



# Building a Nation of Owners: Credit Unions, Financial Access and Asset Building in Puerto Rico

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8 October 2004  
San Juan, PR

# Outline

- This morning's presentation will cover four main areas:
  - The Problem: Profile of the Unbanked Population in PR
  - Why is this Important: Costs of Being Unbanked
  - Who can do something about it: Profile of Credit Unions in PR
  - What can Credit Unions do?



# Credit Union Research

## Profile of the Unbanked

- In 2002, 454,000 Puerto Rican households did not have a bank transaction account;
- Average size of household: 3
- The average annual income of unbanked households is \$8,472; and
- 77% reported income of less than \$15,000 per year.
- The federal poverty threshold for a family of 3 in 2002: \$14,494.



# Credit Union Research

## Profile of the Unbanked

- The person in charge of paying the bills in an unbanked household is:
  - Older, average age is 52;
  - Female, head of household in 72% of the cases;
  - Single (includes separated, divorced and widowed), 54% not married;
  - Less educated than the average Puerto Rican; 61% had less than high school education;
  - Unemployed; 79% did not work; and
  - A resident of the greater San Juan area; 46% lived in San Juan or the suburbs thereof.



# Credit Union Research

## Costs of Being Unbanked

- There are significant costs associated with being unbanked:
- Financial Costs of Using Basic Financial Services: In Puerto Rico, check cashing fees are paid by families that had an average monthly income of \$706, mostly for cashing checks issued by the government.



# Credit Union Research

## Costs of Being Unbanked

- Constraints in the Ability to Save -- In Puerto Rico only 8% of the unbanked population reported savings of some sort.
- Reduced Access to Credit -- 73% of the unbanked did not have credit and the financieras charged an average rate of 27% on unsecured personal loans (2Q 2004).



# Credit Union Research

## Costs of Being Unbanked

- Higher Risk of Robbery – If the unbanked had bank accounts, they could:
  - execute their transactions over the entire month, instead of going to the bank every month (usually on the same days each month);
  - withdraw cash in smaller amounts as they needed it; and
  - store savings safely in an insured depository instead of hiding them in the home, thus, reducing their risk of exposure to crime.



# Credit Union Research

## Costs of Being Unbanked

- Inefficiencies in the Payments System Impose Costs on the Economy at Large :
  - A study by the Federal Reserve Board estimates check processing costs (not including fraud) to be between 0.25% and 1.00% of U.S. GDP.
  - If we use the Federal Reserve cost estimates, check processing costs for Puerto Rico during fiscal year 2002 can be estimated to be between \$177,000,000 and \$711,000,000, not including costs associated with fraudulent transactions.

# Credit Union Research

## Costs of Being Unbanked

- In addition, we have the opportunity cost of all the wasted man-hours every year in connection with the payment of bills in person at a local office:
  - If the customer is unemployed, she is wasting valuable time that could be put use in a training/education program or actually looking for work.
  - If the person is employed part-time, she is misusing time that again could be used for training/education purposes.
  - And if the person is employed full-time, this entails being absent from work for significant periods of time every month.

# Credit Union Research

## Costs of Being Unbanked

- Second, and perhaps most significant of all in the case of Puerto Rico, lack of financial access precludes unbanked households from enjoying benefits associated with asset accumulation. According to Sherraden, asset accumulation could be expected to be associated with:
  - Improving household stability;
  - Creating an orientation toward the future;
  - Stimulating the development of other assets;
  - Enabling focus and specialization;
  - Providing a foundation for risk taking;
  - Increasing personal efficacy;
  - Increasing social influence;
  - Increasing political participation; and
  - Enhancing the welfare of offspring



# Credit Union Research

## Profile of Puerto Rico Credit Unions

- As of March 31, 2004, there were 140 credit unions (*cooperativas de ahorro y crédito*) in operation in Puerto Rico with:
  - total assets of \$6,138,550,954 and
  - 854,223 members (31.44% of population over 18)
- As of March 2004, the average credit union had approximately \$44,000,000 in assets and 6,100 members.



# Credit Union Research

## Profile of Puerto Rico Credit Unions

- The 20 largest credit unions in Puerto Rico, which constituted 15% of all credit unions in operation as of March 31, 2004, hold 53% of total credit union assets, account for 51% of credit union members and employ 47% of all credit union employees.
- Since the year 2000, the total number of credit unions in operation has declined by 17, or 10.8%, from 157 in March 2000 to 140 in March 2004.



