Financial Access Without Expertise

Consumer Implications of the Credit Crisis

Picking Up the Pieces: Fair Credit for All
The Federal Reserve Bank of St. Louis and the RISE Foundation
February 22, 2008

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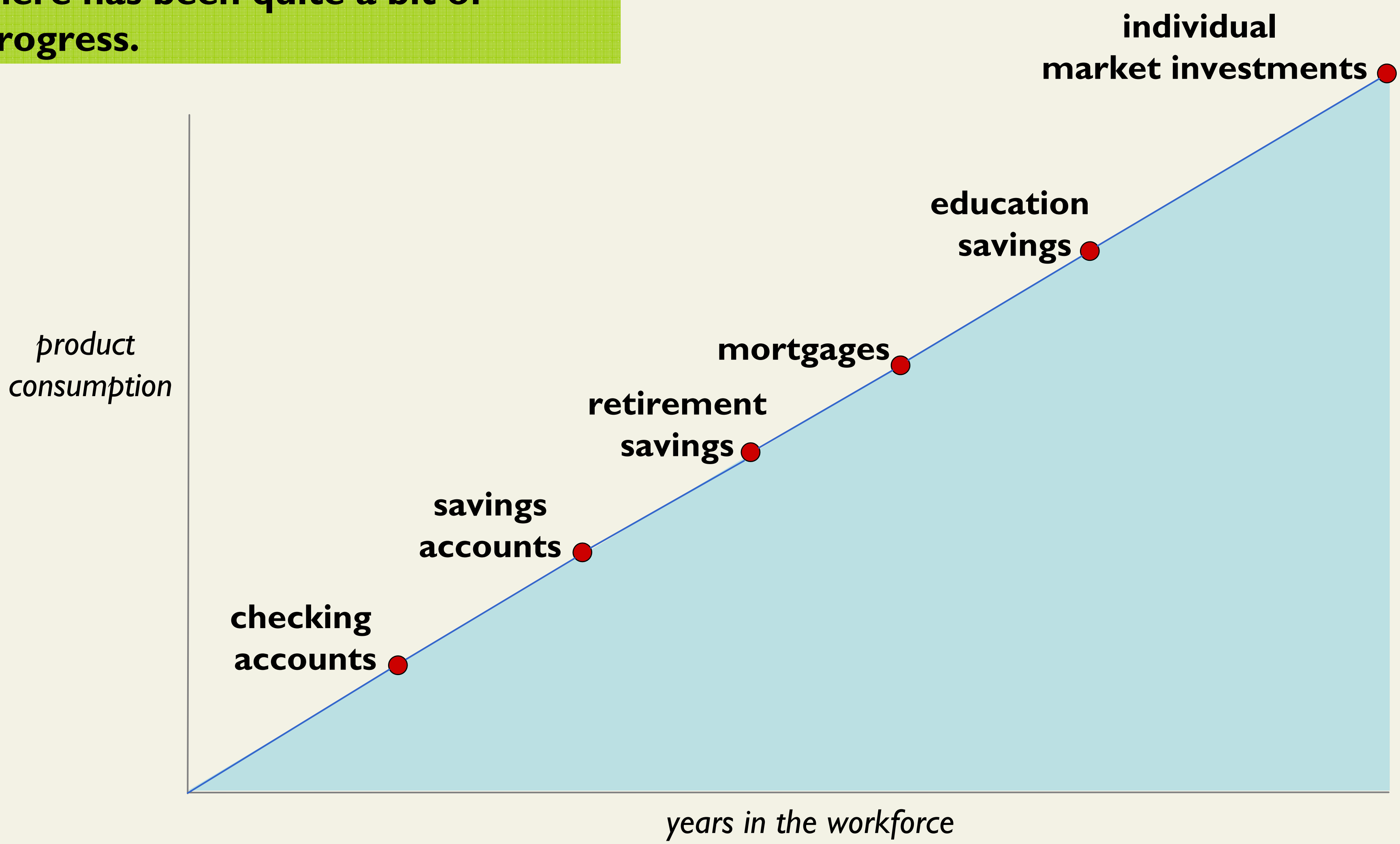
I Background: The democratization of the financial services market

