Center for Financial Services Innovation and Asset Funders Network
Financial Services and Asset Building Brief
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Introduction

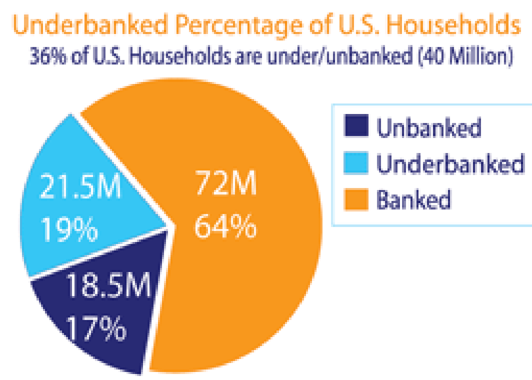
Millions of lower-income consumers lack access to high-quality financial products and services that simultaneously meet their short-term needs and prepare them for long-term financial success. Dramatic changes in technology, demography and the structure of the financial services industry provide new opportunities to reach these un- and underbanked consumers. This brief, prepared by the Center for Financial Services Innovation in partnership with the Asset Funders Network, provides background on the changing financial services landscape and guidance to foundations looking for opportunities to get involved.

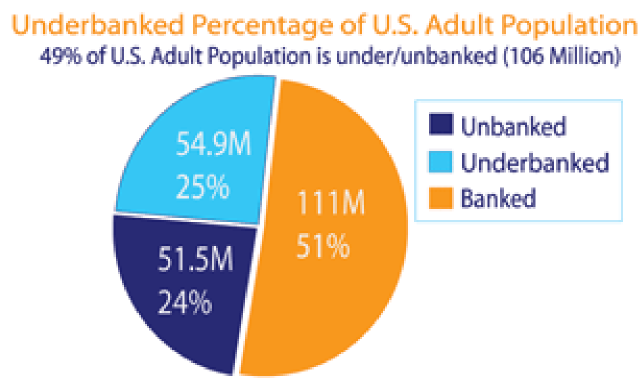
Financial Services, Assets and the Underbanked

An estimated 40 million American households – 106 million adults – are financially underserved.[1] They lack access to the kinds of financial products and services that enable them to save, build assets and achieve financial prosperity. Roughly half of these households are unbanked, meaning they have no checking or savings account with a bank or credit union. The other half are underbanked. They may have an account, but they aren't using it to its fullest, instead relying on a broad array of money-service businesses to meet their short-term needs. While un- and underbanked[2] consumers are a large and varied group representing several different behavioral and attitudinal segments, they are more likely to have lower incomes, be ethnic minorities and have less education.

Key Demographic Facts

Household Income	$26,390—median $47,500—mean
Homeownership	63% own 28% rent
Adults per Household	3—mean
Households with Children	45%
Ethnicity	60% White 16% African-Am 19% Latino 5% Other





[1] See CFSI Underbanked Consumer Study Fact Sheet, June 2008, for more information.
[2] Unless specified, from this point forward we use the word underbanked to include both unbanked and underbanked consumers. We use the words underbanked and underserved interchangeably.

Basic financial services are a critical step on the path to asset building and financial opportunity. Consumers are more likely to save and own assets if they have access to and participate in account-based financial products and services. Research has shown that a bank account is a significant factor in predicting whether individuals own certificates of deposit, car loans and mortgages.[3] Another study showed that low-income households with bank accounts were 43 percent more likely to own other financial assets than households without bank accounts.[4] Well-designed, basic financial products, offered by institutions that want to build long-lasting customer relationships, can serve as stepping stones on the journey to financial prosperity, with one product leading to the next.

Participating in the financial mainstream and having the tools to manage money in the short-term is a prerequisite for longer-term saving and asset building. Yet, basic financial products are often designed, marketed and delivered in ways that fail to meet the short-term needs, interests and abilities of underbanked consumers. They have requirements and minimums that are out of reach for those with low incomes. They lack transparent pricing – consider the upfront $7-per-month checking account fee coupled with the unexpected, back-end $35 overdraft fee – and often fail to provide consumers living paycheck to paycheck with immediate and convenient access to their money. They are marketed with poorly-tailored messages, and sold in locations that are intimidating, with operating hours that are inconvenient for many working families. They are underwritten with tools that cannot properly evaluate consumers with thin or nonexistent credit histories. Small mistakes can have enormous consequences, with consumers being shut out the system completely.

