A Financial Services Survey of Low- and Moderate-Income Households

*By Ellen Seidman, Moez Hababou and Jennifer Kramer**

Abstract

In 2003 and 2004, MetroEdge conducted a survey of the financial behavior and attitudes of low- and moderate-income households in Los Angeles, Chicago and Washington, DC. While the results are consistent with prior research findings that this population is less "banked" than the general public, they also show that much of the population uses both banks or credit unions and alternative financial institutions and systems for payments, credit and saving. Part of this is the result of network effects: checks are not a universally accepted means of payment in the community. The survey also shows a high correlation between saving and multiple forms of asset-building.

Introduction

The past 10 years have brought a plethora of changes to the way Americans interact with the financial services world. Where consolidation has reduced institutional options, new products and delivery channels such as debit and payroll cards and the Internet have increased service options. Where new techniques of credit scoring have raised the cost of credit for some, those same techniques plus advances in securitization have broadened access to credit for many. And while some low-income communities have seen the return (or first arrival) of conventional financial services providers, those same communities and others like them continue to witness the explosive growth of an alternative sector. It is this last phenomenon that this paper discusses and provides new insights about.

This paper discusses the results of a survey of low- and moderate-income consumers of financial services conducted between September 2003 and January 2004 in Los Angeles, Chicago and Washington, D.C. Initial results of the survey (limited to data from Los Angeles) were reported in a paper by Christopher Berry delivered at the Building Assets Building Credit conference sponsored by the Joint Center for Housing Studies at Harvard in November 2003.[1] The major findings reported at that time were:

- The concepts of "banked" and "unbanked" were incomplete; not only did a large portion of those with checking or savings accounts also use alternative providers, but many of those who did not currently have bank accounts had once had them;
- The large majority of those who used check cashers, in particular, were making conscious and rational choices; it appeared that those who valued convenience (e.g., hours, location, collateral services) used check cashers, while those who valued price used banks (including cashing "on us" checks for free at the issuing bank);

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[1] A revised version of that paper, including data from all three cities is posted on the Building Assets Building Credit website: http://www.jchs.harvard.edu/babc/.

- The price structure of both checking accounts (including "free" checking accounts) and check cashing strongly suggests that consumers who are unable to build up and maintain minimum balances and who cash a limited number of relatively small checks each month may well pay less for transactional services by using a check casher rather than having a checking account; and
- The choice not to use a checking account could to some extent be explained by "network effects"; in low-income communities, many service providers, and in particular landlords, refuse to take checks, significantly reducing the utility of having a checking account.

This paper updates and extends the findings of that initial paper to cover the savings and credit behavior and attitudes of the surveyed population.

Background

The passage of the Debt Collection Improvement Act of 1996 was little noticed by anyone outside of the small world of people interested in the system by which payments are made by and to the United States government. And yet, the Act—which required the U.S. government, within a relatively short period of time, to make payments (other than tax refunds) to individuals electronically rather than by check—is in fact the genesis of much of the public policy and academic interest in and research about "unbanked" Americans. For when the Treasury Department, which had been charged with implementing the Act, explored its options, it discovered that a substantial portion of the beneficiary population (variously estimated from 24% to 50% of recipients of federal benefits checks[2]) had no bank account into which benefits could be directly deposited electronically. Charged with finding a way to reach this population, the Clinton Administration went further: it engaged in—and sparked—a broader exploration of not only who the "unbanked" are, but also how they conducted their financial transactions and why they either were forced into or chose to operate through alternative financial services channels.[3]

At the same time, both those looking into the "unbanked" phenomenon and financial analysts began to focus on the other side of the equation: the breadth and growth of the alternative sector, whether check cashers, money transfer agents, payday lenders, pawn shops, rent-to-own stores or auto title companies. It was clear that these alternative providers were not only extremely active in communities in which many of the unbanked resided, but also that they were growing and many were very profitable. Moreover, researchers began to suspect that at least some of the "banked" population was also using these alternative services: after all, to use a payday lender (at least until recently) required that one have a checking account. This part of the population became known as the "underbanked."[4]

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[2] "Electronic Transfers: Use by Federal Payment Recipients Has Increased but Obstacles to Greater Participation Remain," General Accounting Office, September 2002, at 3.

[3] See Barr, Michael S., "Banking the Poor," 21 *Yale Journal on Regulation* 121 (2004).

[4] Ibid. The seminal work was done by John Caskey. See, e.g., Caskey, John P., "Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor," Russell Sage Foundation, 1994. The major surveys that have probed the use of financial services by low- and moderate-income consumers include the 1998-99 Office of the Comptroller of the Currency (OCC) survey of such consumers in New York and Los Angeles, and the work done by Rhine and Toussaint-Comeau in Chicago in 2000. In addition, researchers have made extensive use of the Federal Reserve's triennial Survey of Consumer Finances and the Population Survey of Income Dynamics. See Dunham, Constance R., "The Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities," in J.L. Blanton, S.L. Rhine, and A. Williams, eds., *Changing Financial Markets and Community Development: A Federal Reserve System Research Conference*, Federal Reserve Bank of Richmond, 2001, pp. 31-58; Aizcorbe, Ana M., Kennickell, Arthur B. and Moore, Kevin B. "Recent Changes in U.S. Family finances: Evidence from the 1998 and 2001 Survey

Methodology

In 2003, the Fannie Mae, Ford, MacArthur and Annie E. Casey foundations contracted with MetroEdge[5] to do an in-depth survey of financial services usage and attitudes in low- and moderate-income communities in Los Angeles, Chicago and Washington, D.C. Between September 2003 and January 2004, a comprehensive survey was administered to a total of 1,532 households. One-third of the surveys were done in person, and two-thirds by phone. Respondents were given the option to do the survey in Spanish, and 10% of them did. Feedback from the field work in Los Angeles was used in Washington, D.C. and Chicago to improve data quality and response rates.

To qualify for the interview, a respondent was required to be: (1) a resident of the household; (2) 18 years of age or older; (3) able to take part in the interview in English or Spanish; and (4) the financial decision-maker in the household, defined as the person most responsible for paying household bills such as rent and utilities. If two people in the household shared this responsibility, both were eligible to be a respondent.

The study was restricted to twenty-one low- and moderate-income census tracts in each of the three cities. These were defined as tracts where 80% or more of the population had incomes below the Primary Metropolitan Statistical Area (PMSA) median income as measured by the US Census 2000. The survey sample was stratified by income (low and moderate) and by race/ethnicity (predominantly African-American, predominantly White, and predominantly Hispanic), resulting in 6 strata per city. In Los Angeles only, a stratum for census tracts composed predominantly of other races was also created. Respondents were then given a sampling weight, which is the product of two sampling stage weights: a tract-level weight associated with the selection of tracts within each stratum, and a household-level weight associated with the selection of households within each tract. Face-to-face respondents were assigned a higher weight than telephone respondents.

