
All In: Building the Path to Global Prosperity through Financial Capability and Inclusion

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Introduction

Roughly 75 percent of the world's poor – 2.5 billion people – do not have a bank account or otherwise participate in the mainstream financial system. While many are constrained by limited incomes, many others are hampered by infrastructure and institutional barriers that keep the mainstream financial system out of reach, including an inability to secure the required documentation to open an account and scarcity of transportation to travel to a bank, according to a World Bank study released in 2012.¹ This lack of access to secure, affordable financial products and services severely limits the global poor's financial security and opportunities.

In developing countries, where 95 percent of the population lives on less than \$10 a day and every cent is essential to a household's wellbeing, people need a place to save money without fear it will be lost or stolen.² They need a safe way to borrow money, with interest rates they can afford and on terms that help them to improve their situation instead of hamstringing them with unmanageable debt. These are the standard offerings of the mainstream financial system and are important building blocks of financial stability, financial security, and economic mobility.³

Financial vulnerability is not limited to the world's poorest people or nations. Despite the United States' relative wealth, many Americans are financially insecure, lacking either the ability to meet monthly bills or the necessary savings to cover unexpected expenses. According to a 2013 study by the FINRA Investor Education Foundation, more than half of Americans lack sufficient savings to cover three months of living expenses if an unexpected need arose in the following month.⁴ Notably, 29 percent of all survey respondents earned at least \$75,000 a year and another 19 percent earned at least \$50,000 a year, placing them squarely in the middle class and highlighting the fact that financial insecurity spans the income spectrum.⁵

For many economically vulnerable Americans, that insecurity is compounded by a lack of access to secure, affordable financial services. A quarter of all U.S. households do not have a basic checking or savings account or rely on alternative financial services for banking needs. The result is billions of dollars lost on the high fees and interest rates associated with alternative products. These costly fees can be especially detrimental to low- and moderate-income families already struggling to cover basic needs. The average low- or moderate-income family dedicates the same share of their income to fees and interest as many Americans spend on food in a year.⁶ These costs could be reduced with greater access to affordable financial products and their hard-earned dollars redirected to more productive uses.

Helping fragile consumers to better manage their finances is critical to improving financial stability, financial security, and – eventually – economic mobility. Research suggests that doing so benefits not only the individual, but also employers, taxpayers, and the national economy. In this paper, we discuss the important role that savings, access to affordable credit, and opportunities for asset building can play in assisting the country's vulnerable families to improve their financial footing. Specifically, we assert that well-designed products and services can both meet consumers' unique needs and assist them to achieve their goals, in turn increasing financial security and creating economic opportunities.

JUST THE FACTS

75%

of the world's poor – roughly 2.5 billion people – do not have a bank account or otherwise participate in the mainstream financial system

1/4

A quarter of all U.S. households do not have a basic checking or savings account or rely on alternative financial services for banking needs

JUST THE FACTS

\$2,400

The average underserved household spends roughly \$2,400 annually on alternative financial services, representing an average of almost 10% of their income

\$40,000

By switching from check cashing services to a mainstream checking account, a full-time worker could potentially save as much as \$40,000 during his/her working career

\$89B

Non-bank products and services generate almost \$89 billion in fees and interest annually

i. The Compounding Problems of Financial Vulnerability

A family's path to financial security begins with access to high-quality, affordable financial products and services. Yet, more than a quarter of U.S. households – roughly 34 million – is either unbanked or underbanked, meaning that they lack either a checking or savings account or conduct some or all of their financial transactions outside of the traditional banking system.⁷ Instead many rely on alternative financial products and services, including payday and pawnshop loans, check cashers, and subprime auto lenders, many of which have high rates and fees or other product features that may result in excessive costs to the consumer.

