

THE BROOKINGS INSTITUTION

INSUFFICIENT FUNDS: SAVINGS, ASSETS, CREDIT  
AND BANKING AMONG LOW INCOME HOUSEHOLDS

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## P R O C E E D I N G S

MR. HASKINS: -- today. About a month ago, my wife and I met with our financial advisor, and it turned out to be an extremely depressing experience, as you might imagine. And as luck would have it, the very next day Becky gave me a copy of *Insufficient Funds*, and I kind of leafed through it, and gosh, I sure felt a lot better.

So this book is definitely an anecdote to the middle class depression that arises from financial difficulties. It is really amazing to see the struggles that these families go through.

As a researcher, my whole career was spent studying income, and once in a while, you know, I got really creative and studied consumption, but I never really thought of financial services and the problems that the poor have even getting a bank or figuring out a way to save money to meet emergency needs and so forth, so this is an extremely important topic, it's a relatively new area, and this is a wonderful book that is the best summary available of the area.

Let me begin by first thanking you all for coming in this weather, but also to mention that this event is being sponsored by the National Poverty Center at the University of Michigan, which Becky used to head before she came to Brookings, by the Center on Children and Families that Belle Sawhill and I direct here at Brookings, and by the

Retirement Security Project, which is a joint project of Brookings and the Georgetown Public Policy Institute.

And, of course, we always have to thank our funders. Without our funders, we'd be desperate. And the Ford Foundation generously supported both the research in this volume and this event today.

Becky is in a moment going to summarize the – let me just point out a few things. The book summarizes information on wealth, asset, and credit holdings, it has new survey based information on the use of financial services by low income families, it has a lot of information on cutting edge behavioral economic models that try to look at the way low income people save money, and it has an ample discussion of policy issues.

All of these will be discussed in today's event. I don't think that we'll focus on these in today's event, but the book also has really fascinating chapters on immigrants, which are an extremely important part of this story, and immigrants have additional problems into regular -- additional that normal low income families have with their finances. There also is a chapter on debt and credit cards, which I suggest you not read, it's too depressing, because all of us might have a little debt and credit card issues, I would imagine. And then finally a chapter on what is many ways the key issue, and that is home ownership. So this volume really has a lot of wonderful stuff.

And you can tell that the people involved are really terrific because most of them departed for the Obama Administration. There are three authors or editors in the volume that are or soon will be in the Obama Administration. Michael Barr, one of the co-editors, and along with Becky, one of the originators of the volume, will be the Assistant Secretary for Financial Institutions at Treasury; Raphael Bostic, who wrote the chapter on home ownership, will be Assistant Secretary for Policy Development and Research at HUD, and Brookings' Becky Blank has been nominated at least to be the Under Secretary for Economic Affairs at Commerce.

The price of this book for the people in this audience is exactly correct, it is zero, and you can get it right out back; if you haven't gotten one already, you can get one when you leave. One word about the event this morning, we're going to begin with Becky Blank, who's going to give an overview of the book. Then we're going to focus more specifically on two chapters. Jane Dokko is here from the Federal Reserve Board to talk about the fascinating Detroit area study. This is really an interesting study about what actually happens to the finances of poor people in a difficult urban area, as of all us know about Detroit, and getting worse.

And then also Peter Tufano is here from Harvard, who will talk about financial behavior of low income families and discuss his chapter and plans on ways that we can encourage greater savings among these families.

And then following these two presentations, our own Bill Gale, the Vice President of Brookings for Economic Studies, will comment on the papers and on the volume as a whole. And then we'll close with a panel discussion moderated by my colleague, Belle Sawhill, and then, as part of that, we'll take questions from the audience. So, Becky, it's all yours, congratulations on your new appointment.

MS. BLANK: Thanks, Ron. Thank you all for coming today on a rainy Monday morning. Working on this book was one of the more fascinating things that I've done over the last couple of years. And I also want to thank the National Poverty Center, which really was the organization, and the Ford Foundation, that put this whole project together.

We all started about three years ago on this in terms of lining up authors, and it was long before the current economic collapse. And I was saying, just as – were talking earlier, that we had a pre-conference in the, I guess it was in January or February of 2007, and we were talking about this whole set of policies and saying, gosh, it would be really nice if at some point people became interested in some of these.

And, you know, sort of the bad news is, the economy has evolved in such a way that it's led to the good news, which is, we're really talking about a whole series of policies on new regulations on credit cards, new regulations on mortgage and mortgage behavior, and about the need to expand financial services and to improve financial services for low

income, as well as moderate income families, so I guess that's both good news and bad news. I should note that one of the people who was in the room on that very first pre-conference who was going to be one of the key contributors in the book was Ned Gramlich, who died in the process of this book, and hopefully not because of the book, but he did pass on, and the book is dedicated to him. And many of you here know that Ned was deeply involved in these issues as a member of the Federal Reserve Board and throughout his life as a researcher. And I think the dedication of the book to Ned is just right. I mean he is a person who, you know, really has symbolized the importance of these issues for a long, long time.

So I want to spend just a little bit of time here summarizing what are the main themes that come through this book, because it's, you know, got all these separate chapters written by different people, and so talking about the big themes I think is important to give a sense of the whole message of the book.

And, you know, overall, when you look at the book, there is both good news and bad news. There is a wonderful chapter here looking at long term trends on financial assets and wealth holdings. It turns out that the bottom quintile of the income distribution in 1962, about 60 percent of the bottom quintile held some form of financial assets. That's, you know, credit cards, savings accounts, stocks, bonds, pension plans. By 2004, that 60 percent of the bottom quintile had increased to 80 percent of the bottom quintile. So there has been an expansion among

low income families in their access to financial assets, and there has been, at least through the data that we have, and I must say, we don't have data for 2008 and 2009, there was a long term growth in the level of financial assets.

Now, that might be the good news; the bad news is, there's still not a lot of financial assets down there. On average in the bottom quintile, we were talking in the mid 2000's of about \$1,400 on average in financial assets. That compares to the top quintile, whose financial assets are just under 200,000, so, you know, huge differences here in wealth holdings. As I suspect you all know, wealth holdings are much more unequally distributed than income holdings.

If you look at low income families, those below 20,000, you find that between 20 to 25 percent of them are unbanked, they do not have checking accounts, they do not have a formal relationship with a bank. If you look at moderate income families, between 20 to 40,000, 13 percent of them are unbanked. So there's still a substantial need here to expand and improve formal financial services. What are the four messages of the book that I most want to highlight? Message number one, low income households are financial decision-makers who need a range of financial services. They need a place to receive and store income, to invest and create wealth, to pay bills and to receive credit. And, in fact, one might argue that low income families, in some ways, need at least short term financial services far more than many middle or

upper income families. Why is that? Because of the high degree of variability in the income that low income families face.

Unemployment is much more concentrated among people of lower educational levels and in low wage jobs. So right now, if you look at unemployment rates among the college educated, they're around four percent. Among those who are high school dropouts, they're around 13 or 14 percent.

That spread, while it's going up, is not unusual. And even in times of low unemployment, you have a huge spread in, you know, the bulk of unemployment is born by low wage and low education workers. They are also disproportionately involuntary part-time workers, therefore, they move in and out of jobs much more, they're much more likely to have variable incomes because their jobs come and go. In addition to that fact, it's also true that household composition in low income families turns over more and changes more. It's more common for earners and adults to move in and out of the household. You know, partnership arrangements change at a little bit higher rate, so that you've not only got variability in individual income, you've also got greater variability in the composition of who are the adults in the household. And you put those two forms of variability on top of each other, and incomes simply are much more volatile among lower income families than among higher income families.

What does that mean? That means their need to smooth consumption is much greater than among higher income families on a



short term basis. They need either short term savings or flexible credit in order to handle exactly those sorts of income fluctuation problems. So message number one is that low income families, you know, need involvement with financial sector.