II Consumer problems with that democratization

III Policy and business solutions

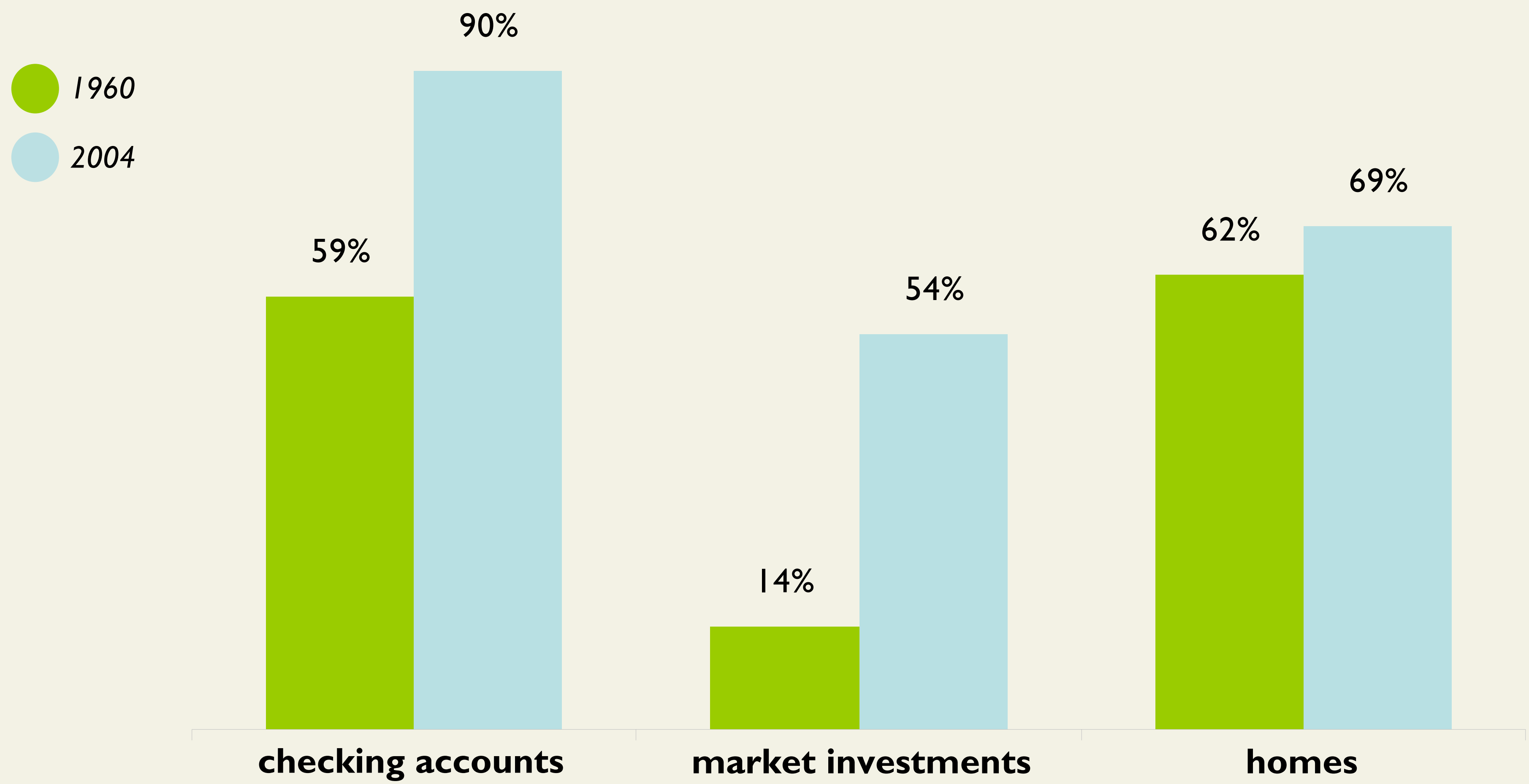
During the 20th century, there was a broad democratization of access to a broad array of financial services and products.

While much remains to be done, there has been quite a bit of progress.



Overall, utilization of financial services products has greatly expanded in recent decades. Here we look at the growth in ownership of checking accounts, market investments, and homes since 1960.

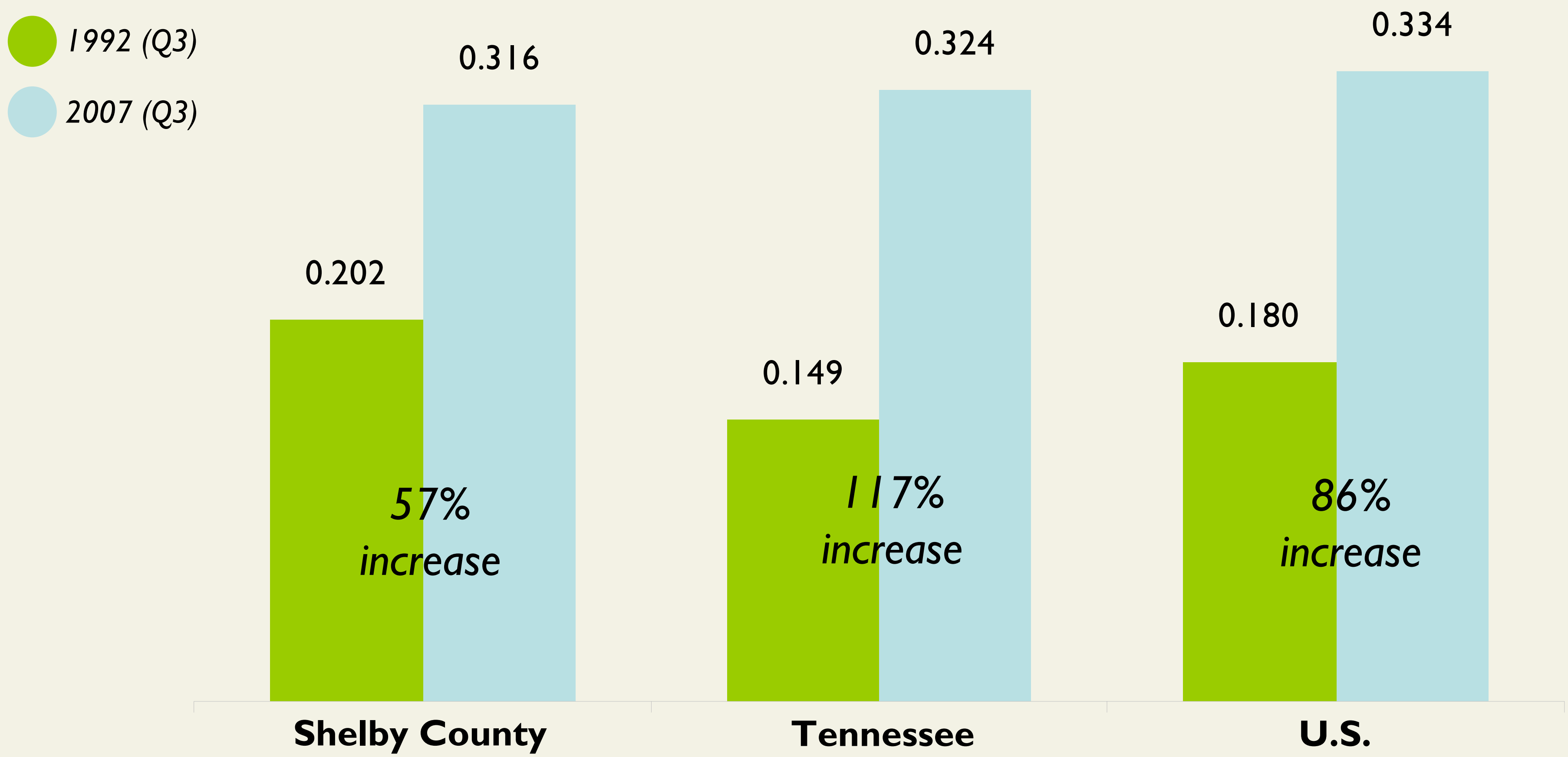
Growth in the ownership of major financial services products, 1960-2004



Source: Analysis of data from the Survey of Consumer Finances, New York Stock Exchange, and Census Bureau Housing Vacancies and Homeownership Series

Shelby County and Tennessee have experienced this growth as well. Here, for instance, we see that mortgages have become increasingly widespread in the past 15 years.