All too often, the consumers who most rely on alternative financial services are those that can least afford them. The average underserved household earns \$25,500 annually.⁸ That same family spends roughly \$2,400 on alternative financial services, representing an average of almost 10 percent of their income.⁹ A full-time worker could potentially save as much as \$40,000 during her career simply by switching from check cashing services to a mainstream checking account.¹⁰ If this same worker invested those check cashing fees regularly into U.S. Savings Bonds, she could generate \$90,000 in savings, which could constitute a significant contribution to retirement security.¹¹

Consumers who operate outside the traditional banking system not only pay more in fees and interest, they also risk deepening their financial insecurity. Under- and unbanked consumers often lack opportunities to establish credit histories. Unlike mainstream financial institutions, most alternative providers do not report to the major credit bureaus. Almost a quarter of American adults – 50 million people – do not have a credit score.¹²

Research shows that people have a variety of reasons for using alternative financial services.^{13,14} Some consumers feel that they do not have enough money to justify an account. Others are unable to access mainstream products due to blemished or nonexistent credit histories. Regardless of the reason, the result is the same: a thriving market for alternative financial products. In 2012, the alternative financial services market generated \$89 billion in fees and interest.¹⁵ The sheer size of the market demonstrates tremendous demand for financial products and services that can address the specific needs of under- and unbanked households.

II. The Power of a Healthy Household Balance Sheet

Economically vulnerable households will not achieve financial security overnight, and a wide range of factors influence their balance sheets, such as income, access to health care and benefits, housing, and transportation costs. Nonetheless, even families with modest incomes can and want to save.¹⁶ To do so, people living paycheck to paycheck need help making decisions that maximize every dollar and stabilize their finances. They also need cost-effective tools that create opportunities to save money, establish good credit histories, and plan for their financial futures.

A. IMPORTANCE OF SAVINGS

The opportunity and ability to save money is essential to financial stability. In the short-term, savings can provide cash for emergencies, acting as a safety net to help the consumer remain financially stable when confronted by unanticipated expenses or temporary dips in income. Unfortunately, most Americans lack emergency savings. Over half (56%) of respondents to FINRA's Financial Capability study said they have not set aside the necessary funds to cover three months of expenses.¹⁷ When asked if they would be able to come up with \$2,000 if an unexpected need arose in the next month, 39 percent of respondents said they probably or certainly could not.¹⁸ While personal savings are important for households across the income spectrum, they are particularly beneficial for low- and moderate-income families who are vulnerable to even small financial shifts. Families with sufficient savings to support themselves for at least three months in the absence of income have a greater ability to weather adverse financial events, like job loss or medical emergencies.¹⁹

Longer-term savings are also important as they form the basis for life-changing investments in education, homeownership, and a secure retirement, providing a catalyst for upward economic mobility. Research has shown that low-income households with savings are better able to move up the economic ladder than those without savings.²⁰ For example, 71 percent of children born to high-saving, low-income parents move up from the bottom income quartile over a generation.²¹

B. IMPORTANCE OF CREDIT

Approximately 25 percent of American consumers have subprime credit scores, defined as below 620, while another 25 percent do not have a credit score at all.^{22,23} These individuals pay more than their counterparts with higher scores for numerous everyday goods and services, such as rental housing and auto insurance, because many sellers consider consumers' credit histories when setting prices. Researchers at the Brookings Institution examining the impact of a low credit score on mortgage financing found that the difference in annual mortgage payments between the highest and lowest credit score brackets was approximately \$5,000 per year on a \$150,000 mortgage.²⁴ Assuming a fixed-rate, 30-year mortgage loan, consumers with the lowest credit scores may pay over \$150,000 more over the life of the loan than their counterparts with the highest credit score, tantamount to paying the mortgage a second time.

JUST THE FACTS

56%

Over half (56%) of Americans lack emergency savings

71%

71 percent of children born to high-saving, low-income parents move up from the bottom income quartile over a generation

\$150,000

A low credit score can cost an extra \$150,000 in mortgage payments over the life of the loan

JUST THE FACTS

\$46,500

Economic benefits of each new homeowner to the macroeconomy is \$46,500

1/2

A recent study revealed that nearly half of employers check an applicant's credit history when hiring

