Building Bridges, Removing Barriers

The Unacceptable State of Households’ Financial Health and How Financial Inclusion can Help

Executive Summary

Terri Friedline
February 2016
RECOMMENDED CITATION:

EXECUTIVE SUMMARY

INTRODUCTION: FINANCIAL STRUGGLE IS UNIVERSAL, FINANCIAL INCLUSION IS NOT

A majority of US households are struggling financially and are barely able to keep up with their day-to-day expenses let alone invest in their futures. Many struggle to pay their bills and utilities, they forego preventive medical treatment, they do not have savings to deal with financial emergencies, and they are increasingly relying on debt to make ends meet. Moreover, too many households do not have access to the basic bank or savings accounts that they so desperately need to manage their financial lives.

Building Bridges, Removing Barriers proposes that financial inclusion—access to basic bank or savings accounts—can operate as a “bridge” to households’ financial health. A bridge is an infrastructural solution that offers safe passage over rough terrain and a connection to new opportunities. For households stranded on islands of financial struggles, a bridge may be a welcomed passageway to secure ground. Households may be able to afford their day-to-day expenses like rent and utility bills and save for financial emergencies like an unexpected job loss or major car or home repair. Once on secure ground, households can advance on their journey more easily. They have enough money saved to recover from financial emergencies, keep their debt at manageable levels, and begin to invest in the future by saving for retirement. From this perspective, financial inclusion by having access to basic bank or savings accounts can have the dual effects of stabilizing or securing households’ financial health and advancing or mobilizing it.

Policies can help to put the financial inclusion infrastructure into place, such as through regulating where and how different types of financial services can operate, determining the fees that banks and credit unions can charge for their financial products and services, and identifying the information that is used to calculate credit scores. Taken together, the policies proposed in this report can help to provide a sturdier, longer-lasting bridge to achieving financial inclusion and health.

KEY POINTS

- Financial struggle is a fairly universal experience. It is common for most households in the US to experience financial struggles like difficulty earning income and paying bills, experiencing financial emergencies, and accumulating burdensome debt.

- Households often experience barriers on their journey to financial health: tolls and detours that can make it hard to achieve the financial health, like an unexpected job loss or a major car or home repair.

- Unfortunately, and as a testament to the unacceptable state of their financial health, many households probably could not overcome these barriers even if they could anticipate them in advance. For instance, 41% of households do not have enough savings to
cover the expense of a financial emergency. To afford these expenses, the average household would need to increase their savings by over $9,000 (Pew Charitable Trusts, 2015a).

- While financial struggle is universal, financial inclusion is not. Too many households do not have access to the most basic financial tools (i.e., bank or savings accounts) that they so desperately need to manage their financial lives. Up to 25% of the most financially vulnerable households do not own basic bank or savings accounts (FDIC, 2014a).

- Mainstream financial services create barriers to financial inclusion by how they price and promote their products and services. Banks and credit unions use information from consumer reporting agencies like ChexSystems to screen new applicants (CFPB, 2015b). They also require initial deposits as much as $500 or $1,500 (Friedline, 2013), meaning that in order to open an account, many households need to provide a large amount of money up front that is equivalent to the cost of a financial emergency.

- Financial inclusion, once achieved, can help households secure and advance their financial health. When households own a bank or savings account, they tend to be better off on average than households who do not own an account by accumulating more savings and assets, gaining access to low-cost credit, and avoiding burdensome debt (Friedline & Freeman, 2016; Friedline, Johnson, & Hughes, 2014).

- In order to improve the unacceptable state of households’ financial health, policy efforts should focus on infrastructural solutions to expanding financial inclusion via access to bank or savings accounts.

**CHAPTER 1: THE UNACCEPTABLE STATE OF HOUSEHOLDS’ FINANCIAL HEALTH**

Financial health has been defined as being able to plan for and manage day-to-day finances, adjust to changing financial circumstances and unexpected expenses, and plan for long term financial goals (CFSI, 2015). This definition recognizes financial health as being both stable or secure and advancing or mobilizing. As it turns out, the majority of households in the United States—57%—do not meet this definition and are therefore struggling financially (CFSI, 2015). While most households struggle to some degree, the state of financial health is especially worrisome for lower-income households who have fewer financial resources and opportunities.

