

## Building Assets, Building Relationships: Bank Strategies for Encouraging Lower-Income Households to Save

### Introduction

Personal saving enables individual households to withstand unforeseen expenses and income disruptions, such as job loss, health emergencies, or major home and automobile repairs. Saving also helps households fund large expenditures, including buying a home, starting a small business, or paying for college. In addition, saving helps ensure that households will have sufficient assets for retirement. Further, a cushion of savings provides households with many intangible benefits. For example, studies have shown that people who save feel that they have a “stake” in society and have better relationships with family and neighbors, increased community involvement, and enhanced personal respectability.<sup>1</sup> On a macro level, personal saving is a major component of national saving; a country with robust saving generally has more available capital to fund investment and support economic growth.

In very simple terms, individuals can save by putting funds in a deposit account at a bank, credit union, or brokerage firm. However, another way to save is to build financial assets by purchasing a home, insurance policy, stocks and bonds, or deferred retirement plans, among other things. Access to credit is a critical component of asset building, in that large financial assets are often accumulated by borrowing, which can magnify returns. In addition, households with access to reasonably priced credit can borrow money to fund purchases or meet emergency needs without tapping savings. Except in the case of a windfall, such as an inheritance, it is very difficult to build wealth without access to credit.

Not surprisingly, low- and moderate-income (LMI) households have the most difficulty saving. Conventional wisdom suggests that banks do not view LMI households as potential profitable customers because these households have less income and fewer assets.<sup>2</sup>

<sup>1</sup> Margaret Lombe and Michael Sherraden, 2007, *Effects of Participating in an Asset Building Intervention on Social Inclusion*, Working Paper Number 07-02, George Warren Brown School of Social Work, Washington University in St. Louis.

<sup>2</sup> In this article, the term “bank” refers to banks and savings associations insured by the Federal Deposit Insurance Corporation (FDIC).

Nevertheless, banks already have an account relationship or other connection with a large number of these households, and the majority of LMI customers have indicated a desire to expand these relationships. Since the bank has realized the fixed costs of acquiring these customers, the challenge is to increase the profitability of the relationships while also providing LMI households with opportunities to build assets.

This article explains the obstacles LMI households face in asset building, examines the incentives banks have for encouraging these households to save, and describes some strategies banks have used to build profitable relationships that also benefit LMI consumers.

### Low- and Moderate-Income Households Lag in Asset Building

The U.S. personal saving rate has been declining since the early 1980s. As recently as the early 1990s, quarterly saving rates were often greater than 7 percent. Since 2005, however, saving rates have hovered between zero and 1 percent, even falling briefly into negative territory. The most recent saving rate, 0.0 percent as of fourth quarter 2007, is among the lowest since the government began collecting the data in 1959 (see Chart 1).

Chart 1

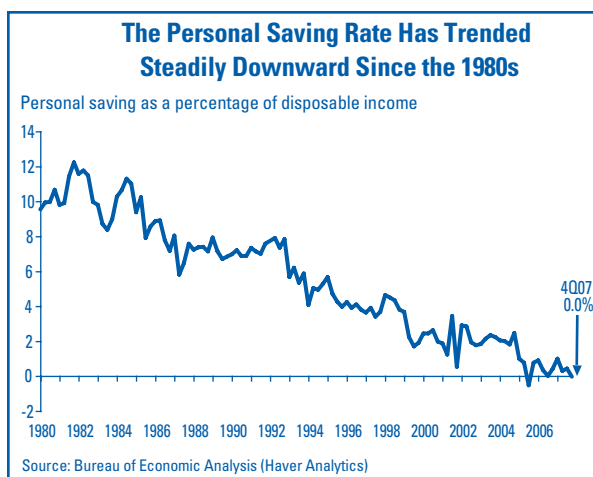
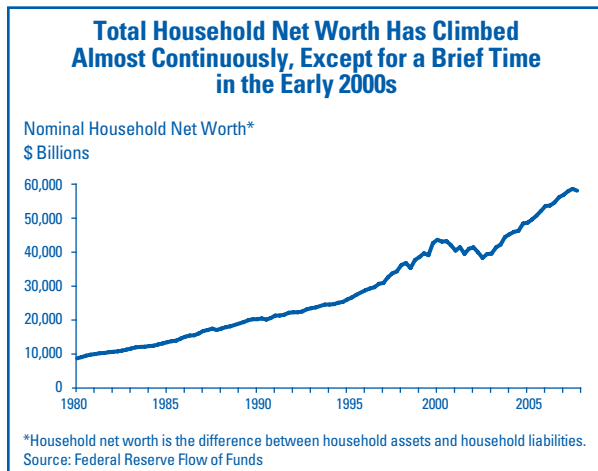