C. IMPORTANCE OF ASSETS

Asset acquisition is fundamental to long-term financial stability. Income-boosting assets, such as education, can increase an individual's earnings. The net lifetime gain to a worker with a college degree is \$830,800 compared to a worker with a high school education, even after accounting for the costs of tuition and lost earnings while in school.²⁵ During the Great Recession, college graduates were more than twice as likely to secure employment as high school graduates.²⁶ Similarly, a car can increase an individual's income by improving both access to employment and the ability to reliably arrive to work on time. Research has consistently shown a strong and positive relationship between car ownership and several employment-related outcomes, including employment rates, number of hours worked, and earnings.^{27,28} In a recent study of low-income households, those with cars were twice as likely to find employment and four times as likely to remain employed compared to those without a car.²⁹

Other assets can increase an individual's wealth over the longer-term. Homeownership, for example, has provided a pathway into the middle class for generations of Americans. Home equity remains the most significant component of net worth in America, accounting for 45 percent of the wealth of middle income households and 51 percent of the wealth of lower-income households.³⁰ According to a recent study by the Department of Housing and Urban Development, each new homeowner generates approximately \$46,500 in spillover benefits to the broader economy through home-related purchases and expenditures.³¹

iii. The Benefits of Consumer Financial Stability to Employers, Taxpayers, and the Macroeconomy

Financial insecurity affects not only consumers but also the broader economy. Excessive household debt and low rates of household savings stymied the national recovery from the recent Great Recession and threaten to reduce worker employability and productivity. Financial instability also increases the demand for public services as households struggling to cover basic needs, such as food, housing, and medical care, turn to the government for assistance.

IMPACTS ON EMPLOYMENT AND WORKER PRODUCTIVITY

Financial insecurity and weak financial capability limit employment opportunities. Employers are increasingly using credit scores as a means to screen job applicants. A recent study revealed that nearly half of employers check an applicant's credit history when hiring.³² People with low credit scores thus face decreased chances of gaining employment and, in turn, improving their economic situation. Given that half of American consumers have a subprime credit score or no credit score at all,³³ it appears that large segments of the population are at risk of being locked out of the job market, making it more unlikely they will achieve financial stability.

Financial insecurity doesn't just affect an individual's employment prospects; it also influences worker productivity. Researchers estimate that each worker impaired by financial stress costs the employer \$400 in wasted time and absenteeism each year.³⁴ In aggregate, employees' financial stress costs employers approximately \$8.7 billion in lost productivity each year.³⁵

IMPACTS ON THE TAXPAYER

Americans' financial insecurity is anticipated to significantly impact public sector costs due to the nation's growing lack of retirement savings. Roughly 45 percent of working-age households – 38 million families – lack any retirement accounts.³⁶ Researchers estimate that fewer than 10 percent of working households are positioned for a financially secure retirement, creating a shortfall of \$7 to \$14 trillion in worker savings.³⁷ Many financial advisors recommend saving at least 10 percent of annual income for retirement, or \$5,300 a year for the median household income of \$53,000. Yet, among those working-age households that maintain any type of retirement account, the median balance is only \$3,000, less than one year of recommended savings.³⁸

A 2012 report by the Senate Committee on Education, Labor, and Pensions³⁹ discusses the likely impacts of the retirement crisis on the demand for public sector services:

"In addition to the strain on family finances, the retirement crisis will have a significant impact on government programs that provide assistance to poor or near-poor retirees. As people are unable to afford basic living expenses in retirement, they will rely more and more on programs like housing assistance, home heating aid, and food assistance. Elder poverty will also increase Medicare and Medicaid costs because seniors living in or near poverty often have higher incidences of chronic and acute health problems and are also less able to afford private long-term care services. The increased costs will undoubtedly strain our social safety net."

IMPACTS ON THE MACROECONOMY

The recession of 2007 to 2009 devastated the nation. American households lost \$16 trillion in net worth, nearly two decades worth of wealth for the bottom 80 percent of households.⁴⁰ Researchers have been caught off guard by the significant role consumers' financial insecurity played in the recession. According to the St. Louis Federal Reserve:

"Prior to the Great Recession, many respected economists were not worried about the management of household balance sheets and the role balance sheets played in macroeconomic performance...It has come as somewhat of a surprise, therefore, that many economists now are calling the Great Recession of 2007-2009 a 'balance-sheet' recession and that balance-sheet failures... are seen as important contributors to the downturn and weak recovery."⁴¹

Though roughly two-thirds of the \$16 trillion in net worth lost during the Great Recession has been recovered (after accounting for population growth and inflation), the benefits of the recovery have not been evenly distributed,⁴² and millions of American households remain worse off than before the recession.