Growth in the number of mortgages per consumer, 1992-2007

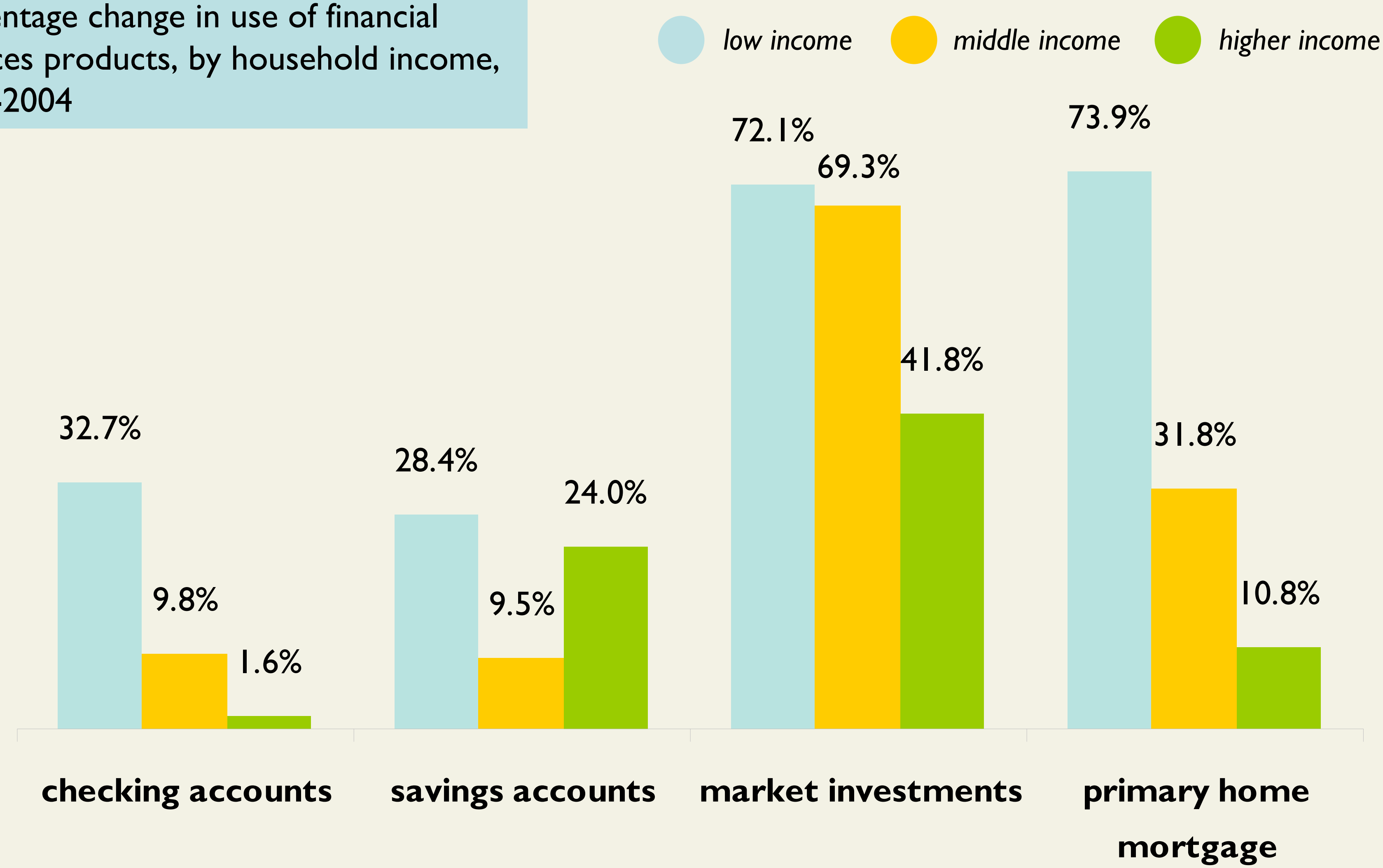


Source: Analysis of TransUnion's TrenData

The bulk of the recent growth has taken in place in the low- and moderate-income market.

We can look at these four products, for instance, to show how the growth in utilization of some products has largely taken place in the low- and moderate-income market.

Percentage change in use of financial services products, by household income, 1989-2004