To the extent possible, attempts were made to randomize the selection of face-to-face and telephone respondents. A $15 incentive was offered to increase response rate and reduce drop-outs. The overall response rate of the survey was 47.8%. Face-to-face interviews had higher response rates (78.7%) than phone interviews (40.2%).

The stratified sampling, the sample weighting, the randomization of respondent selection, and the screening criteria increase the reliability of our results and inferences and the validity of our findings.

The survey respondents represent a population of approximately 957,850 households. Demographically, the survey population is about 20% white, 41% percent black, 31% Hispanic

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of Consumer Finances," *Federal Reserve Bulletin*, January 2001, pp. 1-32; Rhine, Sherrie L. and Toussaint-Comeau, M., "The Homeownership and Financing Experience In Two Chicago Minority Neighborhoods," *Consumer Issues Research Series*, December 2000, pp. 1-26.

[5] MetroEdge was a business of ShoreBank Corporation. ShoreBank Corporation is a $1.4 billion bank holding company that is the nation's first and leading development banking company. In early 2005, MetroEdge's financial services work was in part absorbed into ShoreBank Advisory Services, the research and consulting subsidiary of ShoreBank Corporation.

as well as 5 percent other or multiple races.[6] The median household income of the survey population in 2003 was $18,552, compared with the 2003 national median income of $43,318. About 27 percent of the survey population was born outside the United States.

Who are the Unbanked, and Why Are They Unbanked?

One of the principal goals of the survey was to understand the extent to which the survey population had checking and/or savings accounts, how they used them, the extent to which they used alternative vehicles for both transactions and savings and why they act in the manner they do. We found that 61.4% of the population had a checking account at the time of the survey, 50.5% then had a savings account, and 41.4% had both. Following convention, we label the 70.4% of the population that had at the time of the survey either a checking or savings account "banked," and the remaining 29.6% as "unbanked." We find it reassuring that this is in line with the results from the Population Survey of Income Dynamics, which over-samples low-income families.[7]

Consistent with findings from other surveys, and as shown in Table 1, the unbanked portion of the population is disproportionately poorer and less educated. In particular, about two-thirds of the unbanked earn less than $15,000 a year (in contrast to one-third of those who are banked), and only about 2 percent have a college degree (compared to almost 29 percent of those who are banked). Although a larger percentage of the total banked population was black and about equal percentages of the banked population were white or Hispanic, within those racial groups, the proportion who were unbanked was much higher among minorities. 3.3% of white households were unbanked, compared to 36.0% of black households, 41.9% of Hispanic households and 10.4% of those of other races.

[6] Unless otherwise noted, when we refer to white or black, we mean non-Hispanic white or non-Hispanic black. Race was missing for the remainder of the population.

[7] See Berry, op. cit, at 3.

Table 1: Demographic Comparison of Banked and Unbanked Households

	Banked	Unbanked	Total
Race/Ethnicity			
White	28.9%	2.4%	21.0%
Black	38.1%	50.8%	41.9%
Other	6.5%	1.8%	5.0%
Hispanic	26.5%	45.1%	32.0%
Highest Education Level			
Less than high school	18.3%	45.9%	26.6%
GED	3.1%	6.4%	4.1%
High school	19.7%	26.1%	21.6%
Some college	24.4%	15.6%	21.8%
Community college	4.3%	2.6%	3.8%
Tech school	1.5%	1.4%	1.5%
College grad	17.3%	1.9%	12.7%
Some post-college	1.7%	0.0%	1.2%
Graduate Degree	9.6%	0.2%	6.8%
Income			
Less than $10,000	18.7%	41.4%	25.5%
$10,000-14,999	14.0%	25.5%	17.4%
$15,000-24,999	17.5%	24.7%	19.6%
$25,000-34,999	17.2%	6.5%	14.0%
$35,000-49,999	14.7%	1.1%	10.6%
$50,000-74,999	11.2%	0.1%	7.9%
$75,000 and up	6.7%	0.8%	5.0%
Tenure			
Rent	60.7%	90.2%	69.3%
Own	39.3%	9.8%	30.8%
Nativity			
Immigrant	24.1%	35.9%	27.6%
Native Born	75.9%	64.1%	72.4%
Marital Status			
Single	62.0%	72.4%	35.0%
Married	38.0%	27.6%	65.0%
Average Age	47.3	38.2	44.5
Number of Children	1.0	1.6	1.2

To get behind the statistics, we asked directly about why people were banked or unbanked (distinguishing between checking and savings accounts), and also found out more about how they conduct their financial business. As shown in Tables 2 and 3, the primary reason people do not have either a checking account or a savings account is, broadly, that they don't have enough income or it costs too much. About 55% of those who did not have savings accounts cite either "don't have any extra money" or "do not have the amount of money that banks require to open an account," while 37.4% of those without a checking account said that they do not have enough money. In contrast, of those who did not have a savings account, only about 11% cited motivational factors and about 10% cited "hard" factors such as lack of proper identification or bad credit. Not trusting banks or not feeling welcome were the primary barrier for only about 5% of those without savings accounts, while bank location or hours were the primary barrier for only about 1%. The numbers were similar with respect to checking accounts, although a greater percentage cited lack of proper identification (10.1%), bad credit (3.3%), and difficulty managing an account (6.1%). Only 1.3% cited hours or location as a major barrier and 1.4% cited lack of respect.

Table 2: Main Reasons for not having a Checking Account

Income/Cost	
Don't have enough money	37.4%
Minimum balance is too high	6.3%
Service charges are too high	2.5%
Don't write enough checks to make it worthwhile	2.3%
Motivation	
Don't need/want a checking account	6.8%
Haven't gotten around to it	5.9%
Complexity	
Can't manage/balance a checking account	6.1%
Not sure how to open an account	3.0%
Fees are too confusing	1.4%
"Hard" Barriers	
Credit problems	3.3%
Not allowed to have an account	3.2%
Don't have the proper ID/social security number	10.1%
"Soft" Barriers	
Don't like dealing with banks	4.2%
Would not feel welcome or treated with respect	1.4%
Not easy to speak with bank staff in my language	0.1%
Convenience	
No bank has convenient hours or location	1.3%
Other	4.2%
Refused/Don't Know	5.6%

Table 3: Main Reasons for not having a Savings Account

Income/Cost	
Don't have any extra money	34.3%
Do not have the amount of money that banks require to open an account	20.1%
Fees are too high	3.2%
Interest rates are too low	3.8%
Motivation	
Don't need/want one	9.1%
Prefer to have only checking account	1.7%
Complexity	
Not sure how to open an account	0.6%
"Hard" Barriers	
Don't have proper ID/social security number	6.9%
Bank would not let me open an account (bad credit)	2.6%
"Soft" Barriers	
Would not feel welcome or treated with respect	0.4%
Not easy to speak with bank staff in my language	0.04%
Friends/family would borrow savings if I had any	0.1%
Don't trust banks	4.6%
Convenience	
Banks are not located conveniently	0.8%
Banks are not open when I need to use them	0.5%
Other	4.0%
Don't Know/Refused	7.2%