Chart 2



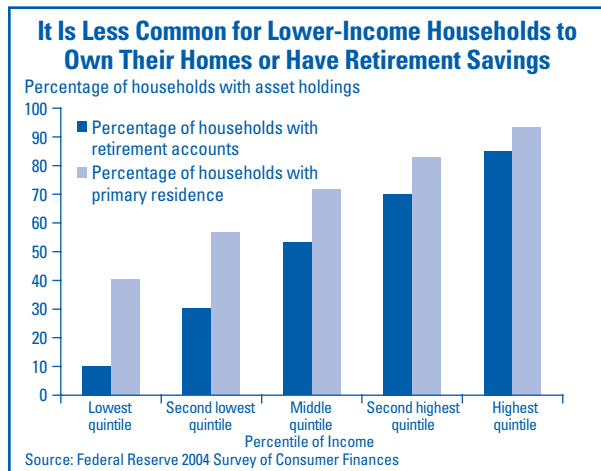
However, the saving rate is an imperfect measure of household wealth accumulation. Some observers have argued that the U.S. saving rate may be understated, primarily because several important asset classes are not included in the calculation (see Text Box on page 31). In addition, a breakdown of the U.S. saving rate by income level is not regularly published. This lack of granularity in the calculation masks the fact that wealthier households drive the overall U.S. saving rate because they earn and spend more and hold higher levels of assets.

To gain a better understanding of the dynamics of personal saving, it is useful to review alternative measures of asset-building progress, namely the trends in and distributions of total household wealth and net worth. According to the Federal Reserve, overall household net worth was \$57.7 trillion by fourth quarter 2007, up 3.4 percent on a year-over-year basis but down about 0.9 percent from the previous quarter. Net worth has grown nearly every quarter since 1953, with the only notable downturn occurring after the stock market declines of the early 2000s (see Chart 2). The most recent dip in household net worth was the first since 2002 and was caused by erosion in home equity and stock values.

Recent increases in overall household net worth have been driven in part by growth in the rate of homeownership—from 65 percent in 1995 to about 68 percent in 2007—as well as an increase in home values.<sup>3</sup> In addition, equity holdings, including the increased participation in and value of retirement plans, have contributed to higher overall household wealth. Higher-income households drive overall house-

<sup>3</sup> Homeownership rates are calculated by the U.S. Census Bureau.

Chart 3



hold wealth figures because asset holdings are heavily concentrated in upper-income bands. For example, homeownership rates for the top quintile of households exceed 90 percent, and retirement account participation is close to 85 percent. Conversely, about 40 percent of households in the lowest quintile own their homes, and only about 10 percent participate in retirement plans (see Chart 3).

Between 1989 and 2004, the median net worth for households increased in all but the second lowest income quintile, although higher-income households have far greater wealth in absolute terms (see Table 1).

Moreover, while the median net worth of households in the lowest income quintile is about \$7,000, almost 20 percent of these households have negative net worth, compared with fewer than 1 percent of households in the highest quintile (see Chart 4).

Table 1

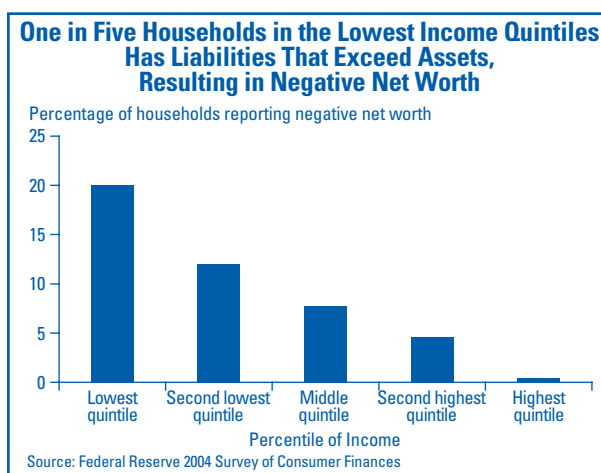
**Between 1989 and 2004, Median Net Worth Grew for Almost All Income Groups, But High-Income Households Have Far Greater Wealth**

Income Quintile	Median Net Worth	
	1989	2004
Lowest (<\$18,900)	\$2,756	\$7,420
Second lowest (\$18,900–\$33,899)	\$36,358	\$33,800
Middle (\$33,900–\$53,599)	\$60,241	\$73,400
Second highest (\$53,600–\$89,299)	\$99,986	\$159,800
Highest (>\$89,299)	\$309,193	\$503,700

Note: Figures are in 2004 dollars.

Source: Federal Reserve 2004 Survey of Consumer Finances

Chart 4



## Barriers to Asset Building for Low- and Moderate-Income Households

There is a seemingly straightforward reason why lower-income households save less—basic necessities such as food, clothing, and shelter consume most, if not all or more, of their available income. Indeed, the median balance in checking, savings, and money market accounts for households in the lowest income quintile was only \$600.<sup>4</sup> Most of these funds would likely be used for day-to-day expenses, with little left for building emergency funds or long-term planning. In addition, other, perhaps less obvious, barriers to saving for lower-income households remain.