Message number two is that – which falls directly out of this, is that short term income – short term consumption smoothing may be even more important than long term savings. And I don't in any way want to imply that long term savings, you know, for education, for retirement, for home ownership, for people for whom that makes sense, is not a good thing to do. But given the variability that you see in incomes, the first need for low income family savings is to smooth short term consumption, so that even \$200 -- \$300 can make a difference. If you hit a point where your utility – you get in trouble with the local utility and your utility gets shut off, or, you know, you get into an accident with your car and your car needs work, to be able to deal with that immediately can make a real difference, and particularly if you are a lower income household, of course, and you can't deal with those things immediately, stuff can, you know, can start cascading on top of each other.

So your car breaks down, you don't have the \$200 to fix it, you don't get to work on time for a couple of days, you get fired from your job, and, you know, you have those sorts of cascading risk issues which happen again and again when you look at what gets low income families in trouble.

So this need for short term consumption smoothing, you know, is one of the emphases of this book, and I think it's quite important, in part, because the discussion in the policy realm, and certainly in the research realm, over the last five to ten years has all been about big long term savings, it's been about things like individual development accounts designed to get people to save for retirement, to save for education, to save for home ownership. Again, I don't want to say that's not unimportant; if we can establish that type of savings, that would be wonderful. But for many low income families, the first need is to provide the short term consumption smoothing so you get, you know, you provide stability on a day-to-day basis and a month-to-month basis in terms of your financial affairs.

And, you know, first of all, getting people to have the short term cushion is the first order of priority, and that can either be savings or it can be some form of flexible credit that doesn't have exorbitant interest rates with it, or, you know – and then, of course, you also want to talk about long term savings, as well, and Peter Tufano I think is going to talk about some of those issues.

So lesson number, you know, comment number two is search and consumption smoothing, and the implications for that, the value of small savings, the value for credit is important. Lesson number three, low income households use both formal and informal means to manage their financial lives. So you see a lot of low income households

that have checking accounts, participate in credit unions, savings plans, credit cards, standard loan, and mortgage vehicles. On the other hand, you also see a disproportionately high use of informal financial sector services, things like pay day lenders, check cashers, and sort of, you know, the money and credit people whose signs hang out there in low income neighborhoods, refund anticipation loans.

And the interesting comment here is that this isn't an either or, it's not that people are either banked or they use pay day loans, but for many people it's actually a both and. And when you go in and look at the data on what people on their day-to-day lives are doing, you see quite a large number of low income families that both participate in the informal financial sector and participate in some ways in the formal financial sector. So they may have a bank account, but they take out pay day loans every so often.

And what this suggests is that the formal financial sector is not meeting the full needs of, as these people define them, for their, you know, financial services, that they turn to the informal financial sector at times when they need, you know, various additional things. And particularly short term credit is often something that people have a great deal of difficulty finding, which leads them to turn to pay day lenders and all of the problems that those involve. You often see people who claim that the costs of formal financial services are very high.

And it turns out, of course, that banks, over the last ten to 15 years, for a whole variety of reasons, have gotten very, very good at segmenting the market, so that they can make it very hard for people who want to hold very small bank accounts and who might have variability in income and may occasionally bounce checks, it can make it very, very expensive for those people to be formally banked. So that often times you will see people who respond to surveys saying that it's actually cheaper to go to a pay day lender than to go to my local bank, or that the pay day lender or the money market check casher provides services I can't get from my local bank.

And thinking about exactly what are the policies that bring people more fully into the formal sector, provide the services that they need, and keep them out of the problems that often they get involved with when they go into the informal sector is one of the big policy issues in this area, okay. Finally, the fourth lesson that I think comes out of this book is that these wealth differences, as we know, are significant between high and low income families. I mean it's nobodies surprise to know there's huge wealth differences.

But there are a couple of groups for whom these wealth differences are not explained simply by low incomes. And the two most common groups that this book talks about are African American – the African American families and immigrant families, that simply taking account of peoples' long term income streams and what their savings

potential might be is not enough to explain the very low wealth holdings among immigrants and African Americans relative to other groups, and that you have to understand more than just what peoples' income looks like, you also have to understand something about the behavior and the institutional opportunities that those particular populations observe or perceive or think they observe.

So, for instance, the chapter on immigrants notes that immigrants who come from countries that have bad financial sectors that are either corrupt, that lack transparency, that go through regular bank failures, that people who come from those countries are very reluctant to engage in formal financial institutions in this country. Perhaps that's not surprising, but, of course, that then puts them at a real disadvantage in this country when they're in need of credit or they're in need of interacting with something that the formal financial sector can provide, and they're more likely to get that in another way and potentially get themselves into trouble.

So thinking, as well, about not just income and how that leads to wealth differences, but behavioral differences and institutional opportunities and how those three interact is what you really need to do to understand long term wealth holdings and differences in wealth holdings across populations.

So having said those – those are the four main lessons that I think are most interesting that come to this book. Let me just talk very briefly about some of the policies.

And I'm going to – there are a few private sector policies, a few public sector policies. I'm just going to touch these, name them, and encourage you to go back and read some of the sections that talk about these in greater depth. So from the point of view of the private sector, increases in banking services aimed at low income families are very important. And this is something that – I'd say there's really good news here of the growing interest in communities to expand banking services to low income populations. And the poster child for this is the bank on San Francisco Project that's being copied in a lot of other cities, where the city and the private banking sector have really joined together to try to expand the services and provide debit card banking, low overhead accounts, you know, small accounts that you don't have to pay a lot because you have a small account at the bank, to make banking available at retail stores that low income families will frequent.

So, increasingly, as you all know, if you go to Target or Walmart or those sorts of stores, there are now banking outlets in a growing number of those stores. It's a way to provide services in a much more convenient way.

And what the employers do in the private sector is equally important. So, you know, there's been a large discussion and a change in

the law that allow employers to provide, you know, a different set of opt and criterion for savings plans, so people who are automatically into pension or savings plans would have to opt themselves out. And those sorts of things can make a real difference. So there are a variety of issues here on the private sector. The public sector is, obviously, a partner in much of this. So let me just name a few public sector programs that are mentioned in the book; tax incentives to banks to help them serve lower income populations, to make it worth their while, because many banks worry that they cannot financially afford to serve expanded numbers of lower income families.

Secondly, IRS refunds, so that when your refund comes through, if you are an unbanked individual, you have the option of having the IRS create a bank account for you by creating a debit card with that refund which you can actually use as a regular bank account. And it's a way to try to avoid some of the refund anticipation loan problems.

A third option here, we have large numbers of public assistance programs that use electronic benefits. They tend to operate with an electronics benefit card that's entirely separated from the financial system, it's run by a separate contractor.

What we should be doing is putting these electronic benefit cards in as bank debit cards that attach you to one of the local banks and give you an actual bank account. So if you're a food stamp holder, your food stamps are coming through a bank account; if you're a public

assistance recipient, you're getting your electronic benefits through a bank account, and you can use that bank account for further purposes, as well.

A fourth issue, savings incentives schemes, and Peter is going to talk about this, he's got a great chapter talking about that particular issue. I don't have to tell you about the regulation of the mortgage and the credit card industry, we're in the midst of those conversations right now on the Hill and in the Administration.

And then lastly, I want to note that traditional redistribution programs for low income families are not irrelevant when you're talking about financial services. First of all, the problems of health and inadequate health care coverage are one of the main reasons that a lot of moderate income families end up in bankruptcy and end up facing a lot of credit related problems, so that simply solving the uninsurance and the underinsurance problems will do a lot to solve some of the really severe financial problems in certain sectors of low income and moderate income families.

In addition to that, many of our redistributive programs really are savings programs for lower income families that may not, by themselves, be able to save enough. So you can imagine savings programs that encourage people to save for retirement, that encourage them to save for education, but that are supplemented by Social Security, that are supplemented by Pell Grants. And particularly, if you're a low



income family, saving enough to get to college, saving enough to create a secure retirement may simply not be possible on very, very low incomes.

But with the knowledge that there is some safety net out there and that what you're doing is saving to provide additional benefits on top of that may make going to college, or thinking about a secure retirement, or, again, under the right circumstances, thinking about home ownership, you know, the right thing to do.