Understanding why people do not have bank accounts is an important first step to devising effective business and policy options to change the situation. For example, this survey confirms other work that suggests that a lack of bank branches in low- and moderate-income neighborhoods is not a primary barrier,[8] and that more attention should be paid to development and implementation of effective risk management techniques that can overcome identification and credit barriers.[9]

With respect to savings accounts, the logic of not having an account because a person lacks enough money to save is straight-forward. As Berry discusses in greater detail in his earlier paper, however, it is less clear what the 37.4% of the households who said they did not have sufficient income to have a checking account really meant. As he demonstrates, for a family

[8] Temkin, K. & Sawyer, N, *"Analysis of Financial Service Providers,"* Fannie Mae Foundation, February 2004.
[9] Park, Esther, *"Risk Management Strategies for New Accounts: RFSI Participants Share Their Experiences. Retail Financial Services Initiative,"* National Community Investment Fund, 2004

with insufficient income to maintain the minimum balance for a "free" checking account and/or one whose liquidity is tight enough that an occasional bounced check is virtually inevitable, using a check cashing outlet rather than paying regular and bounced check fees for a checking account may be less expensive. Moreover, as Berry discusses, the survey respondents had a fairly clear and accurate understanding of the comparative costs of using check cashers and having a checking account.[10] A reasonable conclusion from this survey is that, when taking into account payments transactions alone (not including savings and credit), a decision on the part of a household in the population surveyed not to have a checking account may be economically quite rational.

The Banked/Unbanked Dichotomy Is Too Limited

One of the most important findings of the survey is that asking whether people are banked or unbanked may not be the right question—it is essential to get behind that dichotomy to understand how people conduct their financial transactions and why. Put most starkly, we found that 26.1% of those who were banked and cashed a check had used non-banks to do so,[11] and 28.7% of the unbanked who cashed a check had used banks (or credit unions). Similarly, we found that about half the banked households had purchased a money order in the past twelve months, and only a quarter of those had done so at a bank or credit union. Only a fifth of the 17.1% of banked households who had sent money outside the United States in the last 12 months had used a bank or credit union to transmit their funds.[12]

Moreover, 47.8% of those who were unbanked at the time of the survey once had a bank account, and 8.5% of those who were currently banked once had an application for a bank account denied. We asked those who were currently unbanked why they had closed their most recent account. The most commonly cited reason was cost, with 32.3% saying that a change in personal finance meant they could no longer afford the minimum balance (and an additional 2.7% citing an increase in the minimum balance that had the same effect), and 11.4% stating that fees were too high. 12.4% either closed their account (or more likely, had it closed) because they bounced too many checks, and an additional 9.6% closed the account because of unauthorized use. Only 1.3% closed their account because the bank branched moved, about the same percentage (1.5%) who closed their account because they found it easier to use other types of financial services providers.

Going beyond the mere fact of usage of check cashers by those who are banked and of banks by those who are not, we asked why people made their particular choice. Overwhelmingly, and consistently among the banked and unbanked, those who chose banks used them because a bank was the cheaper alternative, and those who chose check cashing outlets cited convenience.[13] In particular, 47.8% of those who used banks (including 46.7% of the banked and 57.9% of the unbanked) said banks were "cheaper," and 46% of those who used check cashing outlets (including 46.6% of the banked and 45.6% of the unbanked) said the locations of check cashing outlets were "more convenient." Twenty percent of those who said they used banks also characterized that choice as having "more convenient" locations. Only 16% of the unbanked

[10] Berry, op. cit. This finding is consistent with Dunham, op. cit.
[11] As discussed below, 36.4% of the banked use non-bank savings vehicles, and 16.2% use non-bank credit vehicles.
[12] Usage of banks for these purposes by the unbanked was, not surprisingly, even lower, at 5.0% of the 72.6% who had purchased a money order in the last twelve months, and 12.1% of 20.9% who sent money abroad.
[13] This may appear counter-intuitive for the unbanked, but is probably explained by the fact that many banks will cash checks-especially payroll checks-written on the bank for free, even for those without an account at the bank.

who used check cashing outlets said they did so because they did not have a bank account. In short, it appears that the surveyed population is making quite explicit distinctions and choices among check cashing alternatives.

The Role of Networks

The findings described above raise two obvious questions. First, beyond "hard" barriers such as lack of required identification and the financial inefficiency of checking accounts, whether perceived or actual, why does a substantial portion of the surveyed population not have bank accounts? Second, why do a substantial proportion of those who do have bank accounts nevertheless use non-bank providers of payment services? We believe that at least part of the answer lies in the network nature of the payments system.

The importance of networks in telecommunications is well known.[14] It does one little good to have a telephone that cannot connect with others, and the value of the phone increases as the breadth of the network expands. To some extent, the same phenomenon applies to payment systems. One cannot use a specific means of payment unless the people with whom one is transacting business accept that means of payment. And our survey suggests that in low- and moderate-income communities, checks are frequently not an accepted means of payment. For example, 39% of the households with a bank account paid their rent by cash, money order or "other," rather than by check. Why? About 20% of the banked households (and a virtually identical percentage of the unbanked households) pay rent to landlords who will not accept checks at all. And almost 35% of those with a checking account reported that they used money orders because the person or business they wanted to make a payment to did not have a checking account or accept checks. Moreover, over 20% of the banked households reported that none or "only a few" of the friends and family members closest to them had checking accounts. An implication for both policy makers and financial services providers is that changing the payments choices of individuals in low- and moderate-income communities may well depend in part on finding ways to incent payees such as landlords to move away from a cash economy. To the extent that payee behavior reflects a desire for liquidity or is a form of risk management (e.g., concern about checks that might bounce), this may require new structures, such as enabling tenants with bank accounts but without access to on-line bill payment to transfer funds electronically directly to landlord accounts.

Who Saves and Who Doesn't

Of the population surveyed, 50.5% had a savings account at a bank.[15] While having a savings account is a very important predictor of whether someone in the surveyed population will save, it is neither necessary nor sufficient. In fact, while 49% of the population "had savings" at some time during the prior 12 months, the group we call "savers,"[16] about 21% of that group did not

[14] Röller, L. & Waverman, L., Telecommunications Infrastructure and Economic Development: A Simultaneous Approach, The *American Economic Review*, September 2001, p. 909. *See also* Leff, N.H., Externalities, Information Costs, and Social Benefit-Cost Analysis for Economic Development: An Example from Telecommunications. *Economic Development and Cultural Change*, January 1984.