### The Wage Gap

A growing wage gap has diminished the already limited ability of LMI households to save. A recent study on income inequality, using data from the U.S. Census Bureau's Current Population Survey, found that the average income of the lowest quintile of households grew by only \$2,660 (inflation adjusted) during a two-decade period from the early 1980s through the early 2000s. In contrast, average income of the highest-income households, or the top 20 percent, increased by \$45,100 during this period.<sup>5</sup> By 2005, the wealthiest 1 percent of Americans earned 21.2 percent of all income earned, while the bottom 50 percent earned 12.8 percent of all income.<sup>6</sup>

<sup>4</sup> Federal Reserve Survey of Consumer Finances, 2004.

<sup>5</sup> Jared Bernstein, Elizabeth McNichol, and Karen Lyons, January 2006, *Pulling Apart: A State-by-State Analysis of Income Trends*, 12, Washington, DC: Center on Budget and Policy Priorities and the Economic Policy Institution.

<sup>6</sup> "Income-Inequality Gap Widens," *Wall Street Journal*, October 12, 2007.

## Effect of Public Policies on Saving

Many of the major public policies directed at asset building apply mainly to middle- and upper-income households through tax subsidies that reward saving. Examples of these subsidies include tax-advantaged 401(k) retirement accounts and Section 529 education accounts, as well as deductions for mortgage interest and state and local taxes on owner-occupied homes. Since the subsidies are proportional to the household's tax bracket, poorer households that pay few or no taxes receive little or no benefit.

For example, a government study estimates that more than 55 percent of the dollar value of the mortgage interest deduction accrues to households with incomes above \$100,000, while 46 percent of homeowners who pay mortgage interest receive no deduction benefit.<sup>7</sup> Even the Credit for Qualified Retirement Savings Contribution, which was designed to encourage saving among LMI households, is limited to those with positive tax liabilities.<sup>8</sup>

In addition, some public policies can have unintended consequences for LMI households. Short-term poverty alleviation programs, such as the Temporary Assistance for Needy Families and food stamp programs, are sometimes "means-tested," meaning that households may only participate subject to asset-holding limits. Consequently, participants risk having their benefits eliminated or reduced if they build assets.

## Limited Credit Alternatives

Access to reasonably priced credit is another obstacle to wealth building for lower-income households. Often, LMI households do not qualify for, or are unaware of, mainstream credit products, and they may turn to alternative financial services (AFS) providers when unforeseen expenses arise. Although AFS providers, including payday lenders, pawnshops, and car title lenders, provide needed credit, it can be very costly. In some cases, use of their products may contribute to a continuous cycle of debt if borrowers rely on them too heavily. For example, payday lenders typically charge annual percentage rates (APRs) of about 391 percent or more for

<sup>7</sup> The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System*, November 2005. Data are as of 2002.

<sup>8</sup> The Credit for Qualified Retirement Savings Contribution offers a tax credit for lower-income taxpayers who make contributions to existing retirement plans, such as employer-based 401(k) plans or Individual Retirement Accounts. For married, joint filer households, the maximum adjusted gross income to claim this credit is \$52,000.

small, very short-term, emergency loans. At these rates, the borrower will owe more in fees than the original cash advance if the loan is rolled over only a few times.<sup>9</sup>

Some banks also provide costly credit products, such as credit cards with high rates or fees, for those with impaired or limited credit histories. In addition, a number of banks provide fee-based overdraft protection—sometimes referred to as “bounce protection”—which imposes a fee for each overdrawn item. Per-item fees for this protection can be \$30 or more.<sup>10</sup> Occasional use of fee-based bounce protection can help customers avoid overdrawing their accounts and incurring late fees on their bills. However, like payday loans, overuse of these programs can result in fees that exceed the amount of the overdrafts.

### **Why Banks Should Encourage Asset Building among Low- and Moderate-Income Consumers**

On the surface, it may seem that banks have little financial incentive to build deposit relationships with LMI households. Although LMI deposit accounts can be used as a funding source, the profitability of these accounts is hampered by the costs of acquiring and servicing them and the limited ability of LMI consumers to build large account balances.

Because of the competitive nature of banking, banks do not publicly release much information regarding the profitability of specific products or relationships. However, one study reports that upfront fees for developing, marketing, and opening low-cost accounts for unbanked federal benefit recipients are in the range of \$27.60 to \$38.60 per account.<sup>11</sup> Yet the maximum fee banks may charge on these accounts is \$3.00 per month. Another study provides some insight into transaction costs—\$1.07 per teller window transaction, \$0.27 per automated teller machine transaction, and \$0.015 per

online banking transaction—suggesting that these costs could outstrip the benefit to the bank of what would likely be low-balance deposit accounts.<sup>12</sup>

In light of what would seem to be major financial barriers to pursuing deposit accounts with LMI households, it may be surprising to learn that banks are already serving, to some degree, large numbers of lower-income households. For example, while few banks target the very poorest households as customers, in a 2002 survey, banks reported that one-third to one-half of their customers earned between \$10,000 and \$49,900.<sup>13</sup>

