

# Banking the Poor

Financial Services, Asset-building &  
Economic Development: New Public Policy  
Perspectives for Puerto Rico



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©2004 Michael S. Barr, based on Banking the Poor, 21 Yale Journal on Regulation  
121 (2004) (references for slides may be found in that text)

# Low income families lack access to mainstream financial services

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- 22% of low-income families in U.S. were unbanked (10 million households) in 1998
  - Growth of working poor
  - Increase in immigrant portion of working poor
  - Concentration of working poor
  - Decline in cross-subsidization/fee-driven
  - But decline in unbanked from 1995 to 1998 (from 25% of low-income households)
- 50% of Puerto Rico's households were estimated to be unbanked (1996)

# Reasons cited for being unbanked

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- Low income
- High bank account fees
- High minimum balances for accounts
- Low check-writing usage
- Low or no personal savings
- Distrust/ don't like banks
- Privacy

# Alternative financial services providers that serve the poor

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## □ Check cashers

- 400% growth since 1992 to about 10,000 outlets
- Half of unbanked use to cash checks
- Fees: Avg. 1.5-3.5% of check (but wide range), 180 million checks, totaling \$55 billion, \$1.5 billion in fees.
- 80% payroll checks, 16% government checks.
- Loss rates under 0.25 percent of face value of check (compared with interbank rate of 0.64 percent).

## □ Much less growth in use of check cashers in Puerto Rico than in states

# Alternative financial services providers that serve the poor

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## □ Payday lenders

- 12,000 providers
- \$2 b in revenue; \$12b in loan volume; 65 million loans to 8-10 million households.
- APR avg. over 470% (\$54/2 week/\$300 loan)
- Rollovers repeatedly during year
- Credit problems & credit histories
- Federal pre-emption and “renting” charters

# AFS Providers: Refund Anticipation Loans/Tax Preparation Services\*

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- Nearly half of \$32 billion in EITC refunds to over 18 million families distributed through RALs.
- EITC recipients pay \$1.75 billion in tax preparation, electronic filing & loan fees, not including check-cashing fees.
- Example for \$1500 Refund in Washington DC
  - \$100 tax preparation and filing
  - \$90 RAL
  - \$30 check cashing fee

\*Based on Berube (2003)

- Key drivers for RALs
  - unbanked get refunds a month faster; banked 1-2 weeks faster
  - pay off late or mounting bills
  - pay for tax preparation fees from proceeds of refund

# Barriers to account ownership

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- Checking products ill-suited to poor
  - High risk overdraft; high fees; minimum balances
- Problems with accounts in past
  - 7 million in ChexSystem
- Distribution system (e.g., fewer ATMs per capita in low-income neighborhoods)
- Unbanked too poor/low profit
- Lack of documentation (immigrants)
- Lack of financial education

# Costs of Unbanked/Underbanked

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- ❑ Basic transaction services expensive (receive income, store value, pay bills)
- ❑ Reduces government transfer programs (e.g. EITC)
- ❑ May decrease WTW & EITC work incentives
- ❑ Harder to borrow on reasonable terms
- ❑ May make it harder to save
  - cushion against short term crises
  - education, homeownership, retirement, or other goals
- ❑ Risk of loss/theft

# Should we care?

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- Income transfer requires converting government payment to usable form
- May lessen government work incentives
- May reduce savings or access to credit that cushion low-income families from reliance on government programs or bankruptcy
- Payment systems externalities
  - Checks vs. debit
  - Off-line vs. on-line
  - ACH bill payment & direct deposit
  - ATM functionality & location
- Broader social inclusion

# Federal steps to increase access to financial services

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- Encourage low-cost, electronically-based products
  - Treasury's ETA (98,000 accounts) & First Accounts
  - Create new tax credit for FIs providing low-cost electronically based accounts
- EITC, tax refund, and tax preparation reforms
  - Split refunds & encourage direct deposit
  - EITC simplification, filer oversight, e-filing incentives
- CRA services test
- Federal Reserve payment system pricing reforms
  - Remittances through ACH
  - ACH pricing for direct deposit & retail bill payment
  - Check truncation under Check 21 Act

# Puerto Rico: steps to increase access to financial services

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- Direct deposit of government payroll (28% of working unbanked households in Puerto Rico)
- Shift EBT for benefits to account-based cards
- Permit former welfare recipients to retain accounts opened through EBT programs
- Consider using TANF funds for financial access
- Linked deposit programs
- Improve regulation & enforcement of non-depository financial service providers
  - E.g., APR disclosures, rollover limits or minimum repayment periods, but remove anti-competitive requirements (e.g., geographic rules) where they exist
- Education campaigns
- Consider local EITC with direct deposit.

# Private sector steps

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- **Employer-based initiatives**
  - Direct deposit, bank accounts, financial education, payroll cards as transition, & payroll savings plans
- **Banks, Thrifts and Credit Unions**
  - low-cost, debit-card based accounts, with direct deposit
  - accounts with savings “buckets”
  - card-based remittances, linked to accounts
  - automatic check-cashing, bill payment, money orders
- **Others**
  - debit networks—surcharge free alliances for the poor
  - tax preparation services—direct deposit to accounts
- **Leapfrogging** (cell phones, internet kiosks)

# Steps to increase savings

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- Account ownership
- IDA programs
- Employer-based savings plans
- Progressive savings & pension reform
- Financial education

# Conclusion

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- Reaching out to improve access to financial services and savings is still relatively new.
- Initial efforts suggest policies designed to
  - Induce financial institution involvement
  - Increase access to financial services
  - Increase access to savings vehicles
- Expanding access to financial services may be important to economic inclusion.