[15] The survey question asked only about an account at a "bank." It is likely that some credit union accounts are included in this percentage, but that some are not.

[16] 49% is a lower bound of the percentage of savers in the population because people who did not have savings at the time of the survey, although they might have had savings in the prior 12 months, are not included.

use a bank account as a savings vehicle. Conversely, 6% of the population had a bank account but said they had not "kept savings" in the account during the last twelve months.

Who are these savers? We looked at this in a number of ways, as shown in Table 4, and also ran a logistic regression model on key demographic factors. Not surprisingly, income is a key determinant of saving behavior, with, at the extremes, 72.3% of the households with incomes of less than $10,000 falling into the "non-saver" category, compared with only 7.8% of households with incomes over $75,000. However, it is not at all unusual for lower income households to save. Almost 28% of those with incomes less than $10,000 are savers, as are 32.9% of those with incomes between $10,000 and $15,000 and 41.6% of those with incomes between $15,000 and $25,000.

Table 4: Demographic Characteristics of Savers and Non-Savers

	Percentage Savers	Percentage Non-saver
Annual household income		
less than $10,000	27.7%	72.3%
$10,000-14,999	32.9%	67.1%
$15,000-24,999	41.6%	58.4%
$25,000-34,999	62.2%	37.8%
$35,000-49,999	83.7%	16.3%
$50,000-74,999	89.1%	10.9%
$75,000 and up	92.2%	7.8%
Race		
White non-Hispanic	75.8%	24.2%
Black non-Hispanic	40.1%	59.9%
Hispanic	39.3%	60.7%
Other non-Hispanic	72.0%	28.0%
Education		
Less than high school	28.4%	71.6%
High school degree	37.7%	62.3%
Some college	59.3%	40.7%
Undergraduate degree	70.6%	29.4%
Graduate degree	89.1%	10.9%
Place of birth		
USA	53.5%	46.5%
Latin	41.0%	59.0%
Mexico	26.6%	73.4%
Other countries	67.5%	32.5%
Marital status		
Married or in relationship	55.4%	45.6%
Never been married/widowed/divorced/separated	45.7%	54.3%
Number of Children	0.84	1.43

Other than income, the next best predictors of being a saver are education, number of children and race. Those with a college degree are almost twice as likely to be savers as those with only

a high school degree, and savers average .84 children per household whereas non-savers averaged 1.43 children. Over 70% of non-Hispanic whites and others are savers, compared with about 40% of Hispanics and black non-Hispanics. Those born outside of either the United States or Latin America had a higher percentage of savers than either natives or those born in Latin America, and being married or in a relationship seems to encourage saving. Households headed by men are also less likely to save than those headed by women. Probing further about the characteristics of the lowest-income (under $15,000) savers, they are disproportionately non-Hispanic whites, college educated and are less likely to have children than the low-income non-savers. They are also slightly older, with an average householder age of 48.1 years for low-income savers and 44.1 years for low-income non-savers.

It is important to consider the lower savings rates among minorities, and Hispanics in particular, in the context of their behavior with respect to remittances. Fully 39.6% of the Hispanic households, including 41.4% of these households with incomes under $15,000, regularly send funds outside the United States. While some of this money undoubtedly goes toward consumption, part of it likely also contributes to the building of assets outside the United States.[17] Such behavior demonstrates a degree of financial discipline and commitment to saving that is consistent with asset building in the United States as well as abroad. Given the propensity of immigrants to remit less abroad the longer they stay in the United States,[18] this suggests that policy and product development that encourages those who remit to gradually increase saving in the United States could be quite successful.

How Frequently Do People Save and Where?

Not only does the surveyed population save, many do so regularly. Recall that we have defined "saver" as those who had savings during the past twelve months. Of the group of savers, 59.4% said that they add to savings at least once a month. An additional 22.0% added to their savings at least once during the year. The frequent savers (those who added to savings at least once a month) make up 28.6% of the total population.

We noted above that 21% of the savers do not use a bank account to save. The savers use a wide range—and number—of savings vehicles. Among those who save, about 46% used more than one savings vehicle, with almost a quarter using three or more vehicles. Thus, while 79.0% use their bank account for saving, 39.1% have investments in financial instruments such as savings bonds, money market accounts and mutual funds and 33.3% save through a pension or retirement account. In addition to these interest-bearing types of savings, however, 24.0% save cash, 5.4% use their safe deposit box for saving, and 5.0% of the households keep their savings in "jewelry or gold that you might sell for cash."

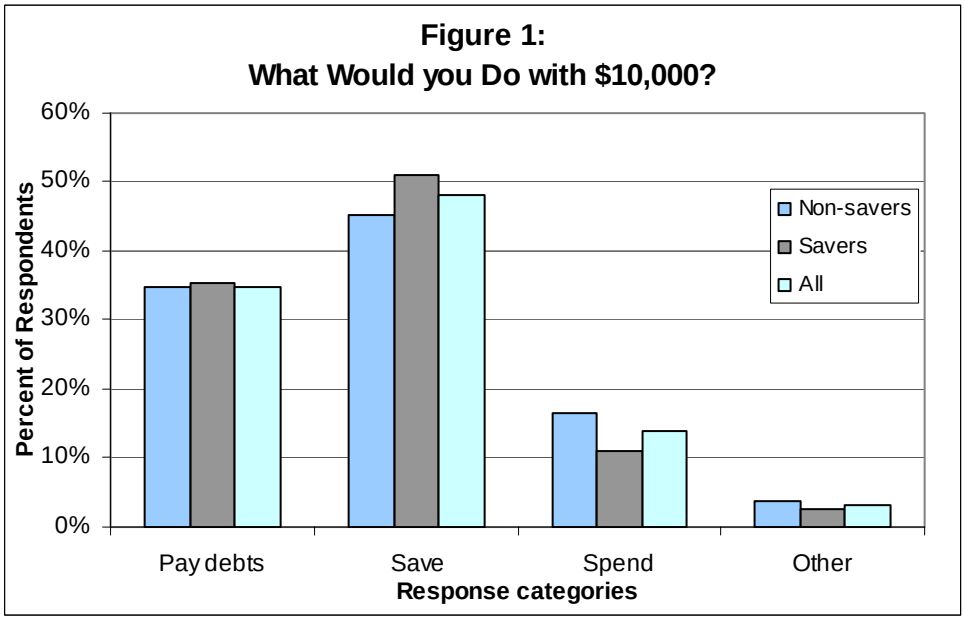
This last group of savers represents a real opportunity for financial services institutions—and for the savers themselves. Many banks that have reached out to immigrant populations in recent years tell of people walking into the bank with significant amounts of cash savings, and buying a home. But banks will have to overcome a number of barriers to get the business. When asked why they did not keep their savings in a bank account, 13.3% of those who save outside of a bank account said they "want to keep savings close to me," 11.5% said they "don't trust banks," 11.3% cited "low interest rate," and 9.3% said the bank was "not convenient." Particularly for

[17] Inter-American Development Bank Multilateral Investment Fund, *Sending Money Home: Remittance to Latin America and the Caribbean* May 2004, http://www.iadb.org/mif/v2/files/StudyPE2004eng.pdf, p. 15.
[18] Ibid., p. 14.

the almost one-quarter of this group who cite wanting to have savings close by or not trusting banks, outreach and financial education strategies might prove quite successful.