**KEY POINTS**

- Bills and emergencies come regularly even when income does not. Households struggle to pay their bills and deal with financial emergencies. One out of every two households struggles to afford at least some of their day-to-day expenses (CFSI, 2015). Over one
quarter of households are behind on their utility payments and 7% have had their utilities shut off in any given month (Gould-Werth & Seefeldt, 2012; Heflin, 2014).

- Thirty percent of all households and 53% of lower-income households are not saving any of their income (Board of Governors of the Federal Reserve System, 2015).

- Households’ financial health should be interpreted within the context of macroeconomic conditions. Macroeconomic decline, higher-than-average unemployment rates, a shifting labor market, and lending and borrowing constraints contribute to households’ poor financial health.

- A series of legislative changes in the 1990s shifted the financial services landscape, limiting some households’ access to basic bank or savings accounts. These changes allowed banks to close their less profitable branches in the local and lower-income communities they once served. Slowly, these branches were replaced by high-cost alternative financial services.

- Financial education is not the first line of defense for improving the unacceptable state of households' financial health. Rather, financial education’s benefits may be observed once households are already able to afford their day-to-day expenses or have already saved enough money to recover from a financial emergency.

**CHAPTER 2: FINANCIAL INCLUSION: A BRIDGE TO FINANCIAL HEALTH**

It is hard to imagine how households could achieve financial health without also having some type of bank account product. Financial inclusion may be a bridge to households’ financial health, offering households a safer passage over rough terrain caused by financial emergencies or debt and connecting them to new opportunities to diversify and accumulate assets and invest in entrepreneurial pursuits.

**KEY POINTS**

- A basic bank or savings account offered through mainstream financial services like a bank or credit union is often a starting place for financial inclusion. In order to expand financial inclusion, these accounts should be affordable and convenient to use.

- Unfortunately, 31% of US adults do not have a savings account and 8% do not have any bank account at all (FDIC, 2014a).

- Nearly one third (28%) have relied on high-cost alternative financial services in times of need and 25% have used alternative financial services at least once in the last year (FDIC, 2014a). Their use of alternative financial services suggests that they have not
accumulated sufficient savings within their bank or savings accounts to cover their basic expenses.

- Financial inclusion has problems of width and depth. That is, many households—especially those that are lower-income, younger, or headed by racial and ethnic minorities—do not have access to even the most financial products and services like bank or savings accounts let alone access to more advanced products and services like low-interest credit, stocks, or retirement accounts.

- Once achieved, financial inclusion via basic bank or savings accounts has the potential to improve households’ financial health.

- Households’ ownership of bank or savings accounts relates to their access to or use of mainstream financial products and services, their accumulated savings, their accumulated low-cost, secured debt, and their protection from accumulated high-cost, unsecured debt (Friedline & Freeman, 2016; Friedline, Johnson, & Hughes, 2014; Friedline & Rauktis, 2014).

- The assets that households accumulate via financial inclusion may buffer them against unexpected expenses and shocks to their income like losing a job or having a medical emergency that could otherwise chip away at their financial health (Acs, Loprest, & Nichols, 2009; Mills & Amick, 2010) and help them to invest in entrepreneurship (Burea, 2009).

**CHAPTER 3: THE PIECEMEALING OF US FINANCIAL INCLUSION EFFORTS**

Efforts to widen and deepen financial inclusion in the US have been somewhat hindered by a piecemeal approach. That is, there are many important and commendable efforts that aim to improve the state of financial inclusion; however, for too long, these efforts have not been intentionally designed to complement one another or to work together. The piecemealing of financial inclusion can be evidenced in at least three ways: the multitude of efforts that are being undertaken at local, state, and national levels, the existence of a two-tiered or bifurcated financial system that funnels lower-income households toward high-cost financial products and services, and the mixed messages from policy that serve to impede financial inclusion rather than facilitate it.