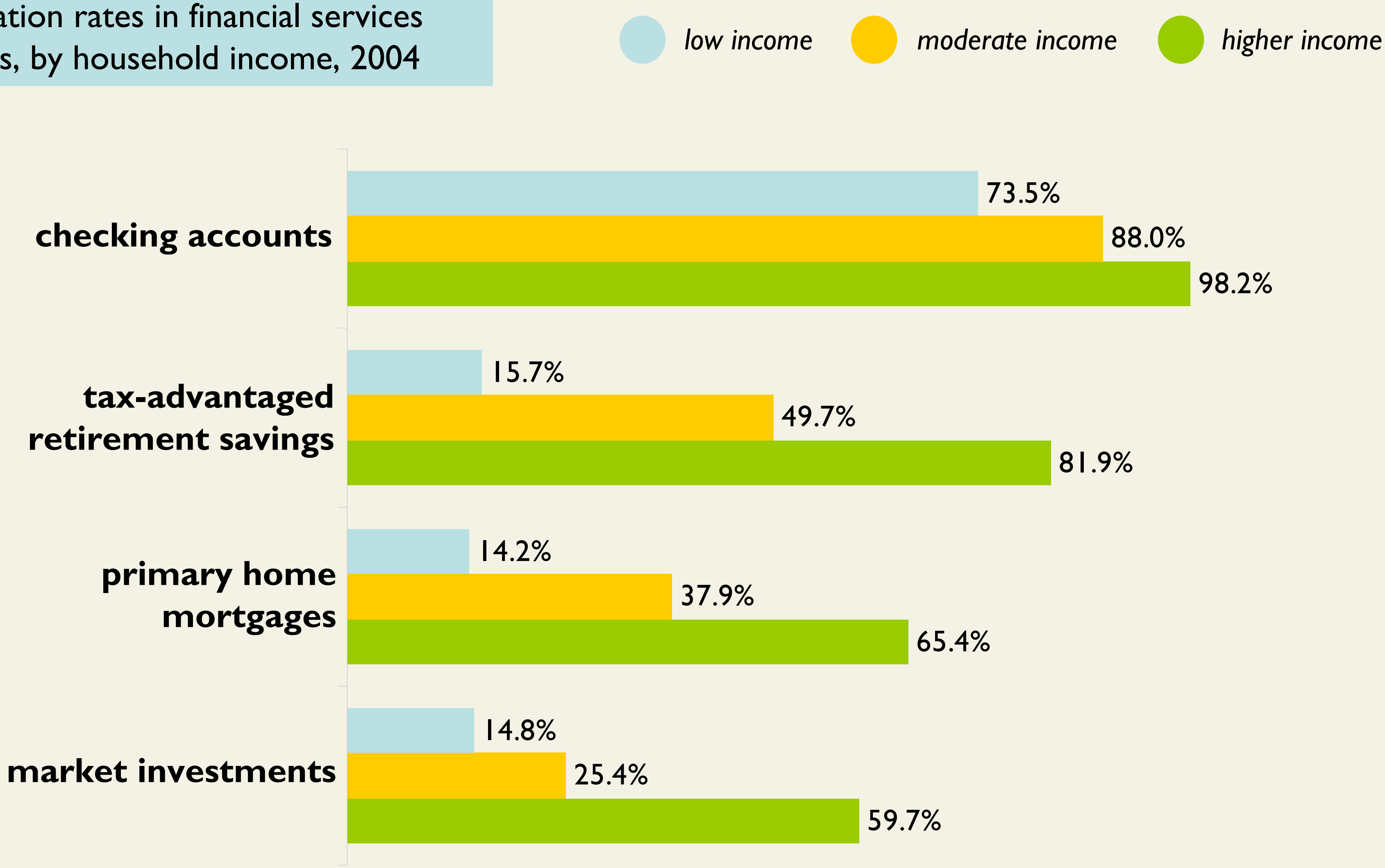


Source: Analysis of the 1989 and 2004 Surveys of Consumer Finances.
Mortgages do not include farms, ranches, or mobile homes.

But this is not to say that the democratization in the low- and moderate-income market is complete.

In fact, the use of many of these products is still heavily concentrated in the wealthier segment of the population. This is true for both basic and more sophisticated financial services products:

Participation rates in financial services products, by household income, 2004



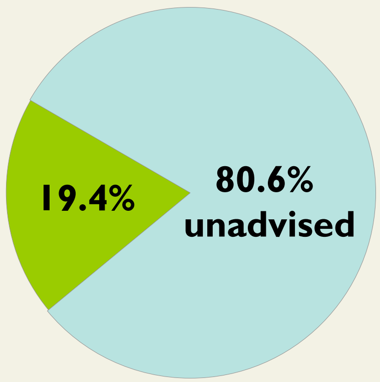
Source: Analysis of the 2004 Survey of Consumer Finances.
Mortgages do not include farms, ranches, or mobile homes.

Collectively, these trends point to a growing amount of access to the financial services market.

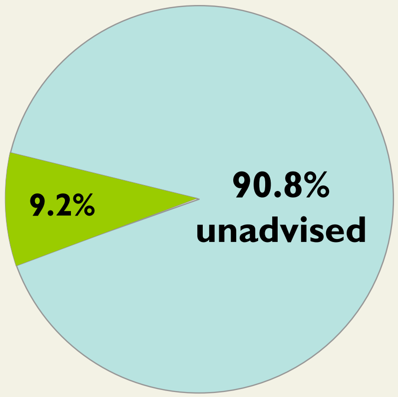
One exception to this trend is access to financial advice.

In fact, very few people have had or currently have access to the expertise needed to navigate the increasingly complex financial services market…

Only 19 percent of households consult a financial advisor when making decisions about saving and investments…



…and even fewer households, 9 percent, seek expertise when making decisions about credit and borrowing.