Why do People Save?

With respect to desire to save, one of the most striking features of the survey was the response to the open-ended question "Suppose $10,000 were suddenly to fall into your lap. What would you do with most of the money?" As shown in Figure 1, 83.0% of the population, including 86.3% of savers and 79.8% of non-savers, indicated they would use such a windfall for asset-building purposes, whether for saving or to reduce debt.[19]



Among savers, by far the most common response to the question (at 29.5%) was "pay off debts" followed by just over 16.9% who would "put it in the bank to save." Of the non-savers, a similar 30.3% would apply a $10,000 windfall to pay debts, followed by 21.4% who would put it towards a new house. About 4.3% of all respondents said they would save it, but not in a bank, and 1.9% said they would invest in financial instruments such as CDs. While this question assumes a windfall, rather than directly probing actual saving behavior, the responses suggest there is a strong propensity within the population surveyed to save—or at least to pay off debts.

What are the barriers that keep people who want to save from doing so? The barriers appear to be both specific to saving and more generally related to life experiences. Not surprisingly given the survey's median income of $18,552, a large percentage of both savers (71.3%) and non-savers (87.5%) said it is hard to save because most of their money goes for necessities.[20] On the other hand, while 59.2% of the savers said it was hard to resist the temptation to spend money, 72.5% of the non-savers gave that response; the percentages were similar with respect to the statement "I could save a little but not enough to make a difference to me and my household." The importance of a having a bank account to facilitating savings was as high (72.8%) among

[19] Responses such as use it for education, to start a business, buy a house, or buy land are included in "saving."
[20] These are the percentages who said they "somewhat" or "strongly" agree with the statement.

the non-savers who did not have an account as it was among the savers who did have an account (73.2%). Interestingly, only 36.8% of the relatively small group of savers who did not have an account thought having one would make saving easier. Among households with incomes below $15,000, 77.5% of the savers said that having a bank account makes saving easier, as did 65.4% of the non-savers.

It appears that a family's recent life experience also is correlated with ability to save, although we are unable to determine the direction of any causality. For example, among savers, 49.6% said their family was doing a lot better or a little better than five years ago, compared to 38.7% of the non-savers. The inverse relationship did not appear to be nearly so important. While 20.9% of the non-savers said their family was doing a little worse or a lot worse now than five years ago, so did 19.7% of the savers. However, the difference is more pronounced within households who make less than $15,000 annually. 23.5% of the non-savers said their family was doing a little worse or a lot worse now than five years ago, compared to 19.0% of the savers. While it is possible that this last group of savers is in the process of running down their savings, it is also possible that some families regard saving as essential even in the face of set-backs.

This latter interpretation would seem to be supported by the continued saving behavior of a striking portion of the low-income (those with household incomes under $15,000) population that experienced set-backs during the last five years. For example, 51.5% of the low-income savers had periods of unemployment or lower than usual income and 48.2% had experienced some sort of disaster, including the death of a family member. We also looked at the relationship between personal setbacks and saving while controlling for income. The proportion of people who experienced any type of personal setbacks among non-savers is 88.5%, 81.1%, and 89.0% for respondents with incomes less than $10,000, between $10,000 and $25,000, and over $50,000 respectively. While lower among savers, the percentage who experienced setbacks was still substantial, at 72.2%, 76.5%, and 70.8% respectively.[21] We cannot tell whether the low-income savers who had experienced set-backs were able to weather those set-backs because they had savings or whether they became savers after having experienced a set-back; either explanation is plausible and further research is needed to determine the extent to which each is applicable.

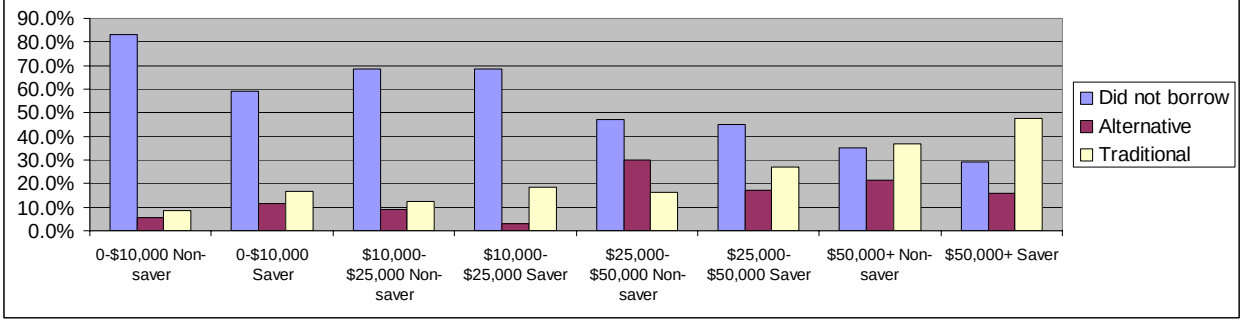
A Debt-Averse Population—Or One that Can't Get Good Credit?

Access to credit is an important part of building assets. While the survey did not gather information about credit prices and terms—an important subject for further research—it did ask respondents how they use credit. The most impressive feature is the very large percentage of the population—55.7%—that did not have any outstanding debt at all. The use of informal sources of credit was also striking. We asked the entire population (not just those who did not currently have any debt) where they would first go when looking to borrow $500 for three months. 32.9% (including 40.4% of the savers and 25.7% of the non-savers) said they would go to a financial institution, whereas over 49.4% (including 45.3% of the savers and 55.3% of the non-savers) said they would use their network of friends and family. Only 2.6% said they would go to a payday lender or "someone in the neighborhood who lends out money and charges interest." In short, there appears to be a strong desire to avoid alternative lenders.

[21] However, 82.2% of savers with an annual household income between $25,000 and $50,000 said they have experienced personal setbacks during the past five years, compared to only 69.7% for non-savers.