A more recent study of check-cashing customers by the Center for Financial Services Innovation (CFSI) showed that the majority of these individuals already have relationships with banks. Indeed, 60 percent of those surveyed have checking accounts, 45 percent have savings accounts, and 27 percent have loan balances.<sup>14</sup> Roughly 75 percent indicated that they used both check cashers and mainstream financial institutions (banks or credit unions) concurrently or at various times, compared with about 24 percent who use only check cashers.<sup>15</sup>

Perhaps most interesting for banks, the survey also indicated that a large percentage of respondents (both those who already have bank accounts and those who rely exclusively on check cashers) wish to increase the number of financial products they have with mainstream financial institutions (see Chart 5). Even among consumers who exclusively use check cashers rather than banks, almost 60 percent said they were “very open” to having a relationship with a bank. This is consistent with previous findings that LMI individuals in general can and do save, and wish to increase their saving and asset-building activities.<sup>16</sup>

<sup>12</sup> Steven Davidson, “Reaching out with Technology: Connecting the Low-Income Population to the Financial Mainstream,” Fannie Mae Foundation *Building Blocks* 3, no. 2 (Fall 2002).

<sup>13</sup> American Bankers Association, *American Bankers Association Retail Banking Survey Report*, Washington, DC, 2003.

<sup>14</sup> Jennifer Tescher, Edna Sawady, and Stephen Kutner, *The Power of Experience in Understanding the Underbanked Market*, Chicago: Center For Financial Services Innovation, July 2007. The study surveyed the check-cashing and banking habits of 760 people from 24 urban markets earning between \$15,000 and \$50,000 a year. The average income was \$31,000. To participate in the study, respondents had to have cashed a check at a traditional check-cashing store or other nonbank company in the past six months, and at least one of the checks cashed had to be a payroll or government check.

<sup>15</sup> Ibid.

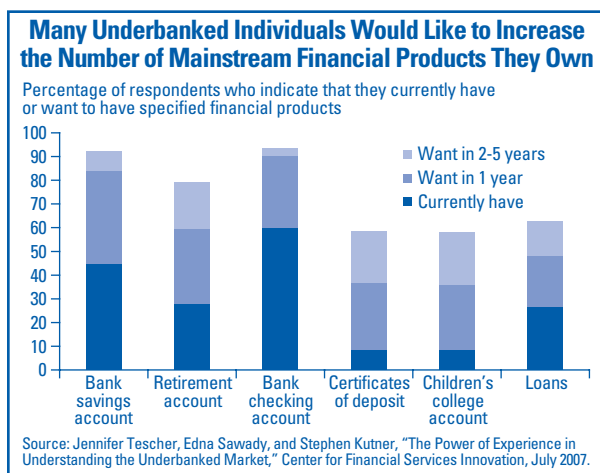
<sup>16</sup> Ellen Seidman, Moez Hababou, and Jennifer Kramer, *A Financial Services Survey of Low- and Moderate-Income Households*, Chicago: Center for Financial Services Innovation, July 2005.

<sup>9</sup> Payday lenders typically charge \$15 to \$20 per \$100 borrowed for two weeks; under a typical payday loan-fee scenario, \$500 is borrowed. Fees are at least \$75 for each two-week borrowing period, which translates into a 391 percent APR. At this price, it takes seven rollovers, or 14 weeks, for a consumer to owe more in fees (\$525) than the original loan.

<sup>10</sup> The average overdraft fee climbed 3 percent in 2007 to a record high of \$28.23. See Greg McBride, “Bounced Check Fees Hit New High,” September 26, 2007, [www.bankrate.com/brm/news/chk/chkstudy/20070924\\_bounced\\_check\\_fee\\_a1.asp](http://www.bankrate.com/brm/news/chk/chkstudy/20070924_bounced_check_fee_a1.asp).

<sup>11</sup> Michael Barr, *Banking the Poor: Policies to Bring Low-Income Americans into the Financial Mainstream*, Brookings Institution Research Brief, September 2004. These cost estimates assume that approximately 10,000 accounts are opened.

Chart 5



There is no single explanation for why customers of check-cashing services, particularly those who already have relationships with banks, so regularly turn to alternatives to mainstream financial institutions. Some may not qualify for a checking account because they cannot meet minimum balances, or perhaps they have had difficulty managing an account in the past. Check-cashing customers in the CFSI study cited the price and convenience of check cashers, negative past experiences with banks, respectful treatment, and good-quality products and services as reasons for patronizing check cashers instead of banks.<sup>17</sup>

From a bank perspective, the sheer size of the market presents a strong incentive to capture some of the transaction volume flowing through check-cashing outlets. According to the Financial Services Center of America (FiSCA), a national trade group representing 5,000 financial service centers, check-cashing companies process 180 million checks annually at a face value of \$55 billion.<sup>18</sup>

One recent report indicated that LMI households pay more than \$8 billion in fees to nonbank check cashers and short-term loan providers.<sup>19</sup> This finding suggests significant possibilities for banks to develop successful long-term relationships with LMI consumers. For check-cashing customers who already have deposit accounts, the bank's customer acquisition costs are

already "sunk," so the challenge is to transition these customers into profitable relationships and products that also enable them to build assets.

