First Accounts: A U.S. Treasury Department Program to Expand Access to Financial Institutions

Program Study by the Center for Impact Research, the University of Chicago Graduate School of Business, the Center for Economic Progress, and ShoreBank

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Introduction

In 2002, there were almost 56 million individuals in the U.S. who did not have either a savings or checking account at a bank or other traditional financial institution.[1] Additionally, over 83 percent of families without a bank account earn under $25,000.[2] These families often use alternative financial services, including check cashing, payday loans, refund anticipation loans, and others, that provide convenience at high cost. A 2004 report estimated that these alternative financial services handled 280 million transactions, generating $78 billion in fee revenue.[3] As a result, "unbanked" low-income workers who can least afford to pay more for basic services often do. They pay to cash checks, are subject to higher interest rates on credit, and pay higher fees and interest rates for consumer loans, auto loans, and home mortgages.[4] This article describes First Accounts, a program designed to provide better financial alternatives for the "unbanked," and highlights some insights from research on the Chicago-based First Accounts program.

The First Accounts Model – Introducing Banking Services to the "Unbanked"

The First Accounts program was an initiative of the U.S. Department of Treasury to expand access to traditional financial institutions for the "unbanked." The program partnered community organizations with financial institutions to provide low- or no-cost checking and savings accounts. A key element of First Accounts was a commitment to financial education.

From 2002 through 2004, the Chicago-based Center for Economic Progress (the Center) was one of fifteen community organizations nationwide to participate in First Accounts. The Center increased economic opportunities for low-income families, children, and individuals by improving access to public, private, and nonprofit programs and services. It was in this spirit that the Center led the Chicago First Accounts program. The Center partnered with Volunteer Accounting Service Team of Michigan and the Consumer Federation of America to implement the program in Detroit as well. First Accounts helped previously "unbanked" consumers open 1,428 bank accounts in Chicago and Detroit, exceeding the initial program target of 1,000 new accounts.

In Chicago, the Center partnered in First Accounts with ShoreBank to provide checking and savings accounts with no monthly fees or minimum balances. Community organizations provided the Center access to over 1,470 previously "unbanked" participants who attended a total of 183 financial education workshops as an entry point to the program. The curricula, developed with the National Consumer Law Center, focused on using accounts effectively, personal budgeting and financial goal setting.

The Center also used free tax preparation services provided by its Tax Counseling Project as another channel to First Accounts. Participants were able to immediately open a savings account and use it for fast direct deposit of their income tax refund, sometimes avoiding more than $100 in check cashing fees. Roughly 26 percent of First Accounts were opened this way. These accounts were opened with deposits significantly higher than the remaining 74 percent of accounts opened by participants who had attended financial education workshops. Total First Accounts program opening deposits were approximately $657,000.

Studies show the importance of financial literacy in making sound financial decisions.[5] For example, the 2002 American Dream Demonstration (ADD) project, which evaluated 14 individual development accounts programs, revealed that financial education had a very significant impact on the savings rates of program participants, and that the higher education participants received (up to eight hours), the better their savings rate.[6] A study evaluating the effectiveness of the Money2000 education program also found significant behavior changes in program participants.[7]

Research on the Chicago First Accounts Program

Two studies have examined the Chicago First Accounts program. Dr. Marianne Bertrand of the University of Chicago Graduate School of Business led a general phone survey of 201 program participants, examined bank data on program participants, and investigated the effect of various program-related and demographic factors on some key measures of program success. Additionally, Dr. Lise McKean of the Center for Impact Research (CIR) led a team in conducting in-depth face-to-face interviews with 77 program participants to examine their financial habits, experiences, and attitudes related to banking, asset building, and managing household finances. Full research reports are available through the Center for Economic Progress Web site, at www.centerforprogress.org. On the national level, ABT Associates, Inc. is conducting a survey of all U.S. Treasury First Accounts grantees, examining program implementation, operations, and outcomes.

Demographics of Chicago First Accounts Program Participants

The participants of the Chicago First Accounts program were nearly 70 percent female, with an average age of 37 at the time of survey. The average household size was 3.3. This population also faces many financial challenges: 70 percent of participants have a high school education or less, 43 percent were unemployed at the time of program entry, and only 33 percent of were employed full time. Thirty-eight percent reported household income of less than $1,000 per month.[8]

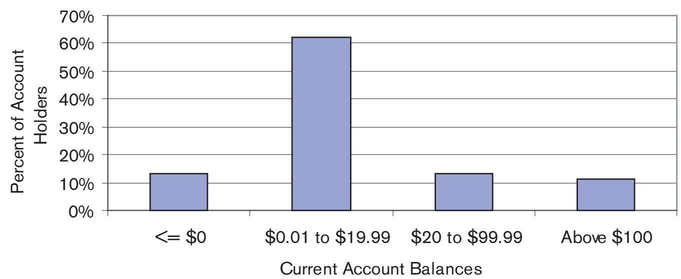
Key Findings from Chicago First Accounts

1. "Unbanked" people want to and can save money.