So if you take nothing else away this morning, the main message I want you to take away is the need for consumption smoothing, and for short term savings, and for short term and flexible credit within low income families, and the need for financial mechanisms that help stabilize and support good economic decision-making. And with that, I'm going to stop and let a couple of our people who have been involved with this book talk specifically about the topics on which they were writing. Thank you. And I'm going to invite the panel to all come up here to the stage and we'll just go down the line.

MS. DOKKO: Good morning. I just wanted to thank Becky for inviting me. And I just need to state the usual disclaimer, that I'm only speaking for myself and not the Federal Reserve Board or the Federal Reserve System. So today I'm going to be speaking about what Michael Barr and I learned from fielding a large scale survey about the financial services behavior of low and moderate income households.

And so, as Ron mentioned, Michael Barr has taken a position in the Obama Administration and was unable to be here, and so I touched base with him last week about what aspects of his chapter he wanted me to highlight, and he sent me a four word email, and those words were, thanks, permeability, formal, and informal.

And so I'm going to just try to – I mean I guess I'm done, right, so I can stop. So I'm just going to try to channel –

MS. BLANK: Say those four words again.

MS. DOKKO: Thanks, permeability, formal, and informal.

MS. BLANK: Okay.

MS. DOKKO: So I'm going to try to channel that inspiration for the project, and obviously I'm not speaking for him or the institutions with which he is affiliated. So one of the many motivations Michael had for this project back in 2004, when he was raising the funds and when we were designing the survey was the "problem" that 25 percent of households in the bottom quintile of the income distribution do not have checking accounts.

And to economists, this presents somewhat of a puzzle, because, seemingly, households are choosing more expensive alternatives to bank accounts in order to make payments and convert their income to cash.

Things raises a lot of questions about the financial products offered by banks versus those in the alternative financial services sector

or the AFS sector, such as check cashers, money transmitters, liquor stores providing bill payment services and money orders, pay day lenders, and many more fringe banking providers.

And so what Michael and I did was, we designed a survey which we call the Detroit Area Household Financial Services Study, and we fielded this with the help of a survey research center at the University of Michigan. We interviewed over 1,000 randomly selected low income households living in the Detroit metropolitan area in 2005. And low income households in Detroit are largely African American, headed by a single female, and a third have less than a high school education.

The median household income is \$20,000, and a little under half were employed at the time of the survey interview. And in this sample, one-third do not have a bank account or are unbanked.

Unlike New York or Las Angeles, Detroit has a small low income immigrant population, so you have to be a little more careful when you're generalizing to other low income communities, and as Becky mentioned, there's another chapter in the book that discusses some issues that immigrants – some unique issues that immigrants face.

And so here's a very short list of what we found. Consistent with work that Peter has done, it seems that having a bank account is not a fixed state for low income households, and so I think this is what he meant by permeability.

Among the unbank, 70 percent have previously had a bank account, and among the bank, 12 percent have had a bank close an account because of bounced checks, maintaining too low of a balance, or fraud. Eleven percent of the banked have closed a previously held account because the fees were too high to justify their need for a bank account. And so we interpret these results as suggesting that maintaining a bank account can be challenging for low income households.

Part of the reason seems to be the fee structure. Forty-five percent of the unbanked would consider opening an account if the fees were lower or if the fees were less confusing. But other factors are at play, including the convenience of banks and bank products and the reported economic activity among households.

Unbanked households are much less economically active than banked households. They are less likely to be employed at the time of the survey interview, they have lower household income, and as a result in the survey, we estimate that their annual outlays on financial services, so this is both transactional financial services and short term credit, are much lower than for banked households.

On a final note, incomes are volatile for some households and material hardships are common. And 23 percent of households experienced a job loss during the year prior to the survey interview. And so it's hard to identify whether it's the structure of bank accounts or household economic circumstances or some combination of both that

makes it difficult for low income households to maintain a bank account.

But regardless of the actual reason, it's just hard to do.

So the second point is that many low income households use alternative financial services, including households with bank accounts. So, for example, 21 percent of households use a check casher to cash checks, 33 percent use a grocery or liquor store to cash checks, 68 percent use money orders, 28 percent took out a refund anticipation loan, and 11 percent have taken a pawn shop loan.

These figures are higher among the unbanked, but not by a whole ton or not by a lot. And we found this to be interesting and a little bit surprising. So this is one of the survey findings that, you know, we think is new to sort of the literature.

And so although using alternative financial services is prevalent on the extensive margin, when we estimate use along the intensive margin and combine this information with the fees that low income households pay for financial services, median household annual outlays are around \$180 or about one percent of income. And about half this amount is spent on services obtained in the alternative financial services sector. And so whether \$180 is high or low, it sort of depends. I mean is one percent of income high or low for a low income household, you know, that's a value judgment that one has to make.

The counterfactual that I like to think about is, you know, what middle and upper income households pay for transactional financial

services through their checking account, and often times that number is zero. And so, you know, relative to that number, \$180 is quite a bit of money.

This being Washington, I think there are at least three different ways to spin the numbers that I just gave you. And the first is the usual consumer advocacy position. And the story here is the following; relatively speaking, the mainstream financial services sector is not meeting the needs of low income households, including those with bank accounts, in terms of the products offered, the fees charged, the level of convenience, and so forth. And a direct implication of this view is that public policy needs to address the incentives and mainstream banks and encourage them to provide the financial services that most low income households need. An alternative way to spend these numbers, and this is just the flip side of the consumer advocacy position, is to say that the much hated alternative financial services or fringe sector is doing something right. They design products that for, whatever reason, low income households find attractive enough to use in spite of their allegedly exploited fees.

Products offered in the AFS sector are relative attractive, especially in non-monetary terms, to low income households. Often times fees are expressed in dollar terms which are easier to understand than APR's or percentages. The hours of operation are convenient, their

locations are easier to access, and AFS providers may fill an unmet need for financial services among low income households.

If this is the case, then policies like usury ceilings which effectively ban AFS products or providers reduce the choice set for low income households, and this makes them at least weekly worse off.

Both of these stories I told suggests that public policy needs to expand the range of financial services available to low income households in terms of increasing the types of products available and reducing their costs. But there's a third view that you can take, and this recognizes that the research and behavior economics suggests that restricting choice can make households better off. In the behavioral economic paradigm, households have self-control problems, they procrastinate, they incur high fees because psychological forces dominate monetary incentives.

And under this view, restricting choice reduces the temptation of pay day loans or of over drafting on a bank account because of over consumption. And so in this paradigm, less choice can, but not always, make households better off.

The behavioral economics view suggests that public policy needs to restrict the choices available to households perhaps through stiffer regulation or mandating better default financial services for all households, not just low income households.

So the evidence in the Detroit area household financial services study is incredibly mixed about, you know, what the right way is to spin these numbers. On the one hand, households seem to want better financial products from the mainstream sector. We fielded a conjoint study, which is a marketing technique, in order to estimate a hypothetical take-up rate for a payment card. And we found that 60 percent of households say they would use a well designed payment card with low fees and federal protection against losses. And that's quite a high number, and that suggests that there is some kind of unmet demand. But then, on the other hand, households report they value services obtained in the alternative financial services sector. The words "convenient" and "easy to use" are often words used to describe AFS products.

And now if I had a third hand, I would say that taking options away could potentially leave households better off. Twenty percent of households over drafted on their bank accounts. Nearly 30 percent take out refund anticipation loans. And we can't really comment on whether this borrowing represents a self-control problem, but to the extent that it does, taking away these options may make lower income households better off.

On sort of a final note, I want to just say that in our data, the extent of borrowing from either mainstream or alternative sources does not appear to be excessive or for the purposes of financing excessive consumption for a couple of different reasons.



First, many low income borrowers report that they took out a loan to pay bills and/or debt, and they may have had to do so because of some kind of excessive consumption, but at least they don't think that this was the case. And second, low income households in Detroit are often too poor to qualify for pay day loans and generally have difficulty obtaining any type of credit. And so there are a ton of other results from the Detroit Area Household Financial Services Study that I'm just not going to have time to highlight. And so this is a really great reason to read Michael's chapter in Insufficient Funds.