# Credit Union Research

## Profile of Puerto Rico Credit Unions

- However, between March 2000 and March 2004 the total amount of assets held by Puerto Rico credit unions increased \$1.721 billion, or 38.9%, from \$4.418 billion to \$6.139 billion.
- In terms of deposits, during the last four years total deposits in Puerto Rico credit unions have increased \$1.320 billion, or 42.30%, from \$3.120 billion in March 2000 to \$4.442 billion in March 2004.



# Credit Union Research

## Profile of Puerto Rico Credit Unions

- Total loans outstanding made by credit unions increased \$501 million, or 16.4%, from \$3.051 billion in March 2000 to \$3.552 billion in March 2004.
- The loan portfolio consisted mostly of personal loans (56%), followed by mortgages (27%) and vehicle loans (10%).



# Credit Union Research

## Profile of Puerto Rico Credit Unions

- Willingness to work and be flexible with clients;
- Positive image in the community;
- Social mission anchored in cooperative principles;
- Importance as cultural/social centers;
- Experience, albeit unstructured, in offering services to the unbanked;
- Relative financial strength;
- Geographic presence; and
- The new legal powers granted credit unions by Act 255.



# Credit Union Research

## What can Credit Unions Do?

- A large majority of the unbanked population in Puerto Rico already uses financial institutions to cash checks on a monthly basis.
- In terms of the “credit path model” developed by Alternatives Federal Credit Union of Ithaca, New York, these individuals are already “transactors”.
- The challenge is to move these consumers further along the credit path and encouraging them to become savers, then borrowers and finally, owners.



# Credit Union Research

## What can Credit Unions Do?

- We need products with the following characteristics:
  - Features to Help the Unbanked Overcome Barriers – People can be motivated to join the financial mainstream either by providing supports, such as financial education or financial planning services, or by incentives, such as match deposits or tax credits.
  - Low Cost – Development and operating costs need to be kept to a minimum so the product can be attractively priced.



# Credit Union Research

## What can Credit Unions Do?

- Scalable – Scale is the key to achieve cost-effectiveness. The product must be easy to sell in a big scale within weeks of rollout.
- Compatible with Financial Institution Objectives – Products must be compatible with other long-term objectives of the financial institution and they must make sense to the financial institution as a strategic business decision.



# Credit Union Research

## What can Credit Unions Do?

- Credit Unions:
  - Are used to offering financial education and counseling, which help overcome barriers to access;
  - Are open to collaborating with other credit unions in developing new products for the unbanked, which helps lower R&D costs;
  - Have a presence in every town of the island, enjoy widespread membership and have access to state of the art technology, which allows for scale; and
  - Are non-profit entities with a social mission, which gives them more leeway in term of offering new products to the unbanked population.



# Credit Union Research

## What can Credit Unions Do?

- Offer Credit Union Individual Development Accounts (IDAs)
  - IDAs are savings accounts, in which
  - Savings by the account holder are matched up to a certain amount by the financial institution offering the account or by a third-party community organization; and
  - In order to receive the matching deposits, account holders usually agree to:
    - Participate in financial education classes;
    - Save a minimum amount each month; and
    - Use the money saved only for education, downpayment on a first home or to capitalize a small business.



# Credit Union Research

## What can Credit Unions Do?

- We suggest that credit unions offer IDA accounts with the following characteristics:
  - Account holders will be required to save a minimum of \$10 a week.
  - Credit union will match account holder savings in a 2 to 1 ratio per year with credit union shares.
  - Credit unions would design and offer a financial education program for IDA account holders. Successful completion of the financial education program would be a requirement for continued participation in the IDA program.
  - Withdrawals after three years will be permitted for (1) the downpayment on a first home, (2) education or vocational training, or (3) starting a small business.



# Credit Union Research

## What can Credit Unions Do?

- An IDA which included matching deposits in the form of credit union shares, would help account holders to move along the credit path by creating a link between **savings** and **credit** products given that many credit unions in Puerto Rico are willing to lend against the value of their own shares in a ratio of four to one.



# Credit Union Research

## What can Credit Unions Do?

- At the end of three year IDA period, if the account holder has deposited the maximum amount, she would have over \$3,000 worth of credit union shares which she could leverage to obtain a personal loan in excess of \$12,000.
- In terms of the credit path, our hypothetical client would have moved from saver to borrower in one step.



# Credit Union Research

## Why IDAs?

- IDAs are particularly helpful to the working poor:
  - $40 \times 52 = 2,080$  hours
  - $\$5.15 \times 2,080 = \$10,712$  (pre-tax)
  - Federal Poverty Threshold for a family of 3 (1 adult and 2 children under 18) in 2003:  
\$14,824
  - Traditional policy responses are not viable