When consumers' short-term financial needs aren't well met, their ability to save, access credit and build assets in the long run is compromised. Without a safe place to store funds, underbanked consumers lack a financial cushion to weather crises. They are also more challenged to build a strong credit history, making it more difficult to access the credit they need at a reasonable price. This in turn makes it more likely that they will turn to products and providers that may cost more and potentially strip assets instead of build them. The result is a two-tier financial system that is leaving a growing number of American families economically stagnant and vulnerable.

The Changing Financial Services Landscape

The federal government stumbled on the problem of the unbanked in the mid-1990s, when it sought to deliver all federal benefits through direct deposit into consumers' bank accounts, only to discover that millions of benefit recipients had no account. Awareness increased again shortly after the turn of the century, when the 2000 U.S. Census figures showed significant growth in the size of the Latino population, helping financial institutions recognize underbanked consumers as an untapped opportunity.

Growing recognition of the underbanked, coupled with dramatic changes in the financial services industry over the last decade, have presented new opportunities to increase the quantity and quality of basic financial services available to underserved consumers. Technology advances have created new access points, such as the Internet and point-of-sale terminals, and more cost effective ways to reach and serve lower-income consumers.

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[3] For more information see Jeanne M. Hogarth & Kevin H. O'Donnell, "Banking relationships of lower-income families and the governmental trend toward electronic payment," July 1999.
[4] For more information see Stacie Carney & William G. Gale, "Asset Accumulation Among Low-Income Households," November 1998.

Technology also has expanded the playing field beyond banks and credit unions. Retailers, technology companies and other non-bank providers have entered the market with new and innovative business models aimed at the underbanked market, increasing competition. While many of these new actors have consumers' best interests in mind, not all of them do. For instance, there has been a dramatic increase in payday lending over the last decade, filling a vacuum left by banks and finance companies as they exited or scaled back their unsecured consumer lending business.

Financial Services Innovations for the Underbanked

Innovation is occurring rapidly throughout the financial services marketplace, and a growing number of organizations – banks and credit unions, community-based nonprofits, government agencies, retailers, technology companies – are working to increase and improve the supply of responsible financial products and services aimed specifically at the underbanked. Nonprofits in particular are playing an important role in these innovations. In 2008, CFSI issued an RFP looking for innovative financial products and strategies and received more than 130 proposals from non-profits working in 35 states.[5]

Innovations can be grouped into three categories: products and pathways, marketing and distribution, and risk management.

Products and pathways

Organizations are redesigning products to better meet the needs of underbanked consumers, linking transactional products and services to saving and credit building opportunities, and developing clear pathways to help consumers advance from one product to the next. A growing number of banks and credit unions have begun offering check cashing, money transfer and other basic services in their lobbies as a way to reach underbanked consumers on their terms and build longer-term relationships. For instance, Center for Community Self-Help is working to open a new credit union in California that will use transactional services to attract new members, gradually moving them to account-based relationships largely through "in-line education." Tying consumer behavior and financial products more closely, the organization seeks to take advantage of every available interaction to enhance the customers' financial knowledge starting with their immediate needs.

Seeking to transform the idea of savings from an activity of sacrifice and deprivation into one of fun and excitement, ***Doorways to Dreams Fund*** *is partnering with the Filene Institute and six credit unions in Michigan to roll out a pilot savings program to grab the attention of lower-income consumers with a top prize of $100,000. The product will be based on the credit unions' share certificate accounts, except that 2% of the interest paid will be in the form of a chance to win prizes from $500 to $100,000. While such a product is still relatively new to the United States, variations of this savings model have gained substantial traction in over 20 countries around the world.*

Other groups are beginning to embrace prepaid debit cards as either a substitute for or a stepping stone to the traditional checking account. Prepaid cards function like electronic bank accounts without checks; consumers load funds on the card and can only spend what they load.