While there clearly seems to be a desire to avoid alternative lending, how did those with outstanding debt actually fare? When those who said they had applied to borrow money during the past five years were asked what type of institution[22] they had actually applied to borrow money from, 65.0% said they had approached a "traditional" source (bank, credit union government, mortgage or student loan provider) while 42.1% said they had applied to a finance company, payday loan company, pawn shop or "somewhere else." As shown in Figure 2, when the population is divided into four roughly equal income groups, we see that it is the higher income segments, not the lowest, who borrow more. However, consistently across all but the very lowest income category, savers approach traditional credit sources more frequently than non-savers. This difference is particularly striking among those with incomes between $25,000 and $50,000; the group with the highest percentage of those who approached alternative sources is the non-savers with incomes in this range.

Figure 2
Where Did People Apply to Borrow From?



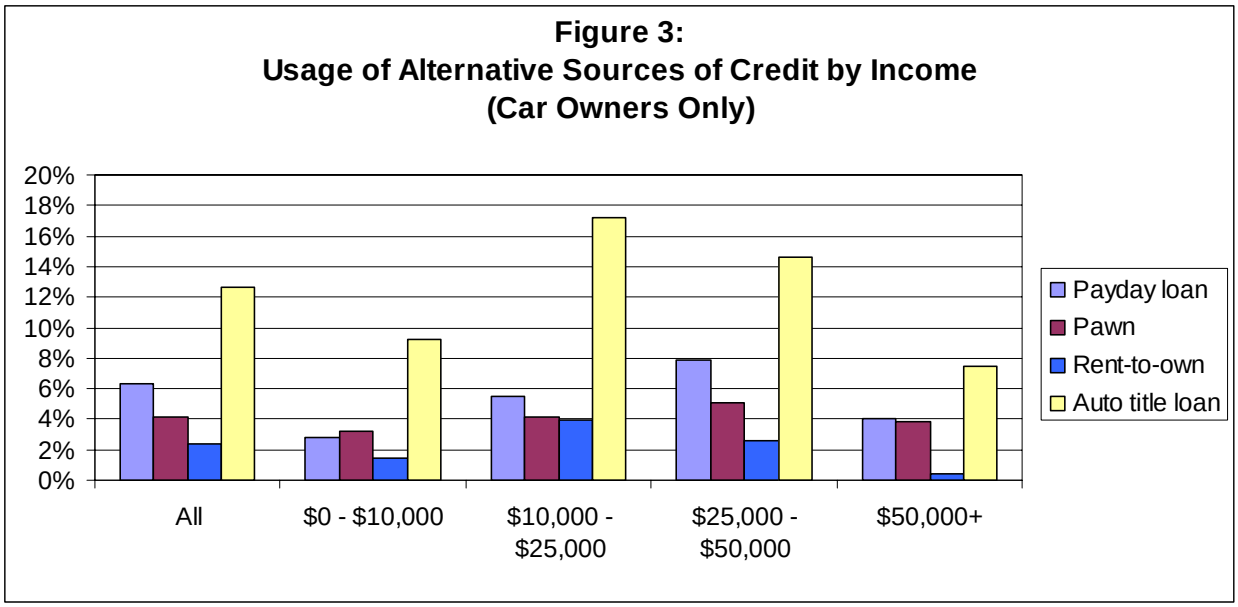
Note: Excludes borrowers from multiple and network sources. Traditional sources include bank, credit union, mortgage, and student loan

But of course applying for a loan does not mean getting it. As noted above, more than half the respondents said they did not have any debt. Of the 44% of the population with debt, 27.6% had car loans, 25.4% had student loans, 18.0% had bank loans, 12.1% had a mortgage, and 14.5% had "other types of loans."[23] In addition, among those with credit cards, 60.1% carried a credit card balance. We also asked about specific types of loans from alternative sources over the prior 12 months. The most interesting finding, perhaps, was that only 17.3% of the population used any alternative source of credit. While 7.1% of the population (including 12.6% of the 56.1% who own cars) had used an auto title loan, only 5.0% had pawned anything, 4.2% had taken a payday loan, and 3.2% had purchased using rent-to-own. As shown in Figure 3, across all income groups, among those who own cars, auto-title loans were by far the most common source of alternative credit. Because such loans are secured by a relatively saleable asset, this

[22] Since only those who had applied to borrow were asked this question and respondents were read a list of "institutions" that did not include friends and family, these responses are not entirely comparable to those cited in the prior paragraph.

[23] The total is more than 100% because some respondents had more than one type of loan; on the other hand, the "other types of loans" were not specified, and in particular, because of the way the question was worded, we believe that respondents did not include loans from friends and family in their response. Respondents were not asked specifically about mortgages, and based on other data, we believe this percentage is understated.

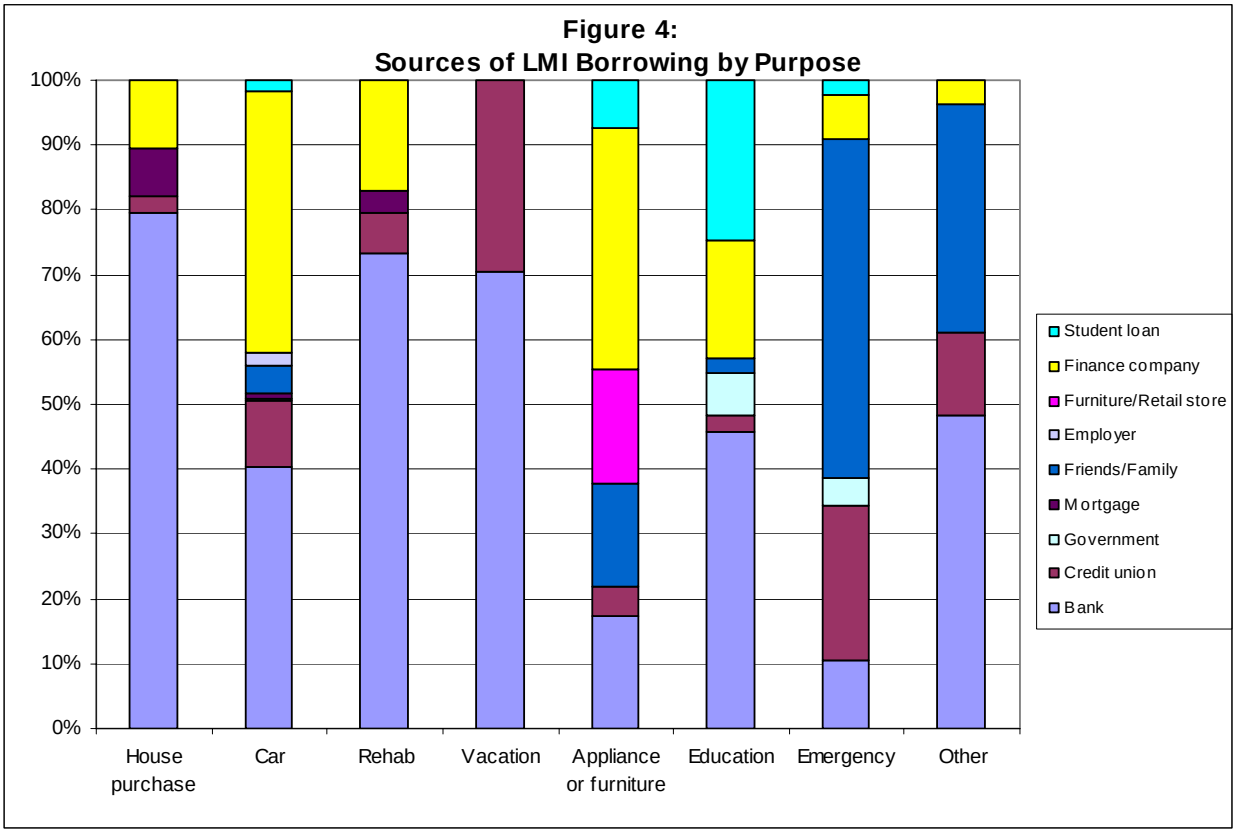
may reflect their lower cost; however the survey did not solicit cost data for alternative sources other than payday loans.[24]



