Financial institutions as stakeholders in individual development accounts

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This article reports on the experiences and motivation of banks and credit unions in the Midwest that participate in individual development account (IDA) programs, one of a handful of vehicles that give lower-income workers a direct incentive to save. Interviews with participating institutions confirm the appeal of IDAs as a community outreach tool, as well as a way to target an under-served market—workers who do not have bank accounts.

This Chicago Fed Letter reports on the characteristics and roles of financial institutions that participate in individual development account (IDA) programs. IDAs are savings accounts matched with outside contributions that are designed to help lower-income families accumulate money for homeownership, education, job training, and business development. In most cases, IDA programs operate through partnerships between nonprofits that recruit and counsel participants and financial institutions that hold the savings accounts. The participants attend classes on financial topics and make regular deposits of earned income. Deposits and interest are matched by government, foundations, the community, and/or financial institutions.

IDA programs are flourishing in each of the five states within the Federal Reserve Bank of Chicago’s district (the Seventh District). A savings strategy for low- and moderate-income individuals appeals to a range of constituencies, including community groups, advocates of welfare reform, and economic development policymakers. IDAs offer a mechanism for drawing “unbanked” households (people without bank accounts) into the financial mainstream, while showcasing the importance of economic education.

This article explores which institutional characteristics are common to the banks and credit unions that participate in IDA programs. I review the roles and motivations for these institutions’ involvement in the programs, based on short interviews with 63 financial institutions in the Seventh District. Recognizing financial institutions as being stakeholders in the IDA strategy may contribute to the sustainability of nontraditional wealth-building strategies that make use of the traditional financial infrastructure.

Institutional characteristics

Sixty-three financial institutions participate in IDA programs within the Seventh District. Forty-nine are banks, and 14 are credit unions. About 80% of the banks in the District have been offering IDA accounts since 1998, and more than 70% of the credit unions began offering IDA accounts as of 2000. The participating institutions range in size from larger banks with broad geographic representation to smaller institutions with a neighborhood focus. They represent a diverse group in terms of institutional mission and service to low- and moderate-income neighborhoods. The majority of institutions in the sample have no explicit community development mandate—they are full-service...
financial institutions that provide a range of traditional banking services. About half of the banks rank within the top five banks in deposit market share for their assessment areas (the geographic market where financial institutions conduct business). The vast majority (over 90%) of banks operate in communities where less than half of the census tracts are low- or moderate-income (LMI). Less than 40% of the banks have higher than average mortgage origination rates in LMI census tracts within their metropolitan areas.

Most of the institutions (63%) in the sample assign a particular branch location to serve IDA customers. The “IDA branches” may be those situated closest to the local service provider (the community-based nonprofit) or they may be those in which members of staff have a particular expertise in working with IDAs. A smaller but nonetheless substantial proportion of institutions (29%) either have an explicit mission to serve distressed communities or base their business strategies on serving low- and moderate-income neighborhoods. Three of these are designated community development financial institutions (CDFIs). Eight are community development credit unions (CDCU) or low-income credit unions (LICU).

In addition, 62% of banks and 86% of credit unions report that they offered products designed for low- or moderate-income customers prior to their institution’s participation in an IDA program (although some say that IDA participants represent the lowest-income group in this customer base). Many of the institutions that do not think IDA account holders fall within their customer base describe the IDA participants as unbanked—having no previous relationship with a financial institution.

Responsibilities of financial institutions
IDA proponents have identified various ways for financial institutions to contribute to IDA programs, ranging from servicing accounts to contributing operating funds. In addition, federal banking regulators have authorized Community Reinvestment Act (CRA) credit for a range of IDA-related activities, including making grants to IDA programs, providing staff to participate in the development of IDA programs, and making loans to IDA holders.

The institutions in this sample tend to focus their responsibilities on traditional depository functions, generally using “off-the-shelf” savings products to set up the IDA accounts. Their unique contribution to IDAs tends to come in the form of waiving fees on balances below pre-set thresholds and paying interest (usually a basic passbook rate) regardless of the balance. The majority of institutions also require no minimum balance for opening an account. Sixty-two percent of banks and 36% of credit unions limit their participation in an IDA program to holding deposits, sending account statements, and/or holding matching funds.