JUST THE FACTS

\$8.7B

In aggregate, employees' financial stress costs employers approximately \$8.7 billion in lost productivity each year

\$7-\$14T

Experts estimate that fewer than 10 percent of working households are positioned for a financially secure retirement, creating a shortfall of \$7 trillion to \$14 trillion in worker savings

45%

Roughly 45 percent of working-age households – 38 million families – lack any retirement accounts

This lost wealth has not only devastated individual households but may also limit the overall growth and productivity of the economy, as highlighted by the Kansas City Federal Reserve:

“Today’s saving influences future consumption because investments in financial assets are channeled into productive investments in factories, industrial machinery, computers, and other kinds of capital. Increases in the capital stock raise the nation’s ability to produce consumer goods and services in the future. A higher capital stock also raises the productivity of future workers and their wages, providing increased income with which to purchase the increased quantity of consumer goods and services.”⁴³

iv. Financial Capability as a Tool for Increasing Economic Security and Mobility

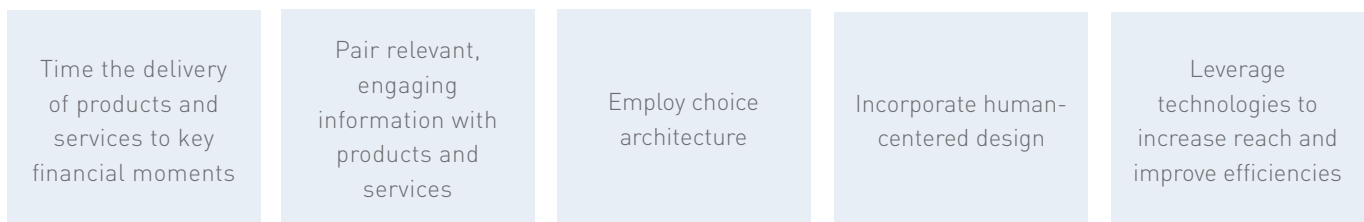
Americans of all ages and incomes need to become more financially secure, yet achieving this goal remains elusive. Evidence from the field of behavioral science is shedding light on why most consumers have difficulty evaluating the impact of daily financial decisions on their long-term goals. Research shows that the brain is hardwired to experience greater satisfaction by addressing immediate needs and has difficulty accurately measuring the delayed and potentially abstract benefits of long-term financial goals.⁴⁴

To date, many of the efforts to improve money management have either focused on classroom-style instruction or general public service campaigns. Evaluations of these types of programs have revealed that knowledge is only one piece of the multi-faceted puzzle of financial decision making. Research indicates that the impact of financial literacy programs diminishes over time and that it is most useful when coupled with programs that target behavior change.

In response to evidence from behavioral science and evaluations of financial literacy programs, researchers and other experts have emphasized the need to identify those strategies that create positive, consistent financial behaviors, actions and outcomes, which has given rise to a new field dedicated to improving an individual’s *financial capability*.^{45,46,47} The Center for Financial Inclusion defines financial capability as “the knowledge, skills, attitudes and behaviors needed to make sound financial decisions that support one’s well-being”.⁴⁸

The financial capability field employs technologies and behavioral insights, as well as product and policy design, to help families and individuals engage in the financial system in a manner that promotes lasting financial security.⁴⁹ Rather than define a specific model that requires a one-size-fits-all program, financial capability is driven by key principles that tailor the delivery of financial products and services including: (a) timing the delivery of products and services to key financial moments; (b) pairing relevant, engaging information with products and services; (c) employing choice architecture; (d) incorporating human-centered design; and (e) leveraging technologies to increase reach and improve efficiencies.