**KEY POINTS**

- Local, state, and national efforts are underway to widen and deepen financial inclusion; however, these efforts have not had a cohesive or comprehensive “inclusion” agenda. For example, Child Savings Account (CSA) policies like the ASPIRE Act haven’t passed through US Congress, making it an effort to expand financial inclusion that has
not yet been realized. The FDIC’s small-dollar loan pilot was implemented in 31 out of over 27,000 banks, meaning that many households are unable to take advantage of small-dollar loans and instead rely on high-cost alternative financial services.

- Mainstream banks, credit unions, and alternative financial services provide the financial products and services that households use to manage their day-to-day financial lives, including basic bank or savings accounts. However, these services increasingly funnel higher-income households toward safer and more affordable financial products and services offered by mainstream banks and credit unions and lower-income households toward higher-cost, alternative financial services like payday lenders (Baradaran, 2015; Friedline & Freeman, 2016; Friedline & Kepple, 2016).

- While alternative financial services fill a void for those who need money and may not be able to access or have been turned away by mainstream banks and credit unions, households risk their financial health when they use these services (Baradaran, 2015; Castro-Cosío, 2015).

- Policies can send mixed messages about financial inclusion. For example, lower-income households that receive public benefits may be encouraged to save; however, at the same time, states’ limits on the amounts of savings and assets they can own to remain eligible for these benefits simultaneously discourage their saving. In some cases, these households avoid using bank or savings accounts altogether. (O’Brien, 2012).

- Policies’ mixed messages can be confusing and their interpretations do not necessarily need to be accurate in order to have effects. That is, even the misperception or misunderstanding that a policy penalizes households for being financially included or saving, and disproportionately penalizes lower-income households, could have negative effects.

**CHAPTER 4: POLICIES FOR BUILDING THE FINANCIAL INCLUSION INFRASTRUCTURE**

Financial inclusion needs to become part of society’s infrastructure so that households can rely on this bridge, building on solid terrain that won’t give way under undue pressure. In other words, the financial inclusion bridge must be built well if it is to become a systemic and infrastructural solution to households’ financial health. Policies can help to put the financial inclusion infrastructure into place, such as through regulating where and how different types of financial services can operate, determining the fees that banks and credit unions can charge for their financial products and services, and identifying the information that is used to calculate credit scores.
**Key Points**

- Financial inclusion policies should be designed to operate at varying levels of scale—local, state, and national—and to coordinate with one another in order to achieve effectiveness. This level of coordination could offer a more integrated approach to financial inclusion by aligning policies that are working toward mutually beneficial goals.

- National policies are ideal for achieving the widest level of scale and national policy is an appropriate level of scale given that households' financial inclusion and health are concerns that stretch across local and state boundaries. Moreover, national policies may be necessary for supporting local and state efforts.

- Stronger regulation and oversight of the financial services industry is needed to protect consumers and to use incentives to encourage mainstream banks to improve services within their communities. These policies should strengthen Community Reinvestment Act (CRA) ratings, eliminate the use of screening tools like ChexSystems, and use new information to calculate credit scores.

- Households need better bank accounts—accounts that are more affordable to open and safer to use (Cramer, King, & Schreur, 2015). The CFE Fund and their Bank On initiative recently released national bank account standards that call for accounts that are low cost with a minimum opening deposit of $25 or less, no monthly maintenance fee or a low fee at $5 or less, and no overdraft fees.

- Other policy opportunities for expanding financial inclusion include a return to offering safe and affordable financial products and services through the US Postal Service and an expansion of Community Development Financial Institutions (CDFIs; Garon, 2012).
REFERENCES


Friedline, T., & Kepple, N. (2016). Does community access to alternative financial services relate to individuals' use of these services? Beyond individual explanations. Lawrence, KS: University of Kansas, Center on Assets, Education, and Inclusion.

Friedline, T., & Rauktis, M. (2014). Young people are the front lines of financial inclusion: A review of 45


A report on Financial Inclusion by the Center on Assets, Education, and Inclusion (AEDI)

Contact:

Terri Friedline
1545 Lilac Lane
307 Twente Hall
Lawrence, KS 66045
Phone: (785) 864-2267
Email: tfriedline@ku.edu
www.aedi.ku.edu