

COMMENTS AT THE CRA & FAIR LENDING COLLUQUIUM

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By

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On

CRA Services Test: Leverage changes to qualifying criteria and take advantage of some old ones too

At the UNC Center for Community Capital, we study CRA-related financial services, from homeownership to basic financial services. I recently testified before regulatory agencies about the CRA service test and will build on those remarks today as well. We applaud recent changes to the CRA related to student loans and the NSP program, both of which we have previously commented on and written about.

That said, if I had looked at a calendar before agreeing to participate in this panel and talk about the policy context, I would wisely have declined after noting that it fell a week after the election.

But let's take a long view. Fundamentally, the rationale for CRA hasn't changed much since 1977; if anything it has been affirmed. We know from our own research that borrowers who relied on CRA mortgages in the recent bubble were much less likely to default than identical borrowers who used subprime and exotic loans. Today, many communities and households are suffering financial setbacks that will hinder their ability to access quality financial services and build financial security for the foreseeable future. And we have been reminded that banks benefit from taxpayer backing, and how much the economic health of all communities is linked to the health of the banks serving them.

The Services Test has a critical role to play in advancing the CRA mission. Access to basic banking services is the gateway to financial opportunity that can eventually lead to homeownership and entrepreneurship, but it starts with basic savings, transaction accounts, and consumer credit.

So how are we doing a third of a century after CRA passed? In a December 2009 survey of 49,000 households (supplement to the Census), the FDIC found:

- 7.7% of households (17 million adults) are completely unbanked – no checking or savings account. 22% of black households, 19% of Hispanic and 15% of Native Americans, vs. 3% of Whites – Black households were 7x as likely to be unbanked as White.
- Another 18% of households have a bank acct but rely on Alternative Financial Services (non bank money orders, check cashers, payday loans, RTO, pawn shops or RALs). Blacks and Native Americans were about 2x as likely as Whites to be “underbanked”, Hispanics about 1.5x as likely.
- All in all, ¼ of US households are un- or underbanked – more than half of all Black households vs. 18% of White (though there are still more un/underbanked Whites than Blacks.)

Moreover, 35 to 70 million Americans lack sufficient credit history to have a credit score.

Underserved households are disproportionately low- and moderate-income households, the target market for CRA services.

These are clear indicators that there is a lot of NEED in the communities left to be met. Instead, consumers turn to services that are often very costly and undermine their financial potential, through high fees and traps:

You are probably familiar with the costs - \$2 billion taken off the top of the Earned Income Tax Credit by RAL and RAC fees; Payday lenders earn \$4 billion in fees a year; An \$850 computer can cost \$4450 in a RTO store. Subprime credit cards, auto loans, it goes on....

When we look at that data, it strikes us that there has got to be valuable business there for banks, but as it stands the CRA service test doesn't seem to encourage you to figure out how. Consider how really few banks ever get bad CRA ratings, in light of the statistics I just read.

Something just doesn't connect. As we have written previously and as our research indicates, the service test is too subjective and needs to be more objectively measured.

The FDIC's companion study of banks' is a great barometer of how motivated banks are (or are not). It also contains a lot of ideas and best practices:

- Most banks know about the need, but less than 18% identify expanding services to un/underbanked as a priority in their business strategy.
- 75% have conducted no research on this opportunity within their CRA assessment area (which makes me wonder how they get context to assess the needs of the community).
- Banks' favorite approaches are providing financial education, participation in other organizations, and outreach visits.
- Other ideas to serve this segment: working with business customers to provide services for employees; cashing checks; bill paying services, prepaid cards.
- Savings accounts aimed at un and underbanked are "few", and typically, monthly fees exceed potential interest earnings. There

was little to report as far as consumer debt products designed for this segment.

Now, I don't know if it's likely that the CRA service test will be changed anytime soon. But there is a lot of related change on the horizon that suggests opportunities:

RAL/RAC changes: IRS changes will make it hard to do refund advance loans, and this may create a unique opportunity in the upcoming tax season. Those of you working with or supporting VITA sites are in a position to open accounts so taxpayers can direct deposit to bank accounts instead.

Changes to Overdraft and impact on bank account services

Changes to credit cards

Changes from Dodd-Frank & CFPB: Some sections of Title XII deal with opportunity and access - Consumer Access to Capital - Orders the Secretary of the Treasury to:

1. Expand LMI access to FDIC insured institutions- By establishing grants and agreements to promote initiatives designed to enable LMI individuals to establish deposit, savings and closed-end loan accounts in federally insured depository institutions. And to,
2. Expand availability of low-cost, small value loans and provide alternatives to payday loans by establishing loan loss reserve funds among CDFIs. This presents partnership opportunities with local CDFIs.

So there is likely to be forward movement.

The way forward is being informed by research on consumer preferences and behavior with respect to financial services, in the field of behavioral economics. This research examines why consumers make the financial choices they do, even if they don't seem rational.

Why for example would low income people over-withhold all year but then rush to a refund advance lender and pay outrageous fees to get their refund ten days early?

Behavioral Economics helps us design products and services that can lead to better financial decisions; the stuff you can't get at with education and disclosures alone.

For example, it turns out people don't really like a lots of choices. They say they do, but their brains don't like too many options. This is clearly relevant to financial products, which are complex to begin with – add too much choice and complexity, and the brain shuts down.

We also know people are easily steered; if you make things automatic and enroll them automatically, people are more likely to simply go along. We see this applied with overdraft programs and the policy requirement that people now have to opt-in to that service.

There are many examples and principals I could share, but since we're in Las Vegas, I thought I'd highlight prize-linked savings. People in the US spend more on lottery on average than on alcohol, and the poor spend disproportionately on lotteries. In a way, this is a form of saving – a long shot at asset building. (Explanation: savers open accounts that have low or zero return. On a regular basis, they are entered into a drawing for a windfall. In some countries this may be a car or a \$100,000 or something similar. The longer you save and the more you save, the better your chances.) In the US, there are certain restrictions to implementing these, but researchers from Harvard are testing and piloting models.

So here are some promising activities that can help the underserved develop basic financial skills, build assets and establish good credit behaviors, as the CRA intends. For example:

Bank On – Has grown to a national effort (Show of hands as to banks participating?)

Prepaid cards

Financial education – The Treasury has an initiative on financial literacy. We talked about tax time opportunities already.

IDAs. There is a policy proposal on the table that would give banks tax credits for participating in IDA programs.

The consumer debt side is not as well developed. You are probably familiar with the FDIC Small Dollar Loan Pilot, which links savings to borrowing. As I mentioned, there's innovation in the CDFI space which might be a place to look for partners.

This was just a laundry list, and I'd be glad to talk in more detail about specifics, but right now, I look forward to hearing from our other panelists about things they have actually accomplished for their communities. (Harbor One and Union Bank).