We asked additional questions of those who had used payday loans. Of the payday loan users, 20.0% reported that they had at some time rolled over a payday loan.[25] The median number of payday loans used in a year among those who had ever had a payday loan was 2, and the mean was 3.4. This suggests that while payday loans are not being used solely to cover emergencies, most of the relatively small number of respondents who reported using them are not rolling them over regularly. At the same time, the price they are paying is quite high. Payday loan users are paying an average of almost $50 to borrow an average of just under $200, and incurred a mean cost of 30.6% of the amount borrowed. Nevertheless, 61.8% of payday loan users reported they were either "somewhat" or "very" satisfied with their payday loans, contrasted to 35% who said they were "not satisfied at all" or "not very satisfied."

The purposes for which the surveyed populations used loans from various sources varied quite sharply. As shown in Figure 4, banks are the most dominant source for house purchases, while finance companies and banks dominate the financing of cars. Education was financed using bank and student loans. Borrowing for an emergency was overwhelmingly from friends and family.

[24] While auto-title loans may cost less than other credit sources and thus appear to be a rational choice, that observation needs to be tempered by the recognition that for some part of the population, such a loan may put the borrower's livelihood at risk, if failure to pay means that the borrower loses his or her means of getting to work.
[25] We did not separately ask about taking out payday loans back-to-back, or getting such loans from more than one provider at the same time or sequentially, so it is likely that this percentage is somewhat understated.



Note: Includes respondents who applied for only one loan. Sample sizes for rehab, vacation, and other are small.

Saving Matters

Since at least the 1991 publication of Michael Sherradan's book, Assets and the Poor: A New American Welfare Policy, there has been significant attention given to both the question whether low-income families can and will save, and the impact of those savings on the ability to build assets, including through access to non-predatory credit.[26] The survey enables us to begin to explore empirically the relationship among savings, credit and asset-building in the surveyed population. The results appear to be consistent with the proposition that those who save have access to "better" types of credit, and also are more effective asset-builders. Note that we have used quite a broad definition of "saver." This may suggest that the act of saving, in and of itself, is importantly related to asset-building behavior of various sorts, even though the amount or frequency of saving may not be particularly high.

The correlation between savings behavior of both the whole population and the portion of the population with incomes under $15,000, and access to both asset building vehicles and assets is striking, as shown in Table 5.

[26] Sherraden, M., *Assets and the Poor: A New American Welfare Policy*, M.E. Sharpe 1991. *See also* Scheiner, M., Clancy, M., & Sherraden, M. (Center for Social Development), *Savings Performance in the American Dream Demonstration: A National Demonstration of Individual Development Accounts*, October 2002. http://gwbweb.wustl.edu/csd/Publications/2002/ADDreport2002.pdf.

Table 5: Asset-building Behavior of Savers

	Percent of savers	Percent of non-savers	Percentage of low-income savers	Percentage of low-income non-savers
Have savings account	89.8%	11.2%	84.3%	7.8%
Have checking account	80.4%	42.5%	53.2%	33.8%
Have a credit card	69.7%	26.5%	45.7%	20.2%
Secured	6.2%	21.5%	5.1%	13.7%
Non secured	62.1%	4.9%	37.1%	6.5%
Unknown if secured of not	1.4%	0.1%	3.6%	0%
Have a car	73.4%	41.0%	53.1%	25.3%
Own their home	44.1%	17.5%	26%	11.9%

Our data do not allow us to determine causation. We do not know, for example, whether having a car enables one to save because it is also a key to a steady job or whether those who save are able to buy cars. However, the correlations are both strong and consistent with results from other surveys.[27]

Findings are similar, although somewhat more ambiguous, with respect to debt. Although 55.7% of the surveyed population has no debts, only half the savers fall into this category, compared to 60.9% of the non-savers. But the type of debt the savers carry also differs from the debt of non-savers. As shown in the following table, higher percentages of savers tend to carry asset-related debt; a larger percentage of non-savers have "other types of loan." Non-savers are also more likely to carry credit card balances. The pattern holds even among the lower-income segments of the population.