Source: Analysis of the 2004 Survey of Consumer Finances

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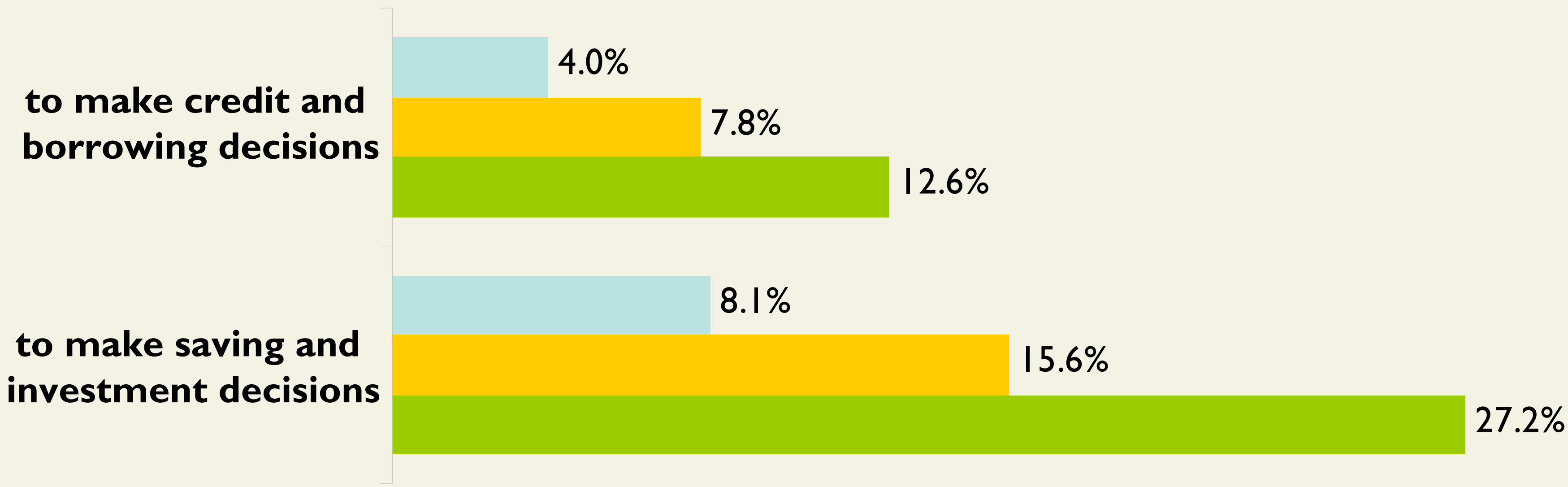
…and those that do tend to be concentrated in the highest income bracket.

Proportion of households consulting a financial advisor, by household income



Source: Analysis of the 2004 Survey of Consumer Finances

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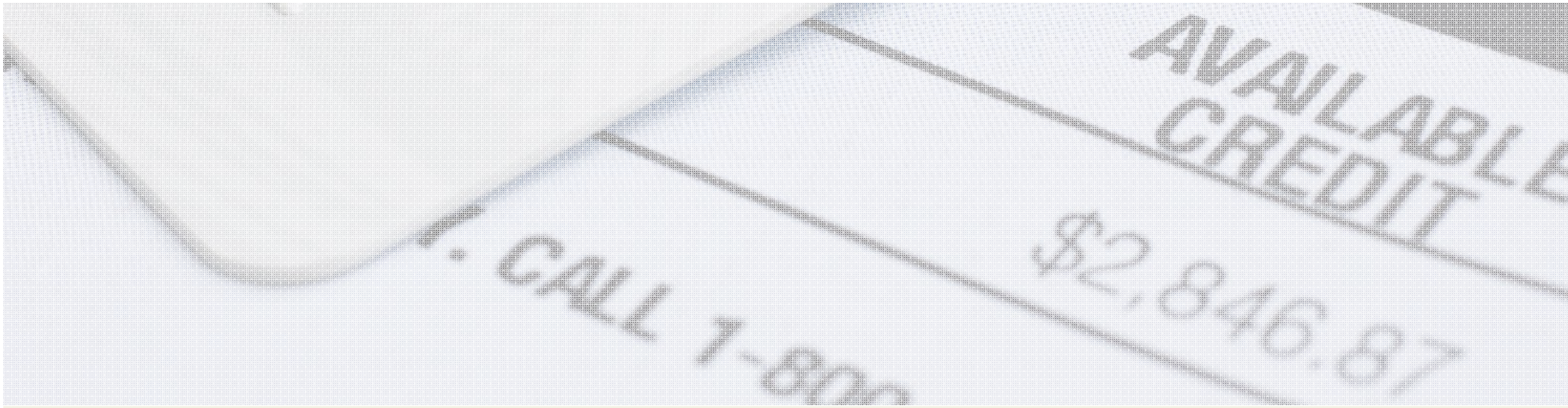
Growing access to financial services gave more people potential to convert wages to wealth…

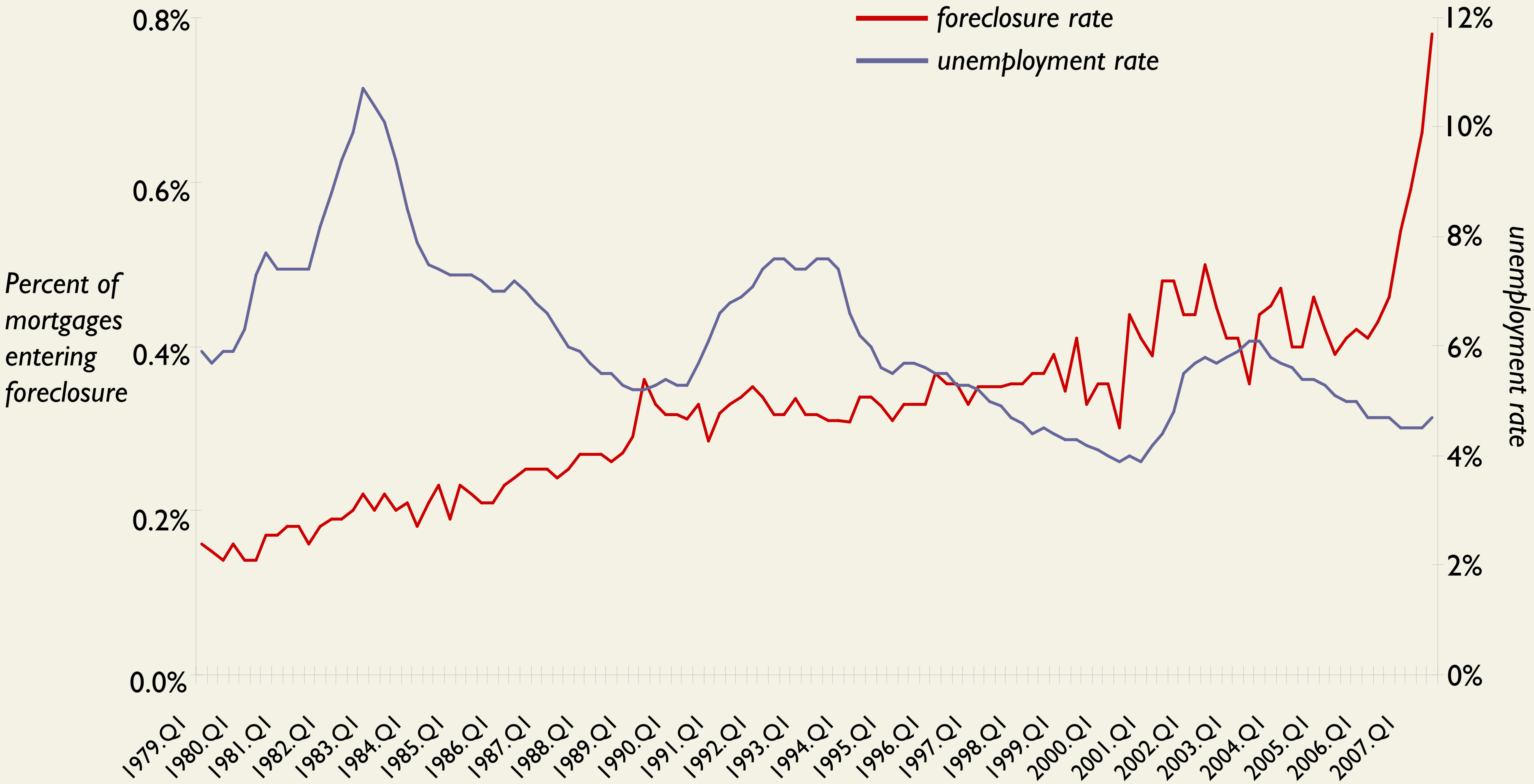
…but without access to the expertise needed to most effectively make that conversion, too many consumers have seen that potential go unrealized.