And also, I think that there's a lot we don't know about the financial services behavior of low income households. And, obviously, Michael and I were unable to ask everything we wanted to in the survey. And so there's a lot of opportunity for research, and in particular, experimental research to extend what we know about the savings and borrowing decisions of low income households. So on that note, I'm just going to end, and thank you.

MR. TUFANO: Good morning. I'm delighted to be here with you this morning to talk about some of the research that we had done that got embedded in this chapter, as well as a broader research agenda. And we have to solve the problems of getting the economy started again, and, you know, today worry about H1, N1, and, you know, rethink systemic risk. But the problems of the poor will be with us forever, and we have to make sure that we're focusing on those both in public policy arenas, as well as

in the business arena. I am not one of these folks who's here in Washington, I'll get back on a plane and fly back to business land soon, and so I try to think about this not only as a policy matter, but also what can businesses do, since businesses and governments are the two organizations that I think can play an important role here.

So as Becky has pointed out already, you know, there are some things about the poor that are the same as everyone else and there are some things about the poor that are different.

In terms of the sameness, you know, on the one hand, the financial services needs of the poor are similar to the financial service needs of everyone else, at least at a functional level.

When we think about financial institutions as a business proposition, we identify four functions that financial institutions serve; they serve the payment function, which is the ability to buy goods and services, moving money from today until tomorrow, we call that savings, moving from tomorrow to today, we call that credit, and finally, managing risk. Whether you're rich or poor, whether you're in America or Western Europe or China, these four functions have to be performed. So that's the same between low income and high net worth individuals.

The other thing that's the same and a very interesting chapter I'd recommend you read by Sendhil Mullainathan and Eldar Shafir they point out that the psychological biases and the cognitive decision-making skills of the poor are no different than those of the rest of us, and so, therefore,

they face the same kind of issues like, for example, loss aversion, which is, they tend to value losses much more than they do gains.

And so in many ways what low income families need and how they process information is similar to the way that we all do it. But then what is different? Why do we have to worry about them especially?

I think you can think about both in terms of level and volatility. Becky talked about volatility this morning. Their lives are more volatile. But I want to focus on level for a moment.

The sheer fact that low income families are that. Low income and low asset mean that the sheer scale of their activities, their financial service activities are small. They have smaller bank accounts, they'll tend to have smaller credit lines, they take out smaller insurance policies, things are smaller. Well, what does small mean? Well, a couple of things; one is because they have less money, we have to be able to deliver their products at lower costs, because if you put the same cost structure on a smaller product, it's going to become much more expensive. And that's particularly a problem because a lot of the cost structures in business are fixed structures and not variable.

Now, this may seem odd to think about this, but because the nature of a lot of financial services activities are, in fact, fixed costs plus a little variable component, therefore, the prices that we see charged to the poor can seem extraordinarily large despite the fact that they shouldn't be

that large, and we especially see that when we see APR's. So one issue is simply size.

The other issue which relates size to volatility is small errors or small problems for a low income family can lead to massive problems. So if I were to lose \$1,000, it probably wouldn't make a big difference to my life. If a low income person were to lose \$1,000, it could mean the difference between getting a car fixed and not, and as Becky pointed out, that could mean a job or not. So the sheer size of their incomes, their assets, and their other activities mean that the cost to deliver products tend to be higher and that the cost of making an error tend to be higher. And so, therefore, one of the things that we have to worry about in terms of coping strategies is savings and credit, the chapter that we wrote. When I say "we", I should acknowledge that this was jointly done with Daniel Schneider, who's a doctoral student at Princeton. The chapter that we wrote focused on savings.

So there's an old saw that if you have a hammer, everything looks like a nail. The good thing about this book is, there are 16 authors, and we have among us a variety of tools. Just think about who wrote this book. We have economists, psychologists, sociologists, and lawyers who teach at economics departments, law schools, public policy schools, schools with social work, and yes, even a business school.

So we have a full panoply of tools, and we use them in different ways. And I want you to think about that full range of tools when

we think about ways to encourage and support people to save. Why is savings important, as Becky has already pointed out, is because it means the difference between getting your car fixed or not, as well as the difference between retiring or not, although for low income families, it's the former issue that becomes really important. So the taxonomy that we developed for this book chapter arrayed savings innovations from – along a scale; let me describe the scale.

The first set of innovations had to do with mandating savings. So in my tool analogy, this is the sledgehammer. Typically, the only person who has a sledgehammer in society is the government. And you can mandate savings either by forcing people to save, think of Social Security, or by giving them savings, and think of the United Kingdom Child Trust Fund, which gives every child at birth and then again at age seven I think about 500 pounds as a birth right.

So all the way on one end, and there are things that can be done in this town and probably a very few others, are basically the sledgehammer activities of mandating or forcing savings.

The second level of activity is making it really hard for people not to save, and how would you do that? Well, in business, our tool of choice is a stapler. We staple together savings products with non-savings products. So, for example, the Bank of America Keep the Change Program staples together a savings program with a debit card. The North Carolina SALO Program staples together a loan product, a pay day loan

actually, with a savings program. Much more elegant ways of doing that are actually described in some detail in Sendhil Mullainathan and Shafir's chapter, and that's about setting up intelligent defaults, as Jane talked about, reducing the dimensionality of choice, making fewer choices available to consumers, and having the options being ones that will tend to get people into a savings vehicle.

So, for example, we see that, in 401K participation, when the option is made that you have to opt out, and savings rates increased from the teens to the 80's percents, so that's making it hard not to save.

Third, you can make it easier to save. And here, kind of the instrument of choice might be a smaller hammer or maybe kind of a wrecking bar, and what you're trying to do is to reduce some of the obstacles between people and savings.

My favorite here is making it easy for folks to save at tax time. As some of you know, the non-profit that I founded in a lot of the work that we do tries to leverage the savings that comes out of their income program in order to support people to save. What we found is that by making it super simple for people to say, yes, I'd like to take some of that refund and turn it into savings, we've had reasonably remarkable success, in particular, with a very old fashioned instrument, called the U.S. Savings Bond.

People associate with savings bonds with savings for their kids, and what we found is that by just reducing the barriers, allowing –

almost check off a box and to direct their savings into savings bonds, we've been able to help families materially move some money to support their kids.

By the way, that would be a really simple policy thing to do, which is just have the IRS talk to the Bureau of Public Debt within the Treasury Department to create that conduit. And there are other examples of just finding ways to make it easier to save.

Economists, well, economists think they have all the tools in the world, but as it turns out, their tool of choice is simply paying somebody else to do something. And so financial incentives is how economists typically solve the problem of savings, and the way that one does that is through bribery, so bribe people to save some more. These, if you have enough money, are particularly effective. So, for example, there's a chapter in the book I recommend strongly by Michael Sharadin about individual development account programs. By giving people matches, match savings programs, the IDA programs have shown that they can induce savings activity. In a world where we have fewer dollars to throw after savings, this might be harder to do, but clearly the IDA experience is extraordinarily positive and demonstrates that economic incentives do work.

You can also see the impact of economic incentives in programs such a 401K matches.

Now, the sociologists, they have a different mindset all together. They see the individual as part of a family, and the family as part of a community, and their tool of choice isn't a hammer or a stapler, but is rather a community that's going to do a communal barn raising. And we talk about social structures that can encourage savings.

Most of the time when we think about savings, we think of it as a solo activity, an I activity. But in truth, in many communities, savings is a we activity and people get together to save.

For example, in the book you'll see a chapter by Jonathan Wardick and Darryl Collins that looks at financial diaries in developing countries. And one of the things that'll jump out at you is communal saving structures, burial societies, roskas, rotating savings and credit associations, and other activities. These activities are below the radar screen in America, although they do exist. We can bring them up above the radar screen and make them more accessible to everyone.

So remember the panoply that we've gone through; we've forced people to save, that's the jackhammer, we've made it hard not to save, we made it easier to save, we bribed people to save, and then we've made social – we made savings a social activity. I come from a business school, isn't there a better way? Isn't there a way that we can get people excited about savings?