In addition to using deposit accounts as a strategy for gaining and strengthening business with LMI households, banks have a strong incentive to serve LMI consumers as part of their obligations under the Community Reinvestment Act (CRA). Banks that provide low-cost saving-related products or services that are responsive to the needs of the community, including LMI neighborhoods and individuals, may receive favorable consideration under the CRA.<sup>20</sup> More generally, banks recognize that helping to improve the financial well-being of individuals can result in a stronger, more stable local economy, thereby creating additional business opportunities for the institution over the long term.

## Bank Strategies That Promote Asset Building

An increasing number of banks are beginning to view LMI households as a long-term business opportunity and are recognizing that asset-building programs can play an important part in engaging these consumers. While strategies vary, most banks realize that, like upper-income households, LMI families are not monolithic in terms of their needs, wants, financial awareness, and capabilities. To be successful, banks must determine the needs of their local market and tailor their product offerings accordingly.<sup>21</sup> While many banks use multiple approaches and platforms, the following are some strategies that banks have used in developing asset-building programs for LMI consumers.

<sup>20</sup> For banks examined subject to large bank procedures, positive consideration may be available under the service test (12 CFR 345.12(i) & 345.24) and potentially also the investment test (12 CFR 345.12(t) and 345.23). Likewise, intermediate small banks may receive positive consideration (12 CFR 345.26 (c)). Small banks seeking an outstanding rating may also receive positive consideration for certain activities (Appendix A to 12 CFR 345 (d) (3) (ii) (B)).

<sup>21</sup> Several research initiatives are under way that may help banks understand, segment, and market products to unbanked and underbanked consumers, many of whom are also LMI households. For example, the FDIC is working with the U.S. Census Bureau to explore the feasibility of conducting a survey of U.S. households in 2009 to estimate the percentage of the population that is unbanked or underbanked. The FDIC is also surveying banks about their interactions with these consumers and conducting a case study to highlight innovative practices that banks have used to bring underserved consumers into the financial mainstream.

<sup>17</sup> Tescher et al., *The Power of Experience*.

<sup>18</sup> Data are from 2006/2007, according to FiSCA's website at [www.fisca.org](http://www.fisca.org) (accessed January 7, 2008).

<sup>19</sup> Matt Fellowes and Mia Mabanta, *Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential*, Brookings Metropolitan Policy Program, Washington, DC, January 2008.

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**Do No Harm.** Banks that are successful in attracting and expanding relationships with LMI households appear to use a fairly straightforward strategy—they provide reasonably priced products and services. In other words, these banks have found that the best way to help customers save is by not overcharging them. Of course, most banks strive to ensure that all of their products and services are fairly priced. Nevertheless, high-cost bank products have been criticized for hampering peoples' ability to build assets.

One example is fee-based bounce protection (see page 26), particularly when it is paired with "free" checking accounts that have no minimum balance requirement. According to one analyst, "They [banks] are able to make money on this once-unprofitable segment by imposing hefty fees for overdrawing. Customers rarely consider these fees when opening an account, and the low-balance segment has a much higher frequency of non-sufficient fund incidents than others."<sup>22</sup> "Free" checking tied to fee-based bounce protection can be a profitable approach in the short term. However, as another analyst pointed out, the high, and sometimes unexpected, fees "provoked customer dissatisfaction," which strains, and often ends, customer relationships.<sup>23</sup>

Many banks offer lower-priced alternatives to fee-based bounce protection, such as "account linking," which, for a small fee, automatically transfers funds from savings accounts or credit cards to checking accounts in the case of overdrafts. Another popular alternative is an overdraft line of credit tied to a checking account. For example, Citibank, N.A. offers the *Checking Plus* overdraft line of credit to all qualified checking account customers for a maximum \$5 annual fee and a variable APR currently at 19 percent in most states.<sup>24</sup> Another product specifically targeted to LMI consumers, or those who have difficulty balancing accounts, is a low-fee debit or stored-value card that helps prevent overdrafts by declining purchases that exceed the account balance.

**Direct Deposit.** A checking account is often considered the basic service for entry into mainstream banking.

Checking, particularly when paired with direct deposit of payroll or other steady income streams, is considered "sticky" in that its convenience tends to anchor the customer to the bank. The ability to split direct deposits among accounts is a simple and effective asset-building strategy, particularly for LMI customers who may be able to save only a small portion of their paycheck.

There is considerable potential for banks to increase customer relationships simply by promoting and expanding direct deposit programs. According to the CFSI study, two-thirds of checks cashed at nonbank outlets were payroll checks, and another 18 percent were state or federal benefits checks.