The overwhelmingly positive response to the Chicago First Accounts program shows that "unbanked" people want to save money. When surveyed, participants "talked about the importance of saving and their efforts to save, with the belief that it is empowering to do so regardless of the amount."[9] They overwhelmingly reported three reasons for attending a First Accounts workshop — desire to manage their money more effectively, desire to learn how to manage a bank account, and desire to open an account. More than 90 percent of workshop participants responded very positively when surveyed about their experience.[10]

In the period studied, 1,428 accounts were opened; 65 percent of these were savings accounts. Participants also maintained their accounts — 87 percent of First Accounts were still open at the end of the period, and over 89 percent of savings accounts carried a balance. At the time of the survey, the average savings account balance was $134.92.[11] Sixty-one percent of survey respondents had saved at least $10 the previous month,[12] compared to just 42 percent who reported having saved anything in the month prior to entering First Accounts. Although a majority of the accounts had low balances, these participants still enjoyed the benefits of having an account: direct deposit of paychecks, ease of saving, free access to cash, FDIC-insured deposits, and the ability to build credit history and maintain a relationship with a bank.

Figure 1: First Accounts Savings Balances November 2004



2. First Accounts program led to dramatic reduction in use of check cashing.

Alternative financial services providers are a growing phenomenon in Chicago and across the nation. The number of individuals that use check cashings services nationally is now estimated at around 10 million per year,[13] and they paid $8 billion in fees. Non-bank check-cashing establishments in the United States doubled between 1996 and 2001, and there are over 520 in the Chicago area alone.[14] Typical fees charged in Illinois to cash a check are 1.4 percent to 1.85 percent the face value of the check,[15] adding up to $300 or more per year for some low-income families who primarily use check-cashing services.

About 72 percent of First Accounts participants used check cashing an average of 3.8 times a month prior to attending the financial education workshops and opening their accounts.[16] Only 18 percent of those surveyed who opened an account are still using check cashing, and even those who chose not to open accounts reported a significant drop in its use.[17] Participants that continue to use check cashing do so because of hours and locations, services available, not having to wait for checks to clear, and convenience of combining finance related tasks in one trip.[18]

Figure 2: First Accounts Participants Using Check Cashers

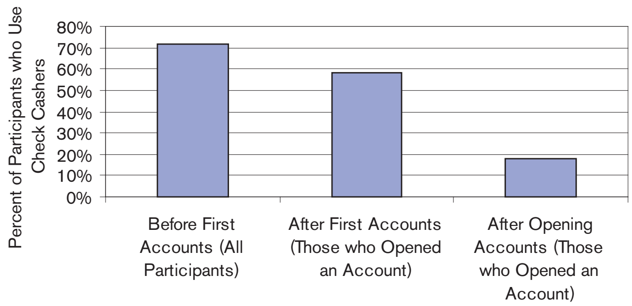
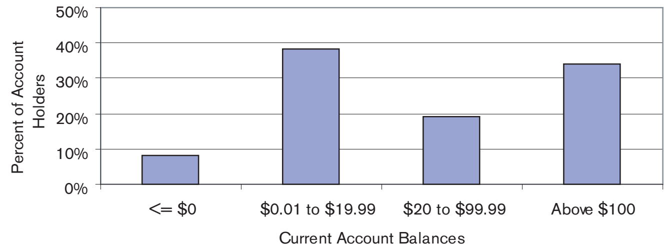


Figure 3: First Accounts Checking Balances November 2004



3. First Accounts made significant impact in financial behavior.

Surveys of program participants and examination of one month of ShoreBank account data show significant account usage and impact on financial behavior. Of those individuals surveyed by CIR, 88.6 percent said that the checking account changed the way they managed their finances.[19] They reported it helped them to:

- Become more aware of their money and their expenses,
- Keep money in the bank (i.e., save more),
- Track their money better,
- Reduce impulse buying,
- Pay bills more conveniently, and
- Reduce the need for money orders.