So my last, you know, bring the tool is actually a paintbrush. You may recall in Tom Sawyer, I think it was Tom Sawyer, where he had



to paint a fence, and he convinced other people that they wanted to paint the fence. Can we convince other people that they want to save? Can we make them excited about savings?

And so one of the projects that we're most excited about is, in fact, just that. It's a project that brings to America an idea that's been around since 16 – well, since the 1690's, and has been used in countries all around the world, and it's getting people excited about savings. In particular, it merges two products that normally you don't think of merging together, which is savings and lotteries. The average American household spends how much in lotteries? This is the audience participation part of this. How many of you think that the average American household spends \$100? Raise your hands, \$100, \$200, \$300, \$400, \$500. The average American household spends \$514 on lottery tickets.

Lottery play is extraordinarily popular in America, as it is in most other countries. So this product that emerges lotteries and savings is quite simple. Imagine that everybody in this room put their money into a low risk account. You can take your money out any time that you want, so therefore, you have liquidity. Your principal is guaranteed, you'll never lose \$1.

And what we're going to do is, we're going to assemble a pot of money on the stage and that's the interest that we will all earn. We've collectively earned a market rate of interest. And your interest is not a

function of how much you've saved, but your chance of winning is a function of how much you saved. That describes the premium bond program in the United Kingdom which is run by the government there; it also describes private schemes all around the world. We've launched this program in Michigan, in conjunction with the Filene Research Institute and the Center for Financial Services Innovation. We've been running in Flint, in Detroit, and in six other locations in Michigan since about the third week in January, and deposits are flowing in quite nicely, thank you very much.

It turns out that this structure which merges both, you know, a traditional lottery product and a savings product, is quite popular among people. I should say that in this town, it's illegal. There is, however, a small loophole in Michigan law which allows this to take place, it's a savings raffle.

In any event, to get the full range of things, we started by a program which is Social Security or the UK Child Trust Fund that mandates savings, and at the end we end up with programs where people voluntarily decide they want to save. And I'd suggest that if we want to really support family savings, we have to go where they are and think about that full range of alternatives, some of which require public policy, but many of which require kind of new ways of imagining that savings could be a social activity or savings could be a business supported activity in a completely new way. Thank you very much.

MR. GALE: All right. Thank you very much. It's always hard to follow Peter Tufano because he's such a great speaker and has such interesting ideas. It's particular hard this morning because he swiped some of my ideas. But I will – I take that as a sign that sort of brilliant minds think alike, they just can't communicate with each other.

Anyway, this is an extraordinarily good book. A lot of people put out conference volumes and a lot of people care about the poor and a lot of people care about saving. I put out some of those conference volumes on saving, and so I can say I think with appropriate authority, this is an excellent book, the editors make great choices in terms of the authors and the topics, the authors really put together some first rate paper, some first rate thinking, and it's really kind of the state-of-the-art where the profession is on this issue right now.

I am going to comment not so much on the book, but on the whole diastole of the literature, and the way I want to do that is by focusing on five issues, starting with the simplest one, moving to the most complicated one. And all of these issues are touched on in the book. I'm not going to create all the links for you, but it's all in there. So the first question, focusing on Becky's emphasis on the short term consumption issues, is how important is it to have a bank account for someone to move up the economic ladder?

Clearly, for someone who is upper middle class or is running a big business or whatever, a bank account is a regular functioning –

regular part of functioning. But if someone is low income and sort of marginal to the system, how much do we gain by getting them into the financial system, into the formal financial system? I think that's a first order question.

Of course, the counter hypothesis that when people are ready to move in, they move into the formal financial system. But there's a lot of emphasis in the policy discussion on getting people in who wouldn't otherwise be, and there's a question of how valuable that is, I think that's one of the big, open questions here.

And, of course, it depends, in part, on what the bank account looks like. You can imagine high fee, kind of your father's bank account, which is not going to be very helpful, you can imagine some of these innovative, new bank accounts that could potentially be very helpful, but we don't know essentially how much it helps people who would not otherwise be in the formal financial system, to move into the formal financial system, that's point one.

Question two is, what are the economic benefits of home ownership? This was almost a religious questions for many years in that you couldn't even have a conversation in Washington about, hey, maybe it wasn't such a great idea to push people into homes that they were not either mentally or financially ready to sustain and maintain.

The experience in the last 18 months has sort of reopened this discussion. We've seen a lot of people who, if the good times had

kept rolling, it would have been fine for them to be in homes, but when home prices fall all of a sudden, they do not have the financial wherewithal to continue.

So we need to understand better what the benefits of home ownership are, in particular, what the benefits of moving people into home ownership before they would otherwise move into home ownership are. Peter mentioned the IDA results that – in Michael Sharadin's chapter. Michael and I and two other people, Mikal Weiss and Bill Rowe at North Carolina, have just finished being in the field for a ten year follow-up survey on those households. We can look at stuff like long term effects of IDA's on home ownership, and wealth accumulation, and in particular, how the IDA group did relative to the control group over the last five years during all the turbulence in housing markets, and hopefully I'll report back on that in a couple months.

Okay, the third issue, moving to slightly more complicated and somewhat away from the focus of the book, per se, but important in the saving literature is, are people saving enough for retirement, and this is a very strange literature. In the '90's, basically every paper said we're all going to hell in a hand basket. At the end of '99, I wrote a paper that said, well, it looks to me like about one-third of households are doing fairly well, one-third are doing pretty badly, and one-third are in this nebulous middle where you can't really figure it out, and that was regarded as like a revolutionary outcome at that point.

Since then, though, almost all the literature has found even stronger effects. Michael Heard, Carl Schultz, Eric Hurst have all found that 80 to 100 percent of Americans are doing just fine. Now, two comments on that, one is, all of that is before the recent downturn; the other comment is, it doesn't square with what we think of when we think of people on, you know, if you go to a party and ask, people, are you saving enough for retirement, you not only get, you know, no's, you get, you know, laugh, that doesn't pass the laugh test, of course, I'm not saving enough for retirement.

So there's a distinction – there's a tension between what the data say and what people seem to think. And, you know, if 20 percent of the population can't calculate change on a restaurant check or whatever those statistics are, you know, it's hard to believe that 80 percent is saving enough for retirement. So there's this tension there and we don't know what the right answer was, and we certainly don't know what the right answer is now that the stock market and housing market have both fallen.

Okay, fourth issue, how different are low income households? Yes, they have less money than us, but does that make them different? Is it their constraints that are different, is it their behavior that are different? I think this notion that I believe either Peter or Becky touched on that the same, you know, absolute dollar change, \$1,000, can be a devastating impact on a low income household because they lose

their car, they lose their job, they start a downward spiral, that wouldn't happen with the same shock to a middle or an upper income household.

Understanding the sources of differences between the behavior, the constraints, the goals, the needs of high income and low income households is a growing area. But I think there's been a growing recognition of the difference, but I don't think there's a full answer in terms of, oh yeah, they're just like everybody else, they just have more constraints, or they have different goals or needs or different time horizons.

All right. The last point then is, what do we do about all of these issues. Peter mentioned I think six different tools. The way I've thought about this generally is in four categories; one is the mandate, you can impose Social Security taxes; the second is incentives, this is, of course, the classic economic solution in terms of tax incentives for saving, you know, IRA's, 401K's, IDA's. I'm less sanguine than Peter was about the benefits of tax incentives for saving, but it is a second option. A third option is to change the defaults, to change the choice architecture to automatic enrollment or automatic investment in 401K's or IRA's; and the fourth option is to educate people, to give information. And these options are not exclusive, are not mutually exclusive. You can think of them, in fact, you can think about whether they're substitutes or compliments. If you default someone into an account, into a 401K, and they start accumulating a balance, does that mean you need to do less education

because you've already gotten them into the account, or does that mean you need to do more education because you just gave them an account that they have no idea what to do with.