Table 6: Savers Have More Asset-Related Debt

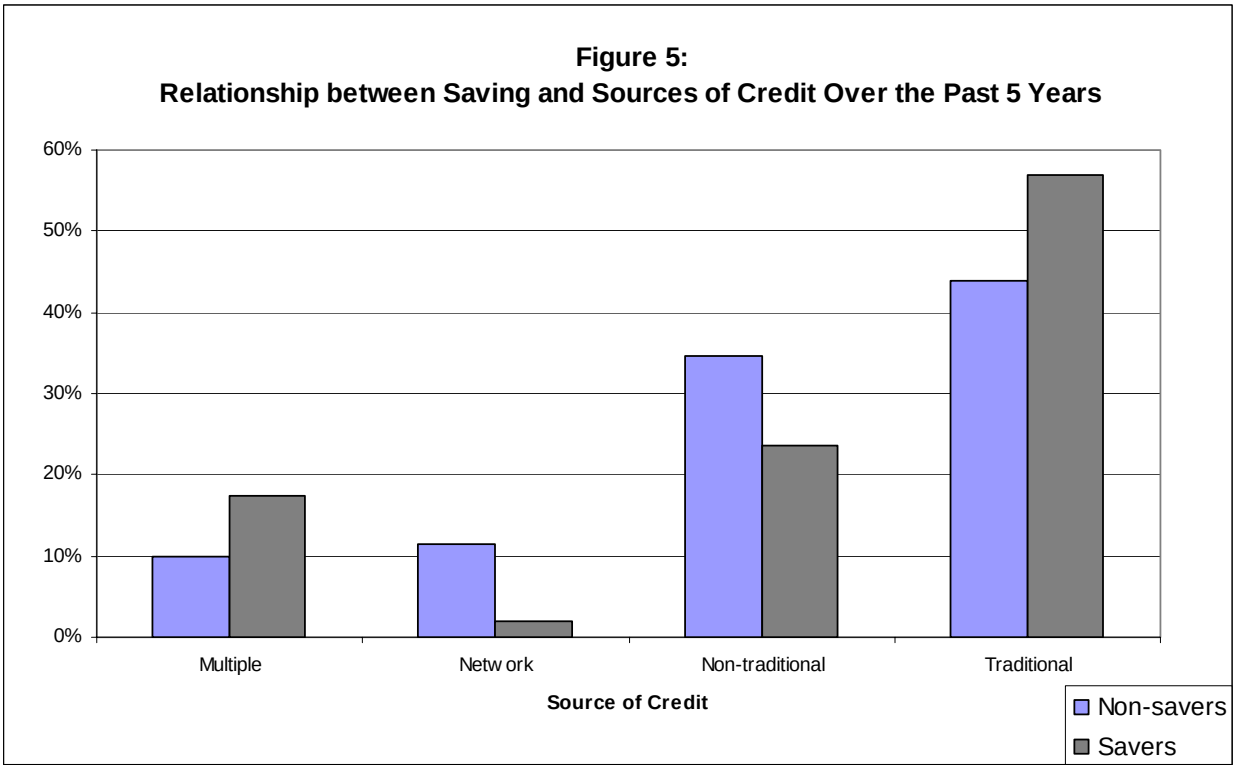
Type of Debt	Percent of savers	Percent of non-savers	Percentage of low-income savers	Percentage of low-income non-savers
Bank loan	12.9%	3.4%	8.0%	1.7%
Student loan	13.7%	9.0%	8.3%	5.6%
Car loan	17.9%	7.3%	11.9%	4.3%
Mortgage	9.3%	1.8%	5.6%	2.4%
Other type of loan	3.5%	8.8%	1.9%	8.1%
Credit card balance*	33.6%	42.4%	26.3%	29.6%
Has no debts	49.5%	60.9%	60.7%	68.7%

* Includes only those who have credit cards

[27] See Aizcorbe, et.al, op. cit.

Use of alternative sources of credit follows a similar pattern, as shown in Figure 5, with non-savers relying more heavily than savers on both network and non-traditional sources of credit.

Figure 5:
Relationship between Saving and Sources of Credit Over the Past 5 Years



Note: "Network" refers to friends/family or employer

More particularly, 5.1% of non-savers stated that they had a payday loan within the last 12 months, compared to only 3.5% of the savers. This is consistent with the results concerning pawning (6.6% of non-savers and 3.5% of savers) and buying something on rent-to-own terms (4.5% of non-savers and 1.4% of savers). On the other hand, 10.0% of the savers but only 4.2% of the non-savers had taken out an auto-title loan, which may reflect the substantially higher incidence of car ownership among savers.

Both saving and insurance provide protection against risk, an especially important feature for those who actually have been able to accumulate assets. Moreover, in many states, it is illegal to own a car without carrying automobile insurance, and most mortgage lenders require homeowners insurance. Again, as shown in the following table, savers have more insurance coverage across the board; this is especially pronounced with respect to the important but "optional" insurance categories of life, health and renter's insurance.

Table 7: Savers Carry More Insurance

Category	Savers	Non-Savers
Car insurance*	94.0%	71.4%
Homeowners insurance**	94.2%	82.0%
Health insurance	83.2%	47.0%
Life insurance	67.1%	35.2%
Renters insurance***	17.6%	3.9%

*Car owners only
**Homeowners only
***Renters only

Implications

Understanding better why the low- and moderate-income population (at least in the surveyed cities) makes the account and usage choices it does is important to both financial services institutions and policy-makers. While the survey is only a beginning in deepening our understanding of this population, it provides us with several important insights.

First, as shown in both this paper and the earlier Berry paper, it is a serious mistake to regard the banked and unbanked as a dichotomy. In low- and moderate-income communities, households at all income levels are on both sides of the divide, with many of those who have bank accounts using check cashers, money orders and independent remittance providers. In addition, a substantial percentage of those currently without bank accounts once had them. Finally, even many of those with savings accounts also use other savings vehicles, and there are savers among those without bank accounts. This suggests that the functionality of bank accounts, not bank accounts per se is what is important. If a savings account has high fees and low interest, it is less likely to be used for savings. If a checking account does not provide needed liquidity, there is less reason to have one. Those who want to bring the low- and moderate-income population into the "financial mainstream" must find a way to understand and meet those functional needs, and to make sure the target population knows that they are doing so.

Second, it is important to understand the informal portions of the financial network in these communities, which operate with respect to payments, credit, and even savings. One of the survey's most unexpected findings was that 20% of the respondents said their landlords did not accept checks. In addition, more than a third of the respondents with a checking account buy money orders because those to whom they are making payment don't take checks or don't have a checking account. Among the unbanked population, more than 40% said "none" or "only a few" of the friends and family members closest to them have checking accounts. On the credit side, the majority of the respondents said they would turn to their network of family and friends to borrow $500 for 3 months. And 34% of the savers hold at least a portion of their savings in non-interest bearing forms, including 25% who save by holding cash. Households who use these informal means of payment, credit and savings represent real opportunities for the financial services industry, but their reasons for turning to alternative or informal sources need to be respected. Until landlords are convinced to take checks, there will be a need for money orders. And it might well be that the cash savings are what is tapped for emergency credit, which may not be optimal for either saver or borrower—but will continue unless the saver can be convinced of the ease and benefit of using a formal financial institution.

Third, the surveyed population appears to be quite debt-averse. Nearly 56% of the population has no outstanding debt at all. Among those who do borrow, both sources and uses of credit are varied, with informal borrowing from friends and family playing a significant role, especially for emergency credit. Use of formal alternative sources, including payday lending, pawn shops, auto title lending and rent-to-own, appears to be somewhat more limited that we had expected.

Finally, saving matters. Low- and moderate- income families can save, and can do so regularly. This survey not only confirmed the propensity and ability of low-income families to save but also provided some tangible, empirical evidence that saving is positively correlated to other asset-building behaviors. Savers are more likely to have other types of financial accounts, to own homes and cars, to use asset-building forms of credit and to have insurance against multiple perils. They appear to keep saving even while experiencing personal set-backs. While we are not able to demonstrate causality, the consistency of these results, across types of behaviors and at all income levels, provides support for the importance of saving as an important element of asset-building behavior. As a corollary, it provides support for both public policy and efforts by financial institutions to build savings as a means to encourage financial stability, wealth creation, and financial relationships that are profitable for both consumer and provider institution.