I want to illustrate this in a few ways.



First, let's start with the main topic of this conference -- homeownership. A growing amount of evidence is calling into question the ability of consumers to evaluate whether buying a home is in their best financial interest.

We know, for instance, that the foreclosure rate has recently shot upward despite solid economic growth, rising income, and low unemployment levels, calling into question whether consumers can evaluate whether homes are in their best interest.



Sources: Mortgage Bankers Association (estimates) and Bureau of Labor Statistics

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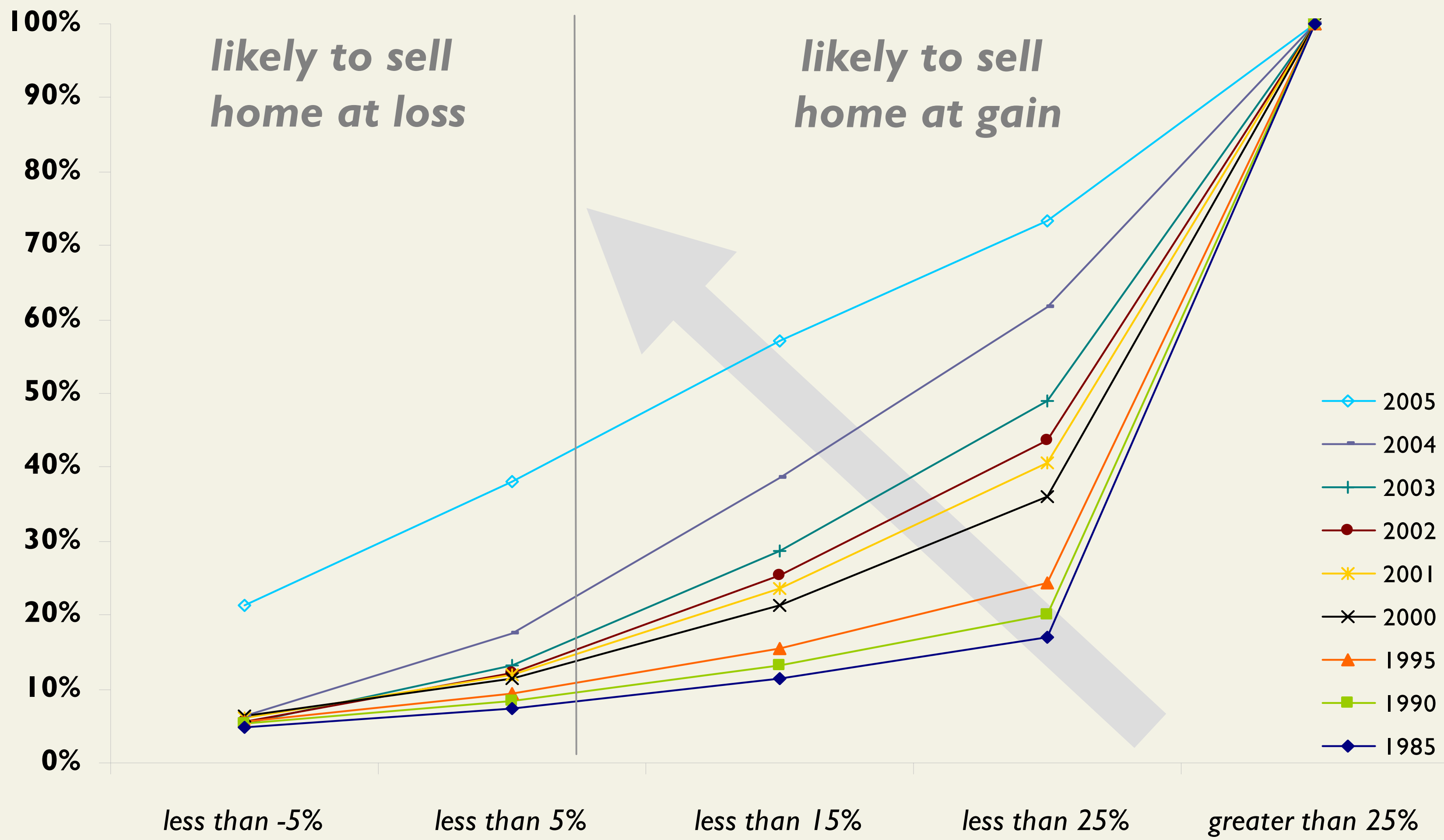
We also know that a growing share of homeowners have negative equity, calling into question whether consumers can evaluate whether homes are in their best interest.