So they're not mutually exclusive categories. Peter had a couple of other categories that I thought were very good. The communal aspect I think is important. And we need to think about what combination of policies work. But then the deeper question is, work to do what. And this is the thing that I'm currently stuck on, is, do we want to change outcomes, do we want to change the environment in which people operate through either default or incentives, hoping that that changes the outcomes, or do we want to change people, do we want to change their behavior, their knowledge, their attitude, their aptitude, et cetera, and maybe we want to do all of those things, but some of those are likely to be more effective than others. And just let me give you an example that we were talking about this morning, which is not financial, just get away from the finance side for a second.

Suppose there were a way to put anti-oxidants into cigarettes, all right, would that be a good thing? Well, you know, people who are smoking anyway would then get more anti-oxidants and they would be healthier. On the other hand, you know, you've got to be real careful suggesting that cigarettes are a healthy thing to be doing.

Now, that's a loaded example, because cigarettes, you know, if you use them as prescribed, you will die, but let's change it to



chocolate bars. Suppose the government – suppose somebody figures out a way to get you your full compliment of vitamins and anti-oxidants and put them in chocolate bars, or I think Diet Coke had calcium or something like that, which my wife thought was the greatest thing in the world, and I thought, well, you know, there's an issue here, which we did not talk about, but there are issues if you, you know, do you want to encourage people to eat chocolate bars as a way to get their vitamins, their anti-oxidants? And if all you care about is getting the vitamins into their system, the answer is yes; if you care about developing healthy eating habits, then the answer is probably no. And the same thing is true, it seems to me to be true in the saving field. If all you want to do is get people into these accounts or get them to accumulate balances, you follow one or two sets of approaches. If what you want to do is sort of inculcate saving behavior, you know, have people learn about the benefits of savings, you know, change attitudes and aptitude about it, then you might follow a different approach.

And I want to be clear, I don't have the answer, this is not a criticism of any particular approach, I just think it – the more I think about this issue, the more – once you get out of the strict confines of economics, which tells you if you change the incentive, people will optimize in a perfectly rationale and have full information, once you get into the world of sociology and behavioral economics and psychology, you face these sort

of issues, not quite morale issues, but they are – they do present interesting ways to think about policy.

So that's currently what I'm thinking about in the saving arena. And I found the articles in this book to be very helpful to me in thinking about what the costs and benefits of each of those options are. Thank you.

SPEAKER: Okay. Well, we'll have a few minutes for discussion up here with the panel, and then we're going to open it up to all of you, so be thinking about what your comments or questions are. And also, let us know where you're coming from if you decide to make a comment.

I want to go back to this theme that Bill has I think nicely put on the table here, which is sort of two big questions, and then I want to go down the line here, maybe I'll start with Becky and go down in this direction, because Becky has the broadest overview here, although Bill, of course, does the whole literature, so you both do.

But the big questions I think are, first of all, as Bill suggested, what are the goals here. And, Becky, you suggested in your opening remarks that – I mean obviously multiple goals, but I'm not going to allow you to give a speech on multiple goals, not a single one of you, okay, so be prepared, I want one answer. I want you to try to tell us what's the most important goal. You suggested, Becky, it might be short term consumption smoothing, but – so you can come back to that if you want, but that's the question for all of you, and then what's your favorite tool for

achieving that goal. You know, Peter put forward this very nice set of tools, all with nice catchy names, you know, from sledgehammers to barns, communal barns, but, you know, Bill got into some issues about how, you know, the tools maybe should be related to the goal. Maybe we don't want to have a form of candy, like a lottery, to encourage people to save if we have some goals other than pure savings in mind, so this is what I'm trying to get at. So, Becky, let's start with you for a few more comments on goals and tools.

MS. BLANK: So I am not going to say smoothing short term consumption because I think that gets into a lot of savings things and I'm hoping someone down there will say that, let me talk about something else, because it's partly a response to Bill's first question.

I actually think one of the really important goals here is to increase the number of people who are involved in the formal financial sector, which is to increase banking, increase the number of banked individuals who have in some way checking accounts, savings accounts, something that connects them to a formal financial institution.

SPEAKER: Why do you want them to do that?

MS. BLANK: I want them to do that for several reasons. I think, first of all, it's really important to have a place to keep money safe, you know. Very few of us, when we cash, you know, get our check at the beginning of the month are going to spend it all immediately. I mean you need a place to keep your money, you need a place out of which you can

pay bills, a way to simply handle money, and you – in this world, that means some form of a financial institution that you don't pay for every time you want to cash a check, every time you need to, you know, pay some sort of bill in some way or another.

Secondly, banks give you access if, indeed, they provide products that are friendly to low income families, should be giving you access to a series of bank services that include check cashing, short term credit lines, savings vehicles, you know, it gets you the opportunity to find out about, to be educated on, and to potentially have access to a number of things that at certain points in peoples' lives, hopefully they're going to have the capacity to take advantage of. So I, you know, plus the ability to earn interest, as well, on the money, so that's my goal. And then the nice thing about this is that there are multiple tools.

SPEAKER: Can I just push you a little bit?

MS. BLANK: Sure.

SPEAKER: Why is it that that's not occurring right now?

What are the sort of failures, market failures if you will, or personal failures that are preventing that?

MS. BLANK: Jane talks about this, it's, you know, very clear in the Detroit area study, as well as in a variety of other pieces of research, that a lot of people consider bank accounts too expensive and too risky, risky in the sense that if they get an overdraft, they end up paying, you know, \$50, and \$50 is a big amount of money for a lot of low

income families, or in many, you know, that issue, there's an issue of people, say you walk into banks, you get this from immigrants a lot, and they're made to feel, you know, very much not welcome, you know, people don't want their money, I mean they're, you know, intimidated by, if not actually treated badly, in their own view, by people.

There's a convenience issue here of folks saying, well, gosh, you know, the pay day lender is right there and there's not a bank nearby. There's a whole number of reasons why people don't use banks, but the most important one, to me, is that banks have not worked very hard in the recent past, and I do think this is changing to provide a set of services that are particularly tailored for low income families and low income individuals, that they price their products in such a way that make them simply less accessible and less valuable to those, if not more expensive to those individuals.

SPEAKER: Okay. Bill, do you agree with that? Are there reasons why banks are pricing this product in a way or delivering it in a way that makes it hard for low income people to use it, or should they be doing something different?

MR. GALE: Well, I thought I was asking the questions.

SPEAKER: Yeah.

MR. GALE: Let me go on that note, it would be very useful to know whether the alternative financial sector, the pawn brokers, the

liquor store owners that sell banking services, whether they make excess returns.

SPEAKER: Yeah.

MR. GALE: If they don't, then that alters the nature of the debate somewhat. The argument that people are getting exploited would suggest that there's excess returns out there. If those can be documented, that would help clarify what's going on. In terms of what's most important, I want to come back to something that Peter said, which is that you need to meet people where they are. You can design fancy instruments, you can come up with complex theories, but if people aren't ready to absorb them, they're not going to work. They'll make nice papers, but not good implementation initiatives.

And so I think that – so what the most important goal is, of course, depends on where everybody is. And from my feel for it, I don't think retirement saving for low income households right now is such a big deal. A, they've got Social Security, B, they've got huge amounts of much more immediate concerns.

And so I think just – not as an expert on low income households, just through introspection, I think getting the constant buffeting out of the day-to-day life is probably the single most important thing you can do. So I'm going to claim the short term consumption smoothing answer, because I don't see how people can reasonably plan

for the median term or the long term if they're just constantly fighting battles every day.

So I don't know exactly what the right solution there is, but something – there is sort of an – I'm thinking sort of loosely, sort of an ordering of needs, and it's hard for me to see how people can save for a home or a business or a retirement or their kids' college when, you know, they're a one car accident away from losing their job, and so focusing on the sort of very mundane, day-to-day stuff I think would be the first step in order to get people to a position where they could focus on the medium term and the longer term.

SPEAKER: Okay, Peter.

MR. TUFANO: The good news about coming third is you get to repeat stuff. You know, so I'm going to think about goals from the perspective of business and then consumers, because I think about both. From the business side, my goal is that there is a sweep of products that form basic financial functions at a fair price. And I need to define the word fair.

