules leaving little free time.

They need the services to be provided in languages they can understand – frequently more than just English or Spanish – by staff that makes them feel comfortable and that reflects the culture, customs and colors of the neighborhood. And, they need products and services tailored to their unique needs, preferences and economic circumstances, rather than being served stripped-down versions of what everyone else in the country has.

Precisely because this audience is defined by low income, it is not uncommon for these consumers to live from paycheck to paycheck. Therefore, rather than being financially illiterate – as they are too often accused – low-income consumers are savvy money managers. They have to be, to survive. The consequences of poor money management for low-income families can be cataclysmic – losing a place to live—losing electricity, gas and water – losing food for children – perhaps even losing the children themselves.

As a result, low-income consumers have no extra money to maintain the minimum balance in order to qualify for free checking accounts, or to keep a savings account active and open – even if they have access to bank branches.

Besides, having a checking account is of marginal value as few neighborhood merchants still accept personal checks.

And check registers require a fair degree of arithmetic skill and fiscal discipline. Many consumers feel challenged by this activity, or see it as a non-value-added activity. A feeling they share with most Americans.

### **The role of alternative financial service providers**

In such an arena, licensed, regulated, supervised Alternative Financial Service (AFS) Providers are absolutely critical to ensuring that low-income consumers have access to legal, convenient, transparent sources of financial services. AFS providers ensure that this population is not totally disenfranchised from high-quality services and that they are not driven into back alleys, into the clutches of illegal providers, and outside the range of basic consumer protections.

AFS providers operate in a space between traditional financial institutions and an informal financial services sector. These check cashers, community currency exchanges and money transmitters operate on a “pay-as-you-go” or “fee-for-service” basis where every transaction has a price, and every transaction is complete when paid for. There is no further financial obligation or liability between customer and provider. It is an extremely effective money management tool.

### **Traditional financial institutions**

Banks and credit unions operate on a deposit account relationship basis. You must put money in before you can obtain services. Transactions and services are effectively paid for “after the fact,” deducted from available balances shown on a monthly statement. Although widely misperceived as “FREE,” the current reality is that monthly maintenance fees, minimum balance requirements, per check charges, non-sufficient funds charges, courtesy overdraft fees, and the like combine to make bank services anything but FREE – particularly for low-balance accounts.

### **Informal financial service sector**

The informal financial services sector is comprised of savings circles, money lenders, and remitters. Usually organized along ethnic lines, these entities often have deep cultural roots. Most are simply family, friends and neighbors seeking to pool discretionary funds as an investment and a source of personal and business credit.

Others, which you may recognize by the names Hawala and Los Prestamistas, are patently illegal, illicit and largely invisible. None are licensed or regulated, so they operate beyond the control of regulators, legislators, law enforcement agencies and consumer protection bureaus.

### **Why consumers choose alternative financial service providers**

The continuing use of the term “unbanked” suggests that these low-income consumers are disadvantaged because they do not have a relationship with a bank, and are therefore *forced* to use AFS providers. The assumption is made that their lives would be substantively improved if they could be moved “into the financial mainstream” and begin using banks and credit unions.

## Serving the Financial Needs of Low-Income Consumers

However, the truth is that this simply won't happen. Nor should it.

Low-income consumers *do* have access to banks. A 2006 consumer satisfaction survey conducted by the Financial Service Centers of America revealed that 58% of AFS customers have either a checking or savings account at an insured depository.

Nevertheless, these consumers *choose* to use AFS providers. In fact, it is not unusual to see a customer cash a check at an AFS provider location, and walk down the street to deposit cash into a bank account.

If denied free access to AFS providers, these customers will be driven to the informal sector – out of regulated, supervised, transparent entities, and into the waiting arms of some really bad people.

Since 1989 the Federal Reserve System's *Survey of Consumer Finances* has shown that tens of millions of Americans refuse to use banks for the following reasons:

- |  |      |
|--|------|
| 1. Do not write enough checks          | 28%  |
| 2. Do not like dealing with banks      | 23%  |
| 3. Do not have enough money            | 14%  |
| 4. Service charges are too high        | 12%  |
| 5. Cannot manage or balance an account | 7%   |
| 6. Minimum balance too high            | 6%   |
| 7. Do not want/need an account         | 5%   |
| 8. Credit problems (Chex Systems)      | 2.4% |

To combat a perceived lack of financial literacy that supposedly drives low-income consumers to use AFS providers, millions of dollars, public and private, have been poured into programs in a misguided attempt to herd low - and moderate-income consumers into insured depositories.

In her analysis of the FDIC's MoneySmart program – the most widely available financial literacy training program in the country – Professor Angela Lyons of the University of Illinois, Champaign-Urbana found that even after many low-income consumers went through the entire curriculum, they were still not inclined to open bank accounts. She observed that “one size does *not* fit all.”

### **Restricting supply does not affect demand**

It is critically important that lawmakers and regulators understand that that low-income consumers use AFS providers because these intermediaries best serve their needs, not because they have no other choices.

Laws and regulations designed to limit AFS providers can certainly restrict the supply of financial services in low-income neighborhoods. However, they can do nothing to stem the demand for these services.

## Serving the Financial Needs of Low-Income Consumers

Low-income consumers – like all consumers – choose solutions that best respond to their needs and preferences. And they vote with their feet, frequenting AFS providers week after week, month after month, year after year.

### **Improving financial services to low-income consumers**

Rather than waste more time and resources attempting alternatives to a robust, well-regulated AFS industry, lawmakers and regulators should consider leveraging AFS locations, their reliability, their commitments to their communities and the trust they engender from low-income consumers by considering expansions of the services they can offer.

A few recommendations for improving financial services to low-income consumers are reviewed below:

**Alliances:** Encourage alliances between insured depositories and AFS providers that expand access to traditional and non-traditional services, such as those currently operating in California and New York

**Micro-loans:** If banks won't make short-term, small dollar value, unsecured loans, despite the Community Reinvestment Act mandating that they serve the credit needs of the communities where they source deposits, empower AFS providers to fill this gap. In many states, low-income consumers must turn to out-of-state lenders or the Internet to obtain small, emergency loans.

**Fee transparency:** Improve consumers' ability to compare the total costs of financial services by requiring insured depositories to post the prices for products and services, just as they are at AFS providers – letting educated consumers be the best customers

**Financial education:** Design financial education programs that help low-income consumers make the best use of both traditional and non-traditional financial service providers in managing their finances and building better tomorrows

**Consumer Protection:** Enlist the support of licensed AFS providers in identifying and prosecuting unlicensed financial intermediaries and protecting consumers from unscrupulous companies.

-----

Jim Wells founded Wellspring Consulting International to expand and improve access to financial services for consumers underserved by traditional depository institutions. He first became involved in such efforts in South Africa prior to the Mandela election in 1994. He worked with several of the large banks to design products and delivery systems to serve a majority population that had not been allowed to set foot in a banking hall for generations.

## Serving the Financial Needs of Low-Income Consumers

He continued that work in the Middle East, designing banking and remittance programs for ex-patriot laborers who signed for paychecks with thumbprints.

Returning to the United States, he worked with the Department of the Treasury on EFT '99, to define “alternative payment agents” and design delivery mechanisms for electronic benefits payments, particularly for beneficiaries without bank accounts.

In 2001, he helped the U.S. check cashing industry pioneer the use of stored value cards as Virtual Bank Accounts for low- to moderate-income consumers.