Many banks encourage direct deposit when accounts are first opened and may offer special pricing as part of their marketing efforts. For example, Apple Bank for Savings in New York offers *Apple Edge*, a workplace banking program that provides employees of participating employers with either advantaged pricing or waivers on minimum account balances if they use direct deposit for their paychecks. As of September 2007, more than 450 employers were enrolled in the *Apple Edge* program, which has generated more than 10,000 deposit accounts, many from households employed in traditionally lower-income professions and located in LMI communities.<sup>25</sup>

**Providing Nonaccount Services.** The most common nonaccount service that banks provide to LMI households is free or low-fee financial education classes. These classes, often conducted on bank premises, allow bank staff to connect with potential new customers in a number of ways.<sup>26</sup> For instance, some institutions have offered LMI customers fee-based transactional services—such as remittance services, check cashing, and bill payment—without requiring the customer to have an account at the bank. The fees are generally competitive with, or better than, those at check-cashing outlets. The goal is to familiarize customers with mainstream banking and, over time, create more profitable banking relationships.

KeyBank in Cleveland, Ohio—with about one-quarter of its branch network located in LMI neighborhoods—

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<sup>22</sup> Somesh Khanna, David Schoeman, and Jack Stephenson, "Profitability Under Pressure," *BAI Banking Strategies* (LXXIX:II) March/April 2003.

<sup>23</sup> Rick Spiler, "The New Survival Skills," *ABA Banking Journal*, American Bankers Association, February 2005.

<sup>24</sup> Derived from Citibank N.A.'s Web site at [www.citibank.com](http://www.citibank.com) (accessed January 14, 2008). The APR in New York is 19.5 percent. Specific banks mentioned in this article are used only as examples. The FDIC and the authors do not endorse any particular bank or product.

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<sup>25</sup> Information regarding *Apple Edge* was obtained from Apple Bank for Savings' publicly disclosed CRA Performance Evaluation from November 13, 2007.

<sup>26</sup> For more information regarding the effectiveness of financial education provided by banks, see Susan Burhouse, Angelisa Harris, and Luke Reynolds, "Banking on Financial Education," *FDIC Quarterly* 1, no. 2 (2007): 33–42."

has been experimenting with fee-based check cashing and other transactional services under a program called *KeyBank Plus*. The goal of the program is to transition at least 30 percent of check-cashing clients to other accounts and services. Although KeyBank has reported that the program is not yet profitable, bank managers recognize that it takes a long-term approach to change consumer behaviors and perceptions about mainstream banking.<sup>27</sup>

**Partnering with Other Organizations.** Promoting saving through partnerships is another popular strategy banks use to build relationships with LMI households. A number of government agencies, nonprofits, faith-based organizations, schools, and philanthropic groups offer financial outreach programs for lower-income families. By partnering with these groups, banks create goodwill within their community while also gaining LMI customers.

For example, *America Saves* is a national social marketing campaign launched in 2001 that encourages people, particularly in LMI households, to save. More than 1,000 organizations are involved in *America Saves*, including more than 500 banks and credit unions that provide no- or low-fee savings accounts to LMI households. To date, *America Saves* has enlisted more than 90,000 people.<sup>28</sup>

In addition, the FDIC's Alliance for Economic Inclusion (AEI) has established broad-based coalitions of financial institutions, community-based organizations, and other partners in several markets across the country to bring more households into the financial mainstream.<sup>29</sup> One of the many programs under the AEI is *Bank on California*, a partnership among the California governor's office, financial institutions, mayors, and community groups to market starter accounts for underserved consumers. Overall, as of year-end 2007, more than 700 banks and other organizations have joined the AEI nationwide, and almost 29,000 new bank accounts have been opened.

Individual development accounts (IDAs) are a relatively low-risk way for banks to partner with nonprofits

and other organizations to introduce LMI consumers to mainstream banking through a savings account. Introduced in 1996, IDAs provide matched savings for lower-income families who are trying to purchase an asset, usually a home, small business, or postsecondary education. About 240 banks, usually working through community groups and nonprofit sponsors, participate in the approximately 540 IDA programs operating across the United States.<sup>30</sup>

Another way banks promote saving through partnerships is with school-based bank branches that establish savings accounts for students. These programs, which can also expose other family members to the benefits of having a bank account, are particularly beneficial to immigrant families, who may face language barriers or who are unfamiliar with or distrustful of banking institutions in their home countries. For example, Mitchell Bank, an \$81 million bank in Milwaukee, operates a high school bank branch primarily to reach Mexican immigrant youth.