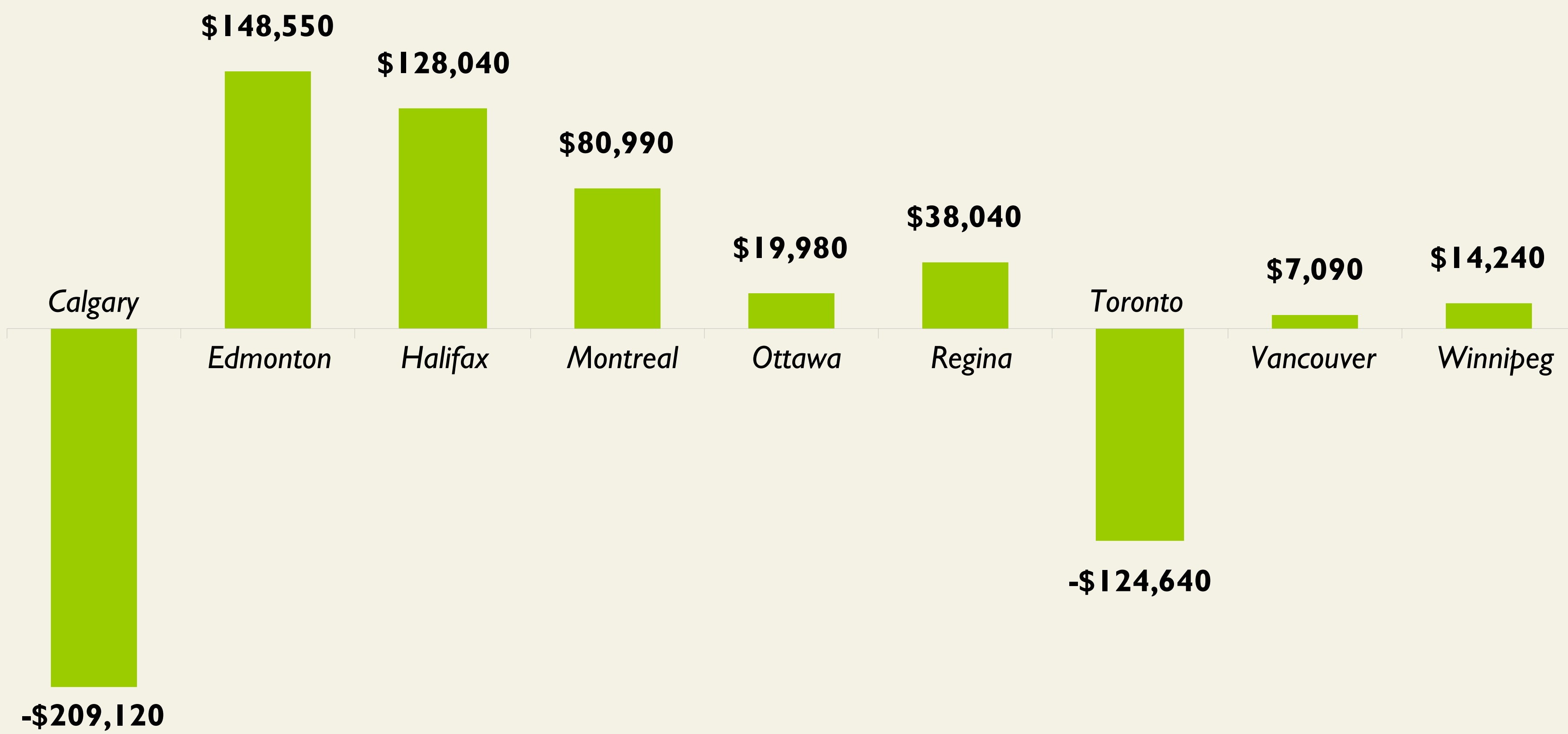
Cumulative distribution of homeowner equity, by year of origination



Source: Christopher L. Cagan, "Mortgage Payment Reset: The Rumor and the Reality," First American Real Estate Solutions (2006)

Finally, a small, but growing number of studies are challenging the financial wisdom of homeownership, relative to other investments, calling into question whether consumers can evaluate whether homes are in their best interest. Much work remains to be done in this literature…

Estimated total potential amount of wealth potentially gained or lost by renting and investing in the stock market instead of owning, in nine Canadian cities between 1979 and 2006



Source: G. Tsuriel Somerville and others, "Do Renters Miss the Boat? Homeownership, Renting, and Wealth Accumulation." In Sumit Agarwal and Brent W. Ambrose, eds., *Household Credit Usage: Personal Debt and Mortgages* (New York: Palgrave McMillan, 2007)