[5] To learn more about CFSI's Nonprofit Opportunities Fund and the trends gleaned from the selection process, see Shaw-Lin Chaw, Sarah Gordon, and Michael J. Herrmann, "Nonprofit Innovations for the Underbanked: Trends and Developments," Center for Financial Services Innovation, September 2008.

Like debit cards, they can be used at ATMs and to make point-of-sale purchases. The nascent prepaid card industry has exploded in the last five years, and providers have begun to add a broad range of features and functions – including bill payment, money transfer, saving and credit building – that hold promise for linking transactions to assets.[6] For instance, the Center for Community Change formed a partnership with a prepaid card company to provide a low-cost, high-function product to low-wage immigrant workers. (See sidebar in Marketing and Distribution section below.)

Payday loans have garnered significant attention as products that trap borrowers in a downward spiral of debt, and a new wave of advocacy efforts has led the product to be banned in several states. A handful of banks, credit unions and nonprofits are piloting responsible payday alternatives to help fill the void. Many included a savings feature to help consumers break out of a debt trap. For instance, the Mountain Association for Community Economic Development (MACED), in partnership with rural businesses and the Appalachian Federal Credit Union, is providing an emergency loan product to employees of participating Kentucky businesses. Employees can apply online for a loan up to $500 with a ten-month payback period at 18% APR, and a pre-funded savings account that is repaid along with the loan amount. With a $500 loan, the borrower would repay $500 plus interest plus an additional $250 toward savings.

Marketing and distribution

The days of the “if you build it, they will come” mentality are over. The focus now is on sending the right marketing messages at the right time, and delivering products through channels that meet consumers where they are. Community-based tax preparation sites, for instance, have been experimenting with marketing a growing array of financial products – checking and savings accounts, prepaid debit cards, certificates of deposit, savings bonds and secured credit cards – that might appeal to lower-income consumers who are receiving large EITC refunds. Other on-the-ground nonprofits are creating financial services centers where they provide basic financial products and one-on-one advice, often bundled with other social services like job training or ESL classes. PROFMEX uses a closed-circuit television network, Saber es Poder, to reach Latino immigrants as they pass through Mexican consulate offices, broadcasting news-like segments on basic financial topics and marketing financial products and services for banks.

Employers are also getting involved, offering their unbanked workers payroll cards and alternatives to payday loans, and providing financial advice. One new initiative, Financially Fit Minnesota (FFM), seeks to increase participation in direct deposit and retirement saving through a unique regional collaboration among companies, government and non-profits. The campaign was launched in late April with

The Center for Community Change *has developed a collaborative of community-based worker centers across the country to deliver innovative financial products and services to the underbanked. Worker centers are community-led organizations that engage in service, advocacy, and organizing to provide support to low-wage workers, many of them immigrants. Through partnerships with financial services providers, the centers are piloting three offerings: 1) a prepaid debit card with on-site reloading, online bill payment with credit reporting, and money transfers; 2) a credit union account with flexible identification requirements and low-cost money transfers; and 3) a low-cost mobile phone money transfer system. Leveraging the trust and relationships worker centers have in their communities, along with their expertise in outreach and education, the project has the potential to reach more than three million low-income consumers.*

[6] To learn more about prepaid debit cards, see Michael J. Herrmann and Rachel Schneider, Nonprofit Distribution of Prepaid Cards,” Center for Financial Services Innovation, March 2008.

endorsements from the mayors of Minneapolis and St. Paul and the governor of Minnesota. Employers set their own goals and implementation plans, while the initiative offers employers supporting data, helpful tools and best practice examples, support from community-based non-profits, and opportunities to network with other participating companies.

Boundary-stretching partnerships are a hallmark of these strategies. Nonprofits have a history of partnering with banks and credit unions on special initiatives for their clients. Now, some are beginning to partner with technology companies and other non-bank providers to offer their clients prepaid debit cards, mobile banking and remittances. Product providers see these partnerships as a cost-effective way to reach an untapped customer segment.