RATHER THAN DEFINE A SPECIFIC MODEL THAT REQUIRES A ONE-SIZE-FITS-ALL PROGRAM, FINANCIAL CAPABILITY IS DRIVEN BY KEY PRINCIPLES THAT TAILOR THE DELIVERY OF FINANCIAL PRODUCTS AND SERVICES INCLUDING:



DELIBERATE TIMING

Many emerging financial capability efforts link the delivery of financial education and services to key financial moments in an individual's life — a high school student considering student loans, a parent transitioning to a new job, or a family preparing to buy a home. Recent evidence suggests that providing relevant financial information and access to high-quality products at these critical moments may increase the likelihood of better outcomes.⁵⁰

This strategy of deliberate timing is the cornerstone of the Tax-Time Savings Bonds program, a federal initiative that enables Americans to place some or all of their tax refund in a federal bond just by checking a box on their tax form. For many households, a tax refund can be the most promising savings opportunity presented all year. This is especially true for low-income Americans, for whom tax refunds can comprise 15 percent or more of their annual income.⁵¹ By creating the opportunity to save at a consumer's critical financial moment, the Tax-Time Savings Bonds program has succeeded in encouraging positive financial behavior. Since the program's launch in 2009, more than 100,000 federal tax filers have saved over \$60 million.⁵²

PAIR INFORMATION & PRODUCTS

Evidence suggests that financial capability improves when consumers receive financial education in conjunction with access to relevant products, as opposed to education delivered in isolation. Specifically, access to a high-quality financial product can help make the delivery of the financial information more tangible. The information can also help consumers understand the potential uses and benefits of the product, thereby increasing confidence, adoption and subsequent use.

A recent study evaluating the effects of classroom-based financial education on elementary students found that those receiving education in conjunction with the opportunity to open a bank account retained more financial knowledge than their counterparts who received only the education. The same study found that using a bank account also increased the students' perceptions about the ease of saving, and attitudes towards banking institutions, over those that received only the classroom education.⁵³

CHOICE ARCHITECTURE

Behavioral economists have demonstrated that people from all income levels sometimes make choices that are not in their own best interest, and that these decisions are often based on incomplete or misleading information, or competing motivations. Based on these insights, practitioners in the field of financial capability are leveraging public policy and product design to make it more intuitive for consumers to weigh financial trade offs and determine the best course of action for their circumstances.

The most notable example of this has been the move towards automatic enrollment in 401(k) retirement plans. Historically, though designed to be an incentive and convenient way to save, 401(k) employer-matched programs have had a lower than anticipated participation rate. By choosing not to contribute, many employees essentially leave "free" money on the table by forgoing the employer's matching contribution. Research indicates that employees are not intentionally forfeiting the "free" money. Instead, it

FINANCIAL CAPABILITY AMONG MILITARY FAMILIES & VETERANS

In a 2006 report, the United States Department of Defense (DOD) identified predatory lending as a threat to military readiness.⁵⁸ Specifically, the authors cited products' costly fees and misleading terms as the cause of financial difficulties for many servicemembers, in turn eroding troop morale and ultimately adding to the cost of fielding a volunteer fighting force. More than one in five servicemember respondents to a survey on financial capability reported engaging in alternative borrowing methods such as payday loans, advances on tax refunds, or the use of pawn shops.⁵⁹

In response, Congress passed the Military Lending Act of 2006, which created numerous protections for servicemembers against predatory lenders, including limits on the annual interest rates for consumer credit to active-duty military.⁶⁰ At the same time the military worked to increase servicemembers' access to high-quality financial products as alternatives to predatory ones, and is also engaged in a national pilot project to determine the best way to deliver financial coaching to military families and veterans.

appears that some employees find it difficult to decide to put aside a portion of their paycheck when signing up for benefits. Research has also shown that when people are faced with choices, it is often easier to make a “non-choice” and stick with the status quo.⁵⁴ This might be due to the desire to not make the “wrong” choice, and thereby avoid regret,⁵⁵ or it might be due to feeling overwhelmed in the face of too many options.⁵⁶ Regardless of the reason, the result is that employees fail to sign up for the program.

Many employers have since changed the enrollment structure such that employees are automatically enrolled unless they choose to opt-out. With this change, employers across the United States and the United Kingdom have been able to significantly boost employee enrollment and, ultimately, retirement savings. One study showed that participation more than doubled for new hires, growing from 37 percent to 87 percent, after a Fortune 500 company adopted the automatic enrollment plan.⁵⁷

HUMAN-CENTERED DESIGN

The concept of human-centered design refers to product design that incorporates the user’s needs, constraints, and usage patterns. In doing so, such design can encourage positive financial decision making.