Fair, to me, means that it's at a price where there are no excess returns, but that means that it's sustainable as a business proposition. And when I said basic, I mean just that, you know, a no risk transaction account, where risk means no risk of loss and no risk of fees, a simple savings account that transforms money from today until tomorrow without, again, risk of loss, a simple credit account. So my goal on the

business side is to create a suite of products delivered, and I don't care whether it's by banks or not, I'll maybe disagree with some folks. I want the functions to be delivered. Some of the most egregious financial products right now are being pedaled by banks. So the fact that it happens to say bank on it, to me, is no stamp of anything.

So overdraft protection, for example, has the highest APR's of any product offered in the financial sector right now. The FDIC's survey that came out in November said that the average overdraft was \$36, and the average fee was \$27, and the time to remediate is a few days. That boggles the imagination with the APRS on that product.

SPEAKER: In your view, does this, you know, excess return, predatory lending, whatever you want to call it, which I presume there's some of, is it interacting with the behavioral thesis that people are a little ignorant about the fact that they're paying too much for these things?

MR. TUFANO: Absolutely; so that actually goes to the other side of the equation. So if I want to, you know, a basic set of business – a basic set of financial products on the other side, you know, maybe goal is not putting it strongly enough, but dream would be the, you know, households and individuals have basic financial management skills in order to make intelligent decisions. So, for example, I'm going to go back to the overdraft example; we did a case study in a bank in Indiana, and 89 percent of individuals use overdraft either zero, one, or two times a year in



that bank, and 11 percent use it over 50 times a year. Fifty times a year times \$25 per incident is an extraordinarily high cost of basic banking services.

So, you know, the bank is set up to maximize their profits from that class of customers and cross subsidize others, and the customers are unwittingly bearing all those costs because they're not able to manage their money any better.

So do some of these business models depend on less than fully informed customers or customers that have severe constraints? Absolutely. And so, therefore, what you have to do is just to try to relieve the constraints by the consumer and improve their financial management skills so they can see, for example, that that's a \$1,200 checking account and not a free checking account, which is the way it was presented. So the goals are both educate the consumer so they make better decisions, and provide a basic set of products so that they can have something good to pick from.

SPEAKER: Jane, I see you nodding your head on those answers; what would you add or –

MS. DOKKO: So I mean I think the advantage of going last is that I can say I agree with everything that's been said. And the thing that I wrote down was, I think, you know, the most important goal, at least in my mind, is to reduce the number of financial mistakes that low income households make, because as Becky pointed out, you know, these

mistakes can compound or cascade upon other kinds of problems that low income households have with, you know, with their income, with their household structure.

And in some sense, there's a huge, you know, efficiency loss in the sense that, you know, the financial mistakes that households make, you know, just can reduce the efficiency and the efficacy of social insurance programs and other anti-poverty programs.

And, you know, I don't think we have a sense for how big that efficiency loss is, but given sort of the high costs that households, you know, can incur in both the banking and non-banking sectors, I mean it could potentially be quite large. And so, you know, as far as tools go, I mean I guess I'm an empiricist, and so I'd like to see sort of evidence on sort of like what works and what doesn't work. I think there's fairly compelling evidence that defaults and sort of changing the environment that households are – make financial decisions and I think there's compelling evidence that that works. I think that there isn't, you know, such compelling evidence on incentives.

I also don't think that there's very compelling evidence on financial education. And so, you know, you can't really, you know, "train" low income households to behave better, and these are, you know, all very controversial words that I'm using, but, you know, that's sort of how we talk I guess as economists.

SPEAKER: Thank you. People out there, what would you like? Bob Lerman, wait for the mic to come.

MR. LERMAN: Bob Lerman, American U and Urban Institute. Two quick questions; one, what about asset tests and low income programs, we haven't talked about that. And the other is, you're sort of talking as if there's a single decision-maker in these units, and has anybody done any real research on the possibility of the fact that when there is a couple of decision-makers, a couple, you know, living with an uncle or a parent or something like that, that complicates things a lot more, or maybe it helps, I don't know, but is there some work on that?

SPEAKER: What one or two people want to take that question? Becky.

MS. BLANK: Let me say a word about the assets test. As many people here know, many public assistance programs basically condition eligibility for the program on many things, including the value of your car or the value of your savings, and there's been a real concern that the conditioning basically discourages savings, it discourages people acquiring wealth because you don't get access to food stamps, and if you need that in the short run, that's a lot more important than worrying about savings.

So there have been, since welfare reform in the mid 1990's, a variety of states that have raised asset levels and have tried to do a number of things to not discourage savings in the process of providing

people with public assistance. You know, Bob, you might know this literature as well as I do. My sense of this literature, much of it is revolved around tests on vehicle – on the amounts for your vehicle is somewhat mixed. There are a couple of studies out there that suggest that it actually makes a difference since you encourage people to have either higher values of cars or some savings, and there are a couple of studies that say it doesn't seem to matter very much at all.

The people who are true believers in the values of savings and the problems of assets tests tend to be on one side of this, and there's still a lot more ideology than there is hard knowledge about the effect. So I think that's one where we simply need more research. I'm sorry.

SPEAKER: It is a hard policy issue going forward.

SPEAKER: Also in that literature, my sense is that the range of variation across states and stuff is not enough to change the kind of basic uninformed person's view, not uninformed, that's not right, the basic kind of 30,000 foot view that the person has that saving could be punished, right. So, you know, if you – people say, well, you don't want to eliminate the asset test because then some millionaire that happens not to be working could get food stamps, fine, raise it to \$100,000, you know. I think that kind of shift might generate a different result in savings – because it kind of changes the view about saving. If you have to worry about whether your car value is 2,500 or 5,000 or 7,000, you're still in this,

oh, a good car is going to mess me up world. So I think there's a lot of room to experiment with big jumps in assets tests that aren't necessarily, you know, elimination.

SPEAKER: Everything with small changes on the margin right now.

SPEAKER: Yeah.

SPEAKER: Okay. Let's get some more people in, right here.

MR. CHASSIN: Dana Chassin, OMB Watch, and I'd like to drill down a little bit further on Ms. Sawhill's question regarding goals and tactics and go to the issue of means, what the costs might be in terms of public resources, in terms of mandates, and then feasibility. Under current political circumstances, how would you analyze the goals that you identified? Thanks.

SPEAKER: I'd be happy to –

SPEAKER: Okay, Bill.

MR. GALE: Sure; it's a great question. In terms of the cost, I used to think we were highly constrained, but now I'm convinced that if the federal government got any overdraft protection business, we could finance all that stuff. Seriously, costs are one of the big objections to the incentive approach because it's just so expensive. We spend \$200 billion a year on saving incentives for pensions, 401K's, and IRA's. A lot of these

other approaches, the communal approach, the excitement approach, the default approach, don't require big budget outlays.

And I think what the literature has learned is that the well developed interventions to encourage saving can work very well even if they don't provide, you know, big tax incentives to do that, and I think that's an important lesson and we should continue pushing that way, because we can't afford, you know, another \$200 billion as year in savings.

SPEAKER: Can I comment on political feasibility?

SPEAKER: Yeah, sure.

SPEAKER: I mean I think it is one sense in which, you know, don't let a good crisis go to waste, that the current economic collapse which has created credit and wealth problems among a much broader group of individuals than is common in a normal economy does bring this set of questions about how should we be regulating mortgages, how should we be regulating credit cards, how should we be providing people access to various savings plans, much more into the current conversation. And I am quite astonished from starting this project at how much – how many of the things that are sort of were, you know, originally talked about, gosh, wouldn't it be nice at some point in time if people became interested in this, a really quite hot topic on the current agenda.

And in that sense, I think political feasibility has shifted quite a bit. The question of will there actually be enough consensus to create

legislation, you know, that remains to be seen. I mean will the feasibility – will the window that has opened actually turn into a change in law, I don't know.

SPEAKER: Yeah; one comment I might add here, the most recent issue of *The New Yorker*, for those of you who may not have seen it, has an interesting article about OMB and Peter Orszag and the sort of new thinking on behavioral economics that's beginning to seep into the public policy proposals of the current administration and probably will more so down the road.