Linkages between the business, nonprofit and government sectors are critical for creating the right conditions for financial innovation. One promising new partnership strategy involves municipal governments using their convening power to reach the unbanked. More than a dozen cities across the country are creating coalitions of banks, credit unions and nonprofits to open user-friendly bank accounts for unbanked city residents. These efforts are an outgrowth of the successful Bank on San Francisco effort. Led by the San Francisco city treasurer, financial institutions developed a set of standards around product design and delivery. The city endorsed the program and launched a marketing campaign, and nonprofits helped get the word out and provide financial counseling. The result: more than 10,000 bank accounts were opened in one year – a full year ahead of the two-year goal.

Risk management

A variety of groups are working to reduce underwriting obstacles – from non-traditional identification acceptance to negative or insufficient credit histories – so more underbanked consumers can gain access to financial services. Immigrants are particularly challenged. Recent arrivals often lack U.S. identification, and even the more established are underrepresented in credit bureau files. Many financial institutions now accept alternative identification like the Mexican matricula consular card in opening bank accounts for immigrants. Some are offering mortgages to immigrants with Individual Taxpayer Identification Numbers, and a few are offering credit cards. But the reputation risk is extremely high given the larger immigration debate playing out across the country. Nonprofit groups like the Appleseed Foundation and others have played a critical role in voicing their support for the use of alternative identification and educating financial institutions about pertinent regulations and best practices.

Nonprofits are also becoming more aware of the importance of a good credit score, not just for getting a loan, but also for renting an apartment, getting a job, qualifying for insurance and opening a basic bank account. As many as 50 million consumers are shut out of financial services because they

> ***Credit Builders Alliance*** *was launched in 2006 to help small, community-based lenders report loan repayment data to the major credit bureaus for the first time, enabling low-income consumers to build good credit. The group's research has shown that six to twelve months of on-time payments can build a credit score of 600 with no other history, and six months of on-time payments toward a $100 loan can increase a score by 50 to 100 points.*
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> *Over the past year, CBA has developed an innovative business model in coordination with community lenders and two major credit bureaus, with a package of products and services that bridges the needs of both industries for reliable data on unbanked and underbanked families. To date, more than 30 organizations are using CBA Reporter to transmit 4,000 tradelines.*

lack a credit score altogether because they don't have enough history logged in their credit bureau file. In part, that's because most consumers don't get credit for paying bills like their rent or utilities.

But that's starting to change. A new crop of companies have started to collect and analyze non-traditional data to help lenders reach consumers with thin or nonexistent credit scores. One of the earliest innovators was PRBC, or Payment Reporting Builds Credit. The company is a repository for bill payment data that doesn't typically get reported to traditional credit bureaus, and it also enables consumers to create their own credit history by submitting receipts for past payments and having them verified and recorded. Earlier this year, a credit union partner used PRBC data to make 40 auto loans to consumers who would not have qualified otherwise.

Remaining Challenges

Promising innovation is happening on numerous fronts, but it is not without challenges. Below are some of the most significant obstacles to improving the supply of financial services for the underbanked:

- **Understanding the consumer.** The financial services industry is only beginning to invest in the kind of research needed to understand underbanked consumers' wants and needs with as much depth as with other consumer segments. National data is increasingly available, but local market data is still lacking.

- **Making the business case.** While newer entrants into the financial services marketplace are building businesses specifically aimed at the underbanked, more traditional financial institutions still struggle with making the case to upper management. In part, this is due to the lack of solid data described above. But even with better information, many banks and credit unions are challenged to develop new underbanked business models that will pass financial muster because they are often a major departure from current strategy.

- **Reaching the consumer.** The typical bank branch may not be a very effective channel for finding and serving certain underbanked consumer segments, and most depositories have little experience beyond ATMs with distribution outside of their branches.

- **Finding and managing partners.** Partnerships can help solve many challenges, but financial services firms may find it challenging to identify the right kinds of partners, sort out roles and responsibilities, and manage what can be complex relationships.