When CARD Bank, a commercial bank in the Philippines, decided to explore ways to assist their low-income customers to increase their savings, it asked a design team from ideas42 to research what account features would help consumers to achieve their savings goals.⁶¹ Using account information and interviews with accountholders, researchers identified behavioral barriers to increased savings based on the process for opening an account. Up to that point, the bank had required customers to open a savings account in order to take out a loan. As part of this requirement, customers agreed to make a small weekly deposit into the account. Through their research, the design team learned that the bank’s customers had come to consider the required deposit as fulfilling their total need to save and so were neglecting their long-term savings goals, such as saving for their children’s education. The fact that bank staff did not conduct outreach to customers to discuss the value of long-term savings only reinforced the clients’ view of the account as perfunctory. In response, the bank redesigned its process for opening a savings account to include goal-setting based on the consumers’ individual needs. With this small change, accountholders increased their savings by 37 percent over an eight-week period when compared with a control group whose accounts didn’t have these new features.

NEW TECHNOLOGIES

The efficiencies, convenience, and ubiquity of technology is reinventing the financial services marketplace. Banks and credit unions of all shapes and sizes have converted to online marketplaces. Debit and prepaid cards have outpaced the use of cash and checks. Online budgeting tools can track transactions and assist in meeting financial goals. In all instances, cell phones are increasing both the speed and volume of information exchange on these sites while also creating new ways to engage consumers.

At the same time these technologies are changing the financial marketplace, they are also creating new opportunities to improve consumers’ financial capability, especially among underbanked populations. Roughly 90 percent of America’s underbanked consumers own a mobile phone and two-thirds of households earning under \$30,000 are online.⁶² This connectivity provides enormous opportunities to interact with consumers at both a time, and with a device, of their choosing. Several new and emerging mobile phone applications seek to leverage these opportunities, including Moneythink, a Chicago-based nonprofit that teaches financial education to teens. Moneythink is taking insights learned from the students they work with to create an app with peer feedback and incentives that will reinforce and supplement the program’s financial education and mentoring efforts.

IV. Conclusion

Around the world and across the income spectrum, billions of people are confronting financial insecurity. While some grapple with insufficient income, others struggle to control daily finances and effectively plan for the future. Transacting outside the financial mainstream compounds these challenges, creating unnecessary barriers to financial stability and economic mobility. As evidenced by the thriving market for alternative financial products, enormous demand exists for secure high-quality, services and products that can address these needs. The explosion in technological innovation and research into consumer behavior patterns creates a unique opportunity to address that demand in new and cost-effective ways that can be brought to scale both nationally and globally.

Researchers and other experts have made significant strides in identifying strategies that create lasting positive financial change, not just by helping consumers gain financial knowledge, but also by changing financial behaviors. We see promise in the financial capability principles currently employed in numerous programs, policies, and products. Yet most of these initiatives are new and not yet fully tested. Additional research is needed to help drive scarce resources towards those efforts most capable of affecting change and, where appropriate, bring them to scale. Specifically, there are three key areas that deserve further attention.

1. Deepening our understanding of the real economic and social costs of inadequate access to financial services and financial insecurity to consumers, to communities, and to the wider economy to ensure the most efficient use of the public and private funds deployed to address financial insecurity;
2. Refining our knowledge regarding the design and delivery of high-quality, affordable financial products that are both scalable and also meet the needs of very diverse under- and unbanked consumers;
3. Creating effective, sustainable, and scalable financial capability models that take advantage of cross-sector collaborations, technological advances, and innovative methods for delivering services.

Creating a more inclusive financial system will improve the well-being of the world's most vulnerable families, strengthen local and national economies, and empower future generations to achieve their goals. Its success requires integrating the expertise and resources of multiple stakeholders, including the financial sector, policy makers, nonprofits, advocates, educators, social entrepreneurs, and researchers. While challenging, this endeavor has the potential to change the life trajectory of billions of people, creating greater equity and economic opportunity for all.

Footnotes

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