SPEAKER: If I can just put in my footnote. I mean the idea of allowing consumers to take part of their \$250 billion in tax refunds and to tell the government to keep it in the form of, you know, treasuries or savings bonds, especially in an investment environment where an inflation index return is probably one of the kind of – one of the products that does the least harm actually is a revenue generator, maybe not revenue, but it's a capital generator for the federal budget as opposed to a drain on the budget. And I think it would require IT changes and that's about it.

SPEAKER: It doesn't help the recovery, but yes, back – all the way – yes, with the glasses, right there, yes.

SPEAKER: Okay.

SPEAKER: All right.

SPEAKER: I do have glasses on, so I will speak. I'll keep them on. Social Security, the main reference I heard to insurance was

that of health insurance, that not being properly insured or insured at all can result in an economic shock to the household. Is there evidence that there are other insurable risks that, because the household is not insured or sufficiently insured, is presenting a shock, and the best way to avoid this problem is not through savings or access to credit, but rather to insurance, and if so, is it feasible for low income households to have other forms of insurance that would be, I mean, you know, an economically sensible, you know, call it what you will, allocation of resources or investment?

SPEAKER: Let's get in a few more questions and then we can choose up here which ones you want to ask. Yes, I was trying to call on you before.

MS. SIDEMAN: Hi, Ellen Sideman from New America and Shore Bank. And actually, I'm sorry that I think I'm going to throw a little bit of cold water on Becky's optimism, because from everything I can see, and I've actually been with a bunch of big banks recently, and small banks, we're having a pull-back, that in 2007, one might have been very optimistic about, or 2006, about banks reaching out to the lower income communities, but because of their own situation, because of the tightening of credit standards, because of consolidations that are happening for supervisory reasons, I think they are pulling back some, and I think actually not finishing up the immigration debate has only exacerbated that issue.



And that leads me to sort of three questions; one is how to encourage them to reverse field again, because I actually think that there are huge opportunities here. A lot of the under bank never had mortgages, never had credit cards, they're in a good deal less trouble than some other folks. Second, whether there are alternatives that really are better at least as an on ramp. Pre-paid cards come to mind here. And many of them, or at least some of them are now really experimenting with things like savings buckets, and Peter knows all about those.

And then the third thing is direct deposit, which cannot – it's much lower in the United States than it is in other countries, other developed countries. In most states, you can't force employees to move to direct deposit, and yet with bank accounts being difficult, and, to some extent, not available, the question of should you be forcing I think is a real one. So I'd be interested in the panel's thoughts on any of those.

SPEAKER: Yes.

SPEAKER: My name is – I'm an independent consultant, and I wanted to follow up on what Becky talked about, people being banked as a goal in itself in terms of having mainstream banking facilities available to them. Are there any studies done that examine the impact of being banked on family well being? For example, apart from just consumption smoothing and savings, say on children's outcomes or health outcomes or any other outcomes. And I would like to mention, I have done some – research using the making connections data set collected by

the Casey Foundation which shows associations between being unbanked and school absenteeism in children. So do you further studies like that?

SPEAKER: Okay. Why don't we have whatever you want to comment on or answer that's out there and any final comments you want to make, and why don't we start with you this time, Jane, and go down the line?

MS. DOKKO: So I guess I'll speak to the insurance question because there's some evidence in the Detroit area study about the extent to which households are and are not insured against, you know, certain kinds of shock.

Certainly, I guess we find in our data that job losses are fairly common and that's sort of the largest sort of shock that households experience. And toward that end, you know, it's not clear whether – I don't think you want households to self-insure against job losses, like we have social insurance for that kind of stuff.

But, you know, the other stuff that happens that's, you know, not necessarily as big, but, you know, maybe happens at a larger frequency is that, you know, households, you know, face, you know, either eviction or foreclosure, households, they also, you know, face having utilities or their phone cut off, and then, you know, they also experience things like homelessness, and so there are a lot of material hardships that can incur.

And it's unclear whether, you know, these, again, are, you know, the result of, you know, something tied to the financial system. But to the extent that it is, I think, you know, again, you know, there's something, you know, with having a bank account that can help, or having access to better financial services that can help smooth some – smooth away some of these shocks.

SPEAKER: Peter.

MR. TUFANO: I'll address Alan's questions. I share your concern about the banking industry. Right now they're going to have to rebuild profitability and going out for small accounts with high cost structures is not a good way to do that. And so, therefore, you suggested, and I share your interest in other on ramps for financial services.

Card based platforms, as we know, as you brought up, can be, they don't need to be, but they can be, if designed responsibly, relatively low cost to deliver much of the functionality, both for transactions and for savings. And a number of non-bank players such as Walmart have expressed a tremendous interest in this space. So I think there are other ways to deliver this basic package of financial services that may overtake the speed with which banks are willing to do that for low income communities.

SPEAKER: Bill.

MR. GALE: Jane, to address John's question on insurance, I think it's a really important issue because there is a whole portfolio of

financial options that people have and insurance should be in the discussion in the same way that saving and prudent use of debt, et cetera, is.

I just wanted to comment on Alan's question about direct deposit. There's sort of an analogy in the 401K literature where firms went to automatic 401K's, and then after a couple of years, people realized, well, they were being defaulted into not so great investment options, and so then the second generation of automatic 401K's came along and said, well, let's try to make this intelligent defaults, not just defaults.

And so my concern with doing direct deposit, which I think is generally a good idea, my concern is that we would put them into these accounts which would then charge \$27 for \$36 overdrafts, and so that if we were going to create a default bank account that people could deposit their money into, we would need to pay attention to the idea that it was an account designed specifically in the way Peter described it, sort of safe return, safe with respect to costs, et cetera. But generally I think that's a good way for policy to be moving.

SPEAKER: Becky, you get the last word here.

MS. BLANK: All right. I'll make two quick comments; one, let me respond to the question about banking and family well being. It's very hard to conclude anything by simply looking at the correlations between those who hold bank accounts and those who don't, and other forms of, you know, child outcomes of family well being, because those

are not too randomly – identical populations except one as a bank account, they're different along a whole variety of dimensions.

To really get at that answer – some form of a, you know, natural experiment, which some people – because banks are more prevalent in one area than another, or reached out in some way that equivalent people compared when they are banked and when they are unbanked, and it's very hard to do that. Both Bill and Peter have done some very clever and very creative randomized experiments around some of these topics, but I don't think explicitly on that one, so that's a hard one. Now, let me just end by making a comment about Alan's statement, which is absolutely right. In this environment, you know, banks have been going through a very bad patch, and to expect them to be expanding their services to a hard to serve population is not necessary a reasonable expectation.

What I think you need is the whole issue of public private partnerships here is highly important. And thinking about both community level concerns, public interest, and private receptiveness to deal with these issues, you need all three of those on the table.

And, you know, of course, on the one hand, sort of the community level concern, and the public concern has gone up, at the same time, the private ability to provide new and expanded services to an uncovered group perhaps has gone down, and that makes the public private partnerships all the more important.

And, you know, yes, I absolutely agree, we need to provide a set of services out there available in most areas to low income families. It would be nice if banks were able to provide those and figure out how to make this profitable. But in some cases and for some populations, that may not be true, and certainly in some economic environments that is not true, which is one reason why you need some form of public involvement in this, whether it's tax incentives to the banks, or you know, some form of assistance for serving particular groups of low income populations, or whether it is coverage of some of the cost structure in exchange for the banks providing, you know, bank accounts to those who are getting refund loans through their – the tax system or who are getting electronic benefit services of some sort through these accounts.

And so the issue is not to go and demand that banks do this, but to do it in an intelligent way that involves the public sector where necessary and gets the community involved, as well.

And as many of you know, for instance, the CDFI's, the Community Based Financial Institution's funding out there is hopefully going to be expanded in the near future, and I hope that that may provide some opportunities, as well, for some new services.

SPEAKER: Of course, to the extent that the government owns all the banks now, it can just do what it wants.

MS. BLANK: That, too.

SPEAKER: On that optimistic note, I want to thank everybody up here for a very interesting and – thank you all for coming.

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