Overall, 24 percent of First Account holders use direct deposit, 78 percent have an ATM card, and 18 percent use electronic funds transfers (such as automated bill payments). All account holders averaged 2.4 visits to the bank each month. Program participants also deposited a monthly average of $743.98. ATM cards were used an average 6.3 times a month as a debit card and 3.1 times a month at an ATM.[20]

According to ShoreBank, 92 percent of current checking accounts had positive balances in the month surveyed. Over 53 percent of these accounts maintained a balance of at least $20, and 34 percent had a balance of $100 or more. Thirty-seven percent of checking account holders had at least one direct deposit per month. Over 51 percent of those with a checking account wrote at least one check in a six-week period, with 28 percent writing at least three checks. For some participants, the checking accounts imposed heavy fees when the account balances were overdrawn. Seventeen percent of First Account checking accounts had fees over $50 in one month, primarily as a result of insufficient funds in the account, with 35.7 percent of all checking account holders having at least one returned check in the previous six weeks.[21]

Recommendations Based on First Accounts

The First Accounts program demonstrates that many "unbanked" households, including low-income families, want and need quality financial education and good vehicles for saving money and conducting other basic financial transactions at reasonable cost. Initiatives like First Accounts are needed to combat the rising tide of high-cost alternative financial service providers. The experience of First Accounts programs can help bankers, policymakers and community organizations to better serve potential customers who are currently "unbanked," or who currently have relatively low levels of income.

Understanding the needs of "unbanked" consumers is crucial to serving them. As shown above, alternative financial services collect $78 billion in fees; often from those who can least afford it, for services that in many cases could be provided at lower cost by banks. Customers of alternative financial services often have a bank account, or have had one in the past. First Accounts participants reporting the following drawbacks regarding the traditional banking industry: the wait for cash necessitated by the check clearing process, fees, and overdraft problems. Providing more convenient service, encouraging direct deposit, and utilizing technology to immediately cash checks, or at least reduce the time to make funds available from deposited paper checks, will go a long way toward meeting the financial needs of low-income families and the "unbanked."

New and better financial products are also needed to better serve the "unbanked." Savings accounts with low minimum balance requirements better meet the typical short-term savings goals and low average balances of low-income consumers. As technology brings down the cost to banks of holding accounts and processing transactions, affordable savings accounts should become more and more available. Additionally, the rise of stored value cards, which have the potential to be tied to savings products, can increase the savings options for all consumers. Although the traditional checking product offered by the Chicago First Accounts program worked well for many participants, it did not adequately meet the needs of a significant number of others. Checking accounts that minimize the risk of overdraft and the resulting fees, while still allowing users to pay bills and meet other basic financial needs, can provide a solid alternative to those for whom a traditional checking account may not be the right fit. By building a relationship based on understanding the customer's needs, bankers can help to steer consumers toward products that are the best individual fit and create a lasting relationship with this underserved population.

Notes

1 General Accounting Office, "Electronic Transfers: Used by the Federal Payment Recipients Has Increased but Obstacles to Great Participation Remain," 2002.

2 Michael S. Barr, "Banking the Poor: Policies to Bring Low-income Americans into the Financial Mainstream," The Brookings Institution Research Brief, September 2004.

3 Kenneth Temkin and Noah Sawyer, "Analysis of Alternative Financial Service Providers," Fannie Mae Foundation and the Urban Institute, September 2004.

4 "Double Jeopardy: Advocacy Explores the High Cost of Being Poor" Volume 7, Number 1, Winter 2005.

5 Angela C. Lyons and Erik Scherpf, "Moving from Unbanked to Banked: Evidence from the Money Smart Program," Financial Service Review, Volume 13/3, pp215-231, Hogarth, Jeanne M., Beverly, Sondra G., and Marianne Hilgert, "Patterns of Financial Behaviors: Implications for Community Educators and Policy Makers," Discussion Draft, February 2003, Federal Reserve System Community Affairs Research Conference.

6 From the CFED Web site at http://add.cfed.org/training.html, accessed July 13, 2005.

7 O'Neill et al., (2000). "Successful Financial Goal Attainment: Perceived Resources and Obstacles," Financial Counseling and Planning, 11(1), 1-12.

8 Marianne Bertrand, Sendhil Mullainathan and Eldar Shafir, "Evaluation of the First Account Program: Final Report," University of Chicago Graduate School of Business, February 20, 2005, Table 1. Hereafter UCGSB.

9 Lise McKean, Sarah Lessem, and Elizabeth Bax, "Money Management by Low-income Households: Earning, Spending, and Accessing Financial Services," Center for Impact Research, February 2005, p71. Hereafter CIR.

10 UCGSB, Table 3.

11 UCGSB, Table 7.

12 UCGSB, p15.

13 A Survey of Check Cashers in the San Fernando Valley, Valley Economic Development Center, December 2004.

14 Sherrie L.W. Rhine, et al. "The Role of Alternative Financial Service Providers in Serving LMI Neighborhoods," Consumer Issues Research Series, Federal Reserve Bank of Chicago, April 2001.

15 Sherrie L.W. Rhine, et al.

16 From Center for Economic Progress records of First Accounts program workshops. Hereafter CEP.

17 UCGSB, p14.

18 CIR, pp45-47.

19 CIR, p47.

20 UCGSB, Table 7.

21 ShoreBank data on First Accounts provided to M. Bertrand. Data based on November 2004, some variables running over a six-week period.

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