**Leveraging Tax Refunds.** Tax season is one of the best times to reach out to LMI consumers. Annually, the Internal Revenue Service (IRS) processes refunds averaging \$2,100 each for more than 100 million taxpayers, many of whom are LMI consumers who receive the Earned Income Tax Credit.<sup>31</sup> H&R Block Bank (a subsidiary of H&R Block, Inc., the country's largest tax preparer) offered several new wealth accumulation accounts during the 2006 tax season, including the *Emerald Savings Account* and the *Easy Individual Retirement Account* (IRA). Both accounts have no minimum balance requirements and feature competitive yields. H&R Block Bank in Kansas City also piloted a small program offering savings bonds purchased with tax refunds; 6 percent (220 of 3,729) of tax preparation clients who were offered this opportunity purchased the savings bonds.<sup>32</sup>

<sup>27</sup> Ann Carrns, "Banks Court a New Client: The Low-Income Earner," *Wall Street Journal*, March 16, 2007.

<sup>28</sup> Information regarding *America Saves* was derived from [www.americasaves.org](http://www.americasaves.org) (accessed February 11, 2008).

<sup>29</sup> The AEI markets are the semirural area of Alabama; Greater Boston/Worcester, Massachusetts; Chicago; Austin/South Texas; the Kansas City metropolitan area; Louisiana and the Mississippi Gulf Coast; Baltimore; Wilmington, Delaware; and Los Angeles. For more information regarding the FDIC's Alliance for Economic Inclusion, see [www.fdic.gov/consumers/community/AEI](http://www.fdic.gov/consumers/community/AEI).

<sup>30</sup> For more information regarding IDAs, see Rae-Ann Miller and Susan Burhouse, "Individual Development Accounts and Banks: A Solid 'Match,'" *FDIC Quarterly* 1, no. 1 (2007): 22–31. As described in this article, the Saving for Working Families Act, which was reintroduced in March 2007, includes a proposal to provide up to \$1.2 billion in tax credits to allow banks to offset part of the cost of opening and maintaining IDAs.

<sup>31</sup> Anne Stuhldreher (New America Foundation) and Jennifer Tescher (Center for Financial Services Innovation), *Breaking the Savings Barrier: How the Federal Government Can Build an Inclusive Financial System*, New America Foundation, Asset Building Program, February 2005.

<sup>32</sup> Nick Maynard, "Tax Time Savings: Testing U.S. Savings Bonds at H&R Block Tax Sites," D2D Fund, June 2007, [www.d2dfund.org/downloads/block\\_bond\\_paper\\_061907.pdf](http://www.d2dfund.org/downloads/block_bond_paper_061907.pdf) (accessed March 5, 2008).

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A number of banks also participate in the *Volunteer Income Tax Assistance* (VITA) program, which provides free tax-preparation services for LMI taxpayers. VITA gives banks an opportunity to open new accounts for these taxpayers to facilitate direct deposit of tax refunds. Opening a bank account may be even more attractive when taxpayers file their 2007 tax returns. Under new IRS rules, taxpayers can now split their refunds among three accounts, allowing at least a portion of the refund to be earmarked for savings.

**Linking Credit and Other Products to Saving.** Cash back, airline miles, and other rewards programs tied to credit cards have been available for many years. For example, the *One* card from American Express links a 1 percent rebate on all purchases to a high-yield savings account at American Express Bank.<sup>33</sup> In practice, most of the rewards programs tied to credit cards are largely limited to qualifying middle- and upper-income households.

However, Bank of America's *Keep the Change* program is one example of a saving-linked product that is more broadly available to LMI households and others. *Keep the Change* rounds up debit card purchases to the next dollar and sweeps the difference into a savings account. The bank also partially matches the customer's annual saving through the program. Bank statistics as of November 2007 show that 6.5 million customers have saved more than \$620 million through *Keep the Change*.<sup>34</sup> Wachovia Bank is also experimenting with a new saving-linked product, *Way2Save*, whereby a customer links a savings account to a checking account and receives \$1 for every debit card purchase, automatic debit transaction, or online bill payment.<sup>35</sup>

A number of banks also provide "credit builder" products, in which all or a portion of an installment loan is placed in a certificate of deposit or savings account. When the loan is repaid, the consumer receives the account balance plus the interest earned. These products enable customers with no credit history, or with a challenged credit history, to positively affect their credit score over the life of the loan. Most banks that

offer this product strongly encourage customers to retain at least some funds in the account.

While the credit builder product is useful for consumers who wish to build or repair credit, it does not address LMI consumers who need access to reasonably priced credit for an emergency or other necessity. To address this need, a growing number of banks have found ways to offer reasonably priced small loans to their customers in a safe and sound manner that is also profitable for the bank. To encourage state nonmember banks to offer these types of products, the FDIC Board of Directors issued Affordable Small Dollar Loan Guidelines on June 19, 2007.<sup>36</sup> These guidelines explore several aspects of product development, including affordability parameters and streamlined underwriting. The guidelines also discuss tools such as financial education and linked savings accounts that may address long-term financial challenges for borrowers.