Among the banks and credit unions that contribute to the non-banking elements of IDAs, 33% participate in financial education, and 10% contribute to matching funds in addition to holding deposit accounts. Another contributes matching funds without holding any deposits. One institution explained that it would not contribute matching funds without direct compensation from the U.S. Treasury Bank Enterprise Award Program for its work with CDFIs; another institution waited to allocate money until it identified other sources with which to supplement its own contribution.

Thirteen percent of financial institutions assume a full range of administrative responsibilities, including recruiting participants and raising operating funds. Not surprisingly, each of these runs an in-house IDA program or works closely with an affiliated nonprofit. Each of these institutions also has a mandate to serve traditionally under-served customers or markets.

Motives for participation
The literature in support of IDAs gives a number of reasons why financial institutions might want to partner in IDA programs. These can be divided broadly into “community service” and “business potential.” In this sample, community service is the most common motive for becoming involved in an IDA program. Seventy percent of banks list “contribution to the community,” “relationship-building with the local service provider,” or “mission of institution” as at least one of their motives. Banks with a mission to serve low- and moderate-income populations explain the need for financial education and asset-building strategies in their markets. Other banks say that there is no reason not to participate. The commitment is relatively “easy,” inasmuch as the bank incurs little or no risk if the accounts can be easily monitored, existing savings products can be adapted to IDAs, and staff do not need intensive training.

In conjunction with the benefits of contributing to the community, banks receive Community Reinvestment Act (CRA) credit for their participation. Fifty-five percent of banks mention CRA as a motive; however, many others are reluctant to explain their involvement in quid pro quo terms. Just under half of the banks participate exclusively for community outreach and CRA credit (i.e., they say they have no business motive). Seventy-nine percent of credit unions want to make a contribution to the community or consider the IDA program an extension of their mission. Fourteen percent—two credit unions—cite these reasons alone as their motive for participation.

On the other hand, 6% of banks and 21% of credit unions participate solely for “business motives”—to cross-sell other bank products or target new customers. Thirty percent of banks mention the opportunity to cross-sell products (some listing this along with community outreach) and 28% report that IDA participants have actually used other bank products, although in six of these cases, cross-selling was not listed as a motive for participation. A comparable percentage of credit unions are interested in cross-selling and 50% actually do provide other products and services to IDA participants. The most common other products for banks are checking accounts and money orders. Three credit unions mention offering secured loans to build a credit history.
Thirty percent of banks and 64% of credit unions see IDA accounts as a means of targeting new customers in untapped markets, including growing Hispanic populations and immigrant groups. Many banks state this incentive as a secondary consideration (after community service) or emphasize the benefits to the IDA participant, in addition to the financial institution, of becoming a “regular” customer.

In keeping with these results, no institution in this study lists profit potential as a motive for participating in an IDA program. Some institutions face higher costs with respect to their management of IDA accounts, sending statements every month rather than every quarter and at times to both the local service provider and the individual account holder. Some institutions are required to complete and submit paperwork for the matching funds, modify account-processing systems, and monitor authorized and unauthorized withdrawals. The extent to which an institution’s management information system is compatible with IDA tracking is another factor affecting costs.

To date, none of the institutions has performed a break-even analysis of the IDA accounts. Among the banks, 34% say the accounts do not cover costs as currently designed. Another 34% steer away from cost measurements given their community development reasons for participation. Twenty percent say they do not know whether the bank breaks even. Two banks say they intend to analyze this question; one says break-even depends on the match rate; and two others say the accounts probably do not lose money for the bank. Among 13 credit unions, 23% report that accounts do not cover their costs; 28% say they are not considering break-even given their goals; 31% do not know whether the accounts break even; and 23% are waiting to judge costs based on future lending opportunities.

In instances where financial institutions say costs are not covered, many acknowledge the possibility that a change in the design of the account could lead to more profitable results. These changes include greater automation and a larger number of accounts with higher balances. The higher the match rate, the shorter the time it takes for the accounts to break even. To paraphrase one respondent, a short-term deposit account is not a money-making product. Four credit unions also recognize that utilizing Volunteers in Service to America (VISTA) substantially reduces the costs of operations.