- **Managing regulatory uncertainty.** The financial services regulatory framework has not kept pace with the dramatic changes in the industry, and some innovative products and risk management tools fall into regulatory gray areas that make it difficult for financial services companies to be nimble.

Nonprofit organizations can play a critical role in addressing many of these obstacles. Nonprofits have a unique advantage due to their close contact and deep relationships with underbanked consumers and have a strong read on underbanked consumers' needs and preferences. Nonprofits often play the role of trusted advisor with their clients, and some even serve as marketing and distribution channels that can penetrate this complex market segment more effectively and efficiently. In some cases, nonprofits may offer a more flexible environment for testing new products and strategies, paving the way for market-based solutions.

Closing the Financial Services Gap: Recommendations for Funders

Foundations have an important role to play in helping to shift the financial services market to provide the kinds of financial products and services that lead to longer-term opportunity.

1. **Invest in research and evaluation.** While nonprofits often know a lot about their clients' financial services needs, the knowledge is usually gained informally and tends to be anecdotal. Nonprofits could increase their own efficacy and have a greater chance of influencing the larger marketplace if they had more quantitative data about their clients' attitudes and behaviors and could distinguish more precisely between various segments. Foundations should invest in action-oriented consumer research that informs product, strategy and business case development. In addition, more evaluative research is needed to understand which efforts have the most impact on increasing financial prosperity. We know that financial services matter in the long run, but we still don't understand precisely *how* they matter, and which mechanisms are most important.

2. **Support nonprofit innovation and pilot testing.** A growing number of nonprofits are developing new financial services products and strategies as a path to assets. Over the last three years, CFSI has witnessed a 30% increase in the number of nonprofits that have applied for funding to support financial services innovation. This work can be capital intensive, particularly when efforts are being developed for statewide or national scale, and can require multiple iterations to perfect. Foundations can help by providing seed funding for new ideas and patient capital for those concepts that are designed to be financially sustainable over time. Funders should strongly encourage partnerships to ensure that nonprofits are playing roles for which they are best suited.

3. **Leverage foundation strengths to incent change.** Foundations have a critical role to play in bridging the business, government and nonprofit sectors to create the conditions for innovation and promote collaboration. Their convening power can attract financial services companies to the table, and their standing in the community enables them to garner media attention, a powerful force in getting the attention of CEOs and ultimately moving markets.

4. **Develop strong leaders.** To strengthen the links between financial services and asset building, the field needs leaders who can traverse both the nonprofit and the business communities and who can speak the language of the private sector. Likewise, the financial services industry needs leaders that understand how their institutions can be more responsive to the underbanked. New training and development opportunities are needed to expose nonprofit providers to financial services, and vice versa. For instance, fellowships could enable financial services professionals to lend their time and expertise to nonprofit innovators. Training initiatives could support nonprofit executives seeking entry to graduate schools of banking. Awards programs could recognize both individual and institutional efforts to reach and serve underbanked consumers profitably and responsibly.

5. **Promote synergies between financial services and other programming.** Financial services access is not a stand-alone issue. Increasing numbers of nonprofits are building

financial services into other programs, whether through workforce development, public benefits access or other efforts. Recognizing how financial services issues interact with other areas of focus can help take a variety of programs to the next level. Consider job training initiatives, for instance. Programs that fail to contemplate financial services issues miss an opportunity to start their clients on the right path when they receive that first paycheck. Foundations can raise awareness of the importance of financial services with their grantees, provide basic information and tools, and ensure that program plans contemplate linkages when appropriate.

About CFSI*:*

The Center for Financial Services Innovation, a non-profit affiliate of ShoreBank Corporation, facilitates financial services industry efforts to serve underbanked consumers across the economic, geographic and cultural spectrum. It provides funding and resources, enables partnerships, and identifies, develops and distributes authoritative information on how to respond to the needs of the underbanked profitably and responsibly. CFSI works with banks, credit unions, technology vendors, alternative service providers, consumer advocates and policy makers to forge pioneering relationships, products and strategies that will transform industry practice and the lives of underbanked consumers. For more on CFSI, go to www.cfsinnovation.com.

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