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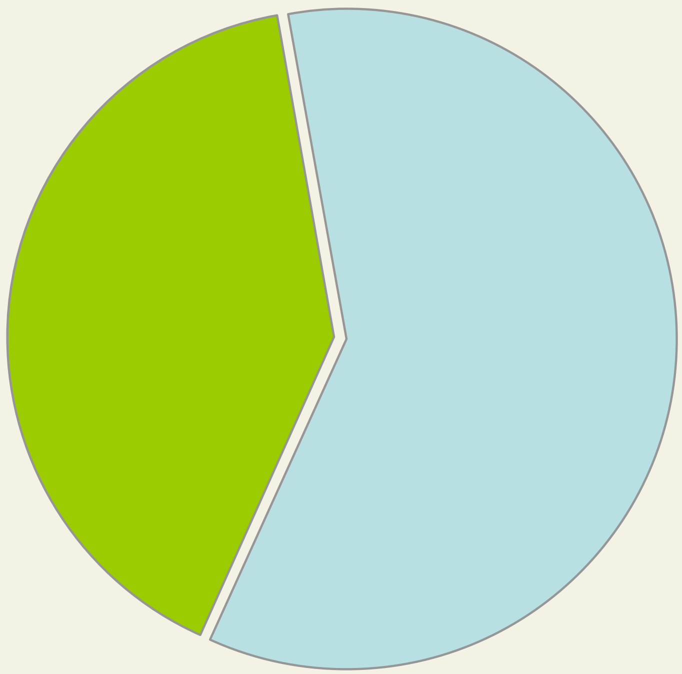
Second, there is the question of whether consumers can effectively manage their investments in the stock market.

Recent research indicates that majority of stock market investors are under-diversified. For instance, of the 23 million households that directly manage their own stock market investments, the majority own stock in 3 companies or fewer.

Only 40.5 percent of investors own stock in more than 3 companies…



…while 59.5 percent own stock in 3 companies or fewer.

Source: Analysis of the 2004 Survey of Consumer Finances

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These are only two examples from a growing body of evidence suggesting that an increasing number of consumers are in need of high-level financial advice.

In addition to mortgages and stocks, consumers are having difficulty making decisions involving other products as well. For example:

Over 10 million households did not have a checking account in 2004, relying in large numbers on non-bank check cashers.

Of the 84 million households with a credit card in 2004, as many as 40 percent may have been paying a higher rate than what they qualified for.

Of the 75 million households that owned homes in 2004, as many as half failed to refinance even though they may have saved money on a lower rate.

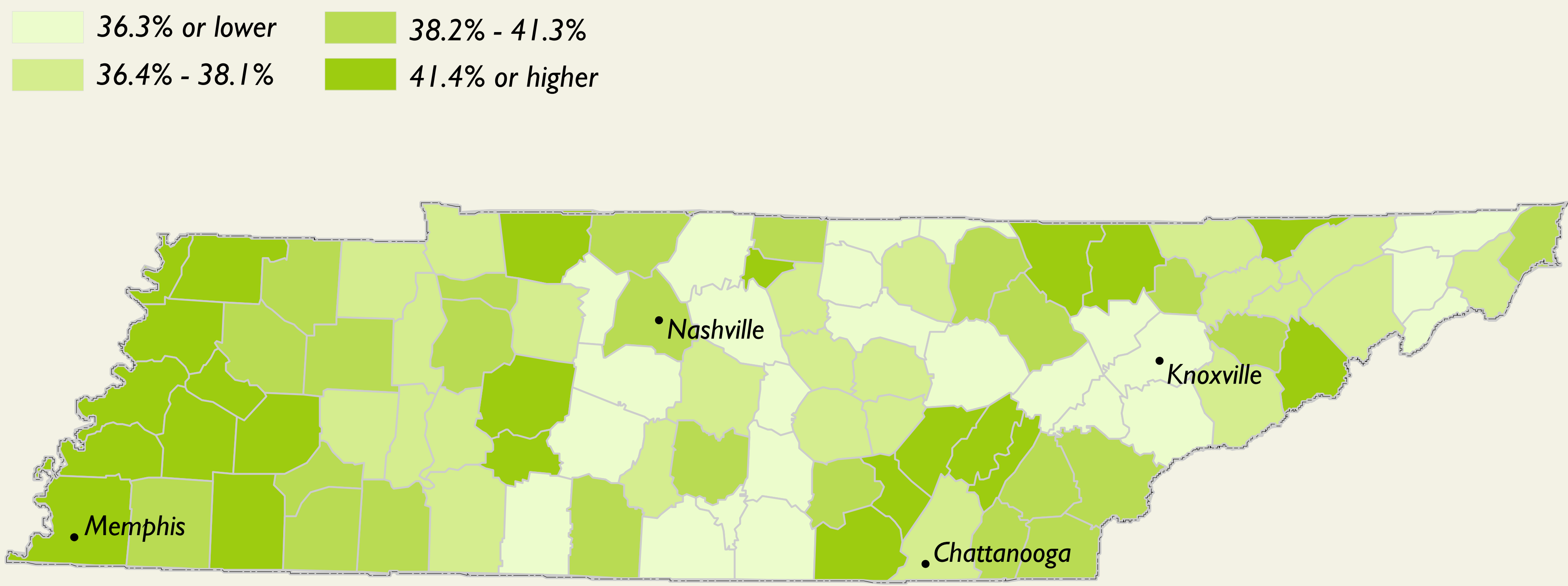
As many as 10 million eligible workers were not participating in an employer-provided retirement plan in 2004.

Most consumers still fail to sufficiently understand the important role that credit scores and reports have on shaping their financial futures.

Source: Analysis of the 2004 Survey of Consumer Finances

That's particularly important in a state like Tennessee, which has one of the highest concentrations of consumers with very poor credit ratings.

Proportion of Tennessee consumers with low credit scores (below 595) in the third quarter of 2007, by county quartile



Source: Analysis of TransUnion's TrenData

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<u>The bottom line</u>: Without the advice of experts, many people are struggling to most effectively use their growing access to financial services.

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Public and private leaders are increasingly focusing on solutions and initiatives aimed at boosting access to financial advice or tools that limit the complexity of the financial services market.

Policy solutions

State- and local- level Bank On initiatives

FDIC Advisory Committee on Economic Inclusion

Fellowes, Seidman, and Tescher federal proposal

Market-based solutions

Web aggregators and financial information sites (e.g., Bankrate.com, Interest.com, LendingTree.com)

Untapped business opportunities

<u>In sum</u>, where the 20th century was focused on expanding access to financial services, the 21st century must be about pairing access with the expertise needed to effectively use it.

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