**Conclusion**

Based on my analysis of the financial institutions that offer IDA accounts in the Seventh District, no obvious features such as size, branch location, or organizational mission appear to make particular institutions likely partners in IDA programs. Local service providers, perhaps anticipating few other choices, have often approached the institutions with which they had a preexisting relationship. Differences in state legislation and policy initiatives have also resulted in various types of institutions holding IDA accounts. The relatively few CDFI-designated banks and low-income credit unions in the Seventh District (nine CDFIs and 59 CDCUs or LICUs) may also explain why more local service providers have not opened IDA accounts at institutions with economic development missions.

IDA programs offer an opportunity for all types of financial organizations to support community development when start-up costs are relatively low and financial institutions can contribute by carrying out traditional bank functions. Any number of depository institutions could have a basic affinity for the IDA concept when the scale of programs is kept relatively small.

Going by what financial institutions report as their responsibilities and motives, a narrower range of institutions might show an interest in IDAs if the number of accounts were to increase substantially. IDA supporters contend that the expansion of asset-building for the poor seems both desirable and possible, given that IDAs do not require major changes to institutional capacities and public policy already promotes asset-building for the “nonpoor” (through 401(k) accounts, individual retirement accounts, education savings accounts, etc.). One group of researchers is already promoting efficient account processing as a way to increase the impact of the IDA strategy. Another broad coalition of IDA activists supports federal tax credits to for-profit depository institutions to mitigate the costs of contributing matching funds. Cross-selling financial products tailored to the needs of IDA participants could create additional incentives for institutions to partner in IDA programs. A number of financial institutions in this sample have not begun to link IDA participation with appropriate financial products, in part because programs are relatively young and many financial institutions have opened only a small number of accounts. On the other hand, institutions that aim to cross-sell often mention credit cards and other consumer products that could potentially undermine the savings-building goals of inexperienced borrowers.

The business potential of IDA accounts might be best appreciated in the context of how people with savings accounts but no checking accounts, and the unbanked population in general, conduct their financial transactions. A survey of banked and unbanked households in New York and Los Angeles revealed that only 12% of savings account holders used personal checks to pay their bills (perhaps from other household members’ checking accounts), while
the remainder rely on money orders and cash, much like the unbanked.10 The profit potential of IDA participation depends in part on the availability and cost of financial services that this population accesses elsewhere. Check-cashing businesses, for example, offer an array of services such as cashing checks, purchasing money orders, wiring money, or paying bills.11 A financial institution’s involvement in an IDA program can improve access to this client base by improving consumers’ qualifications for obtaining a checking as well as a savings account and possibly changing their attitudes toward services offered by banks and credit unions.

IDA accounts are one of a handful of vehicles being applied and tested that give lower-income workers a direct incentive to save. Other initiatives to bring low-income and low-asset individuals into the banking mainstream include the U.S. Department of Treasury’s Electronic Transfer Accounts program, the U.S. Department of Treasury’s First Accounts program, and privately developed models such as payroll cards, the Extra Credit Savings Program of South Shore Bank, and the Cash and Save Initiative of Union Bank in California. The landscape of the IDA field has changed dramatically over the past few years and further changes are expected in the future.

1 The district includes Iowa and portions of Illinois, Indiana, Michigan, and Wisconsin.

2 Interviews took place in the first half of 2001. I spoke with personnel ranging from account representatives to institution presidents, depending on which staff had expertise about IDA accounts.


4 Low-income is defined as less than 50% of the HUD (U.S. Department of Housing and Urban Development) estimated median family income in a metropolitan statistical area (MSA). Moderate-income is defined as at least 50% to less than 80% of median MSA family income. Middle-income is defined as at least 80% and less than 120% of median MSA family income. Upper-income is defined as 120% or more of median MSA family income.


7 The VISTA program is a national program placing volunteers with community-based agencies to address urban and rural poverty issues.


9 See the proposal for the Savings for Working Families Act, sponsored by Senator Lieberman and Senator Santorum.
