Institute for Research on Poverty October 2012 Podcast

"The Balance Sheets of Low Income People"

Featuring J. Michael Collins (Lines in regular font), Assistant Professor of Consumer and Director of the Center for Financial Security at UW–Madison.

Hosted by David Chancellor (Lines in **Bold** font)

You're listening to a podcast from the Institute for Research on Poverty at the University of Wisconsin–Madison. I'm Dave Chancellor. For today's podcast I spoke with J. Michael Collins about savings and debt for low-income people. Collins is the director of Center for Financial Security and an assistant professor in the department of consumer science at UW–Madison.

He says that there is a lot of interest right now in what you might call the 'balance sheets', or the savings and debt, of low income people and in how they use various financial products. So, I asked Professor Collins for the basics of what's going on here.

Oftentimes when we worry about low income people using payday loans and credit products, auto title loans, refund anticipation loans, all of these products that are widely seen as being too expensive or predatory in some way, the root cause of it is just not having any net wealth and so people need liquidity, they'll find liquidity from friends, family, from whatever they can do and then they'll seek whatever they can get in the credit market to try to make ends meet.

The challenge here, says Collins, is to get people to have some savings – a rainy day fund for things like a car repair, or an unexpected bill or a medical expense. But, Collins says that it's important not to just think of these rainy day funds as a protection against the negative stuff in life, but as a social mobility tool. So, you could pay for an enrichment activity through school for your kids, or job training for yourself that might pay off in the form of a raise or a better job—things like that. But, as you would expect, there are some catches. . .

The struggle is a lot of low income programs—so for example the food support programs, or Medicare or Medicaid, we have policies which limit how much in assets people can have to be eligible so there are these outright prohibitions for low-income people having any savings, meaning if they don't have savings accounts, they don't have savings, and their only alternative is to borrow so that makes things a little bit worse. And then there's also issues of the way the sort of "formal" financial sector interacts with low income people. It's difficult. For example, there often aren't financial institutions in their neighborhoods—they don't have a lot of experience working with financial institutions and nobody in their family does so they don't have any historic or social network to talk to regarding using those kinds of products.

Collins points out that the terms and conditions on many of the accounts available through traditional banks or credit unions aren't favorable for a lot of low-income people—especially for someone likely hover near a zero balance at certain times of the month or year. Things like low balance fees or missed payment or bounced check fees can really start to add up. Plus, Collins says there that some of these folks might have good reason to avoid the formal financial sector:

If you're in the legal system in any way, if you have a judgment against you, child support garnishment, any of those kinds of things – a lot of low income people don't want to be in the system in any way an so that's another hindrance. So, all these things sort of conspire to keep people out of the financial mainstream, to keep them from having any savings and relying on debt when the time comes that they need some liquidity cushion and that over time can really start to add up as a share of budget and also limit peoples' options when say, for example, they lose a job or can't pay the rent or something like that.

So, I asked Professor Collins, in the face of all of these obstacles, what do you do about all of this?

Some of this is a policy response: certain states have banned certain kinds of products or, in Wisconsin, we've limited the number of times you can roll over a payday loan, for example. The problem is that those laws don't remove the reason that people are in trouble—they need liquidity and so people will find liquidity—they'll borrow online or they'll borrow from their foreman or something else.

Collins says that these policy responses deserve a lot more scrutiny in terms of how or whether they work. But much of what Collins and his colleagues have been doing is trying to figure out 'how do you help people change their behavior and get out of the spiral of borrowing every two weeks on a paycheck that's three weeks away?' Collins says that some of the things you can do are pretty simple. . .

Things like education, or counseling around 'how do you understand these products and how do we create a plan to help you start to make forward progress? Some of them are more legal in nature where you're helping people understand their rights as debtors and their ability to perhaps negotiate with creditors or even find out if the terms are illegal and have debt written off is oftentimes a strategy for some families that are there.

For some of those families, there are legal remedies that you can point them to. But more generally, says Collins, advice has a key role.

In some communities there are really robust nonprofit organizations that provide counseling and provide coaching and really help people pull their credit report, look at their credit history, correct any errors, and come up with a plan to pay off what debt they have. So I think these are all strategies that are important to think about, but it gets complicated.

I mean, for example, one of the biggest items on low income peoples' credit reports is student loans which we have very few options to deal with. Another one is medical debt

So, there are a lot of challenges here, but Collins says that one of the hopes is that they might be able to find ways to make better products.

Can we work with industry to come up with products that work better—savings products, products that don't have the hidden fees, that are flexible with low balances; credit products that allow people to get some liquidity but don't get them in a trap.

Of course, it's complicated. . . There aren't a lot of incentives for the financial industry to develop more helpful products. Collins says that lack of profit opportunity is the biggest, but also that there are legal and regulatory hurdles – which is where public policy changes might be able to make a difference.

Collins says that since the start of the Great Recession, we're probably actually seeing fewer low income people use mainstream banking products – a trend that's consistent across all income levels.

Some are moving to online accounts which are still banks but they're sort of virtual banks and some are moving to things like prepaid debit cards where they no longer have a checking function at all, they just have a card. Some of those cards have been very well-received by low income people in part because they operate a lot like prepaid cell phone plans which is what—most low-income people have these cellphones where you load 'em at the store and then you run them down then load them again so it's a concept that makes a lot of sense.

As far as traditional banking goes, Collins says that while the economics – the terms, conditions, and affordability – of a product are a big deal, often it comes down to issues of accessibility.

If I have to interact with a financial institution employee at a bank branch that's a barrier because it means I have to get to the bank, maybe I have to ride public transportation and I have to bring kids along – those things can make it more difficult. If I'm a low income person and I have a disability which—oftentimes people have low incomes because they can't work and they can't work because of disabilities, those mobility issues can matter so I think thinking through the issues of low income people specifically, it's more complicated than just creating an account that has low fees, it's also thinking about how easy is it to operate and does it not only have fees that are low but is it transparent in terms of how it works and is it easy to understand and is it accessible—all those kinds of things are important to support people as they get more into the mainstream financial institutions.

Collins says that one of the big changes he sees coming is the advent of mobile banking with people doing more and more of their financial transactions directly from their cellphone. This, of course, will add another layer of complication—moving money around with the push of a button can be a problem for any of us--so he sees education as being crucial to making these new financial technologies a net gain for low income people.

Many thanks to J. Michael Collins for this interview. For more information on these issues, please see the links on the IRP Podcasts page, or visit the Center for Financial Security online at CFS.WISC.EDU. You've been listening to a podcast from the Institute for Research on Poverty.