In addition, on June 19, 2007, the FDIC Board approved a two-year pilot project to demonstrate the value to banks of offering reasonably priced small-dollar lending programs. The pilot, known as the Affordable and Responsible Consumer Credit (ARC) initiative, involves 31 banks and will operate through mid-2010. While the components of small-dollar loans vary among participating banks, these loans generally feature streamlined underwriting, reasonable amortization periods, and APRs below 36 percent. Most also have a saving component, whereby banks offer borrowers the ability to set aside a portion of the amount borrowed, or a portion of each payment, in a savings account. The FDIC intends to follow the participating banks closely and periodically report on the results of the ARC initiative.<sup>37</sup>

## Conclusion

Although LMI households earn less and hold fewer assets, these consumers conduct a significant volume of financial transactions each year. Moreover, many banks already have a relationship with LMI households and are well-positioned to expand these relationships through asset-building products and strategies. Banks that are most successful take a long-

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<sup>33</sup> Information on the *One* card was obtained from [www.americanexpress.com](http://www.americanexpress.com) (accessed January 24, 2008).

<sup>34</sup> Information on *Keep the Change* was obtained from [www.bankofamerica.com](http://www.bankofamerica.com) (accessed January 8, 2008).

<sup>35</sup> Jane J. Kim, "Banks Offer Bonuses to Lure Deposits to Saving Accounts," *Wall Street Journal*, January 16, 2008.

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<sup>36</sup> FDIC's Affordable Small Dollar Loan Guidelines can be found at [www.fdic.gov/news/news/press/2007/pr07052a.html](http://www.fdic.gov/news/news/press/2007/pr07052a.html).

<sup>37</sup> See [www.fdic.gov/smalldollarloans/](http://www.fdic.gov/smalldollarloans/) for information on the ARC initiative.

## Factors That Determine the U.S. Household Saving Rate

Put simply, the U.S. household saving rate (shown in Chart 1 on page 23) is personal disposable income minus consumption expenditures and nonmortgage interest and transfer payments. However, some have argued that the way this ratio is calculated minimizes its usefulness as a true measure of saving.

For example, saving data do not uniformly reflect changes in the value of financial assets, such as homes, stocks and bonds, or private pensions. That is, capital gains on financial assets, whether they are realized or not, are not included in the household saving data, but taxes paid on capital gains realized are included in the expense portion of the calculation, which reduces the saving rate. Similarly, discretionary extraction of home equity does not count as income, but the portion spent outright counts as consumption expenditures and thus reduces the saving rate.

The omission of financial assets from the calculation has a more pronounced effect on the saving rate than in the past because these assets currently comprise a relatively larger portion of household balance sheets. For example, from the mid-1970s through the early 1990s, pension fund reserves, mutual fund shares, and corporate equities together accounted for less than 20 percent of all household assets. In fourth quarter 2007, the combined share stood at 32.3 percent, which, while below the peak of 45 percent reached in early 2001, is higher than levels seen in past decades.<sup>a</sup> Also, tangible assets, including the value of homes, now represent a larger share of total asset holdings (37.1 percent in fourth quarter 2007) than they had during much of the 1990s and early 2000s.<sup>b</sup>

Aside from concerns surrounding the calculation of the U.S. saving rate, a change in attitudes about saving,

shifting demographics, trends in retirement planning, and widespread access to credit could also explain some of the decline in the traditional saving rate. Near the end of World War II and continuing into the 1960s, the United States experienced a baby boom. The baby-boom generation now represents a larger portion of the U.S. population than any other generation. The retirement of this generation means that an increasing portion of the population is in retirement and spending down their previous saving, while a decreasing portion of the population is still working.

Among the working population, defined benefit plans—or traditional pensions—have been virtually phased out in favor of defined contribution plans, such as 401(k) plans. These plans place the responsibility for retirement saving on the individual. While many individuals choose to save in these tax-advantaged plans, participants have more discretion to decide how much to invest. In contrast, the contribution to defined benefit plans was set and mandatory.

According to the Federal Reserve's 2004 Survey of Consumer Finances, 45 percent of individuals cited retirement as a reason for saving, compared to 23 percent in 1989. There has also been a corresponding drop in emergency spending as a reason for saving (33 percent in 1989 compared with 29 percent in 2004). Long periods of economic prosperity may have led some individuals to believe that precautionary saving is less necessary.

The change in the perceived need for precautionary saving has been reinforced by increased access to low-cost credit among middle- and upper-income consumers. Today, credit cards, home equity lines of credit, and other forms of consumer loans are readily available to cover unanticipated expenses without tapping precautionary saving.

<sup>a</sup> Federal Reserve Flow of Funds.

<sup>b</sup> Ibid.

term approach and tailor products and services to their local market. Some successful strategies include “doing no harm” by offering reasonably priced products and services to LMI consumers, expanding direct deposit options, partnering with outside organizations to obtain motivated customers, leveraging tax refunds into saving, and linking saving to credit and other bank products. Going forward, there will continue to be considerable public debate and numerous policy proposals to expand asset-building opportunities for all households.

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