REESTABLISHING TRUST

An Essential First Step for Financial Institutions

Cathie Mahon
National Federation of Community Development Credit Unions

It isn't easy supporting a household on low wages. There is rent to cover, bills to pay and food to get on the table, not to mention transportation, clothing, and child-care and school related expenses. Conventional wisdom suggests that the simple act of budgeting—itemizing regular and anticipated expenses and adjusting them to the steady biweekly paycheck—will help a household to stay "in balance." Combining that budget with a free or low-cost checking account with direct deposit can save hundreds of dollars over the course of a year in check-cashing and bill payment fees, savings that can be reinvested to build a nest egg. Likewise, loans at reasonable rates can enable families to purchase larger items such as cars or appliances and invest in education, homeownership, or entrepreneurial activities.

Community development credit unions and banks, and microfinance institutions play a critical role by providing low-income families with these types of affordable banking and credit services. These vital and growing community development financial institutions (CDFIs) are organized to meet banking or credit gaps and to bring previously disenfranchised individuals and communities into the financial mainstream. During the past 50 years, they have been remarkably successful.

But the communities these institutions serve are changing, and so are their financial services needs. The overwhelming fact of economic life for many families now is the unpredictability of both income and expenses. Recent studies have confirmed what many practitioners have known for some time: steady jobs with a biweekly paycheck are scarce in low- and moderate-income communities. Instead, households rely on unpredictable part-time and seasonal work, patching together income from multiple sources.

For these households, the standard budget-save-borrow strategy simply does not work. Families incur expenses without any certainty of income to cover them. The frequent shortfalls during the month require complex and time-consuming juggling strategies. Outwardly simple, low-cost checking accounts can become pitfalls and traps as overdraft and insufficient funds fees mount. Many households turn to alternative, high-cost, and often predatory financial services to meet their banking needs and access credit to cover shortfalls. Unfortunately, for households with chronic shortfalls, this practice can spiral into uncontrollable debt.

CDFIs, philanthropy, and other allies in the nonprofit sector have begun digging deeper into household finances to better understand this economic reality and better tailor solutions to address this new paradigm. In addition to the U.S. Financial Diaries Project (described more fully in the essay by Jennifer Tescher and Rachel Schneider) and metrics emerging from the financial empowerment field, the Federation explored preferences and behaviors of very low-income households in its 2014 study "From Distrust to Inclusion: Insights into the Financial Lives of Very Low-Income Consumers." Researchers interviewed a diverse group of very low-income consumers to determine in their own words what they use and value most in financial services, and the central challenges they face in accessing and using financial services amid tremendous uncertainty. When asked what would help them become more financially secure, the answer was inevitably, "just one stable, good-paying job." Nevertheless, financial institutions can help, if they focus on their clients' actual financial needs.

The results of both studies challenge conventional wisdom about the financial condition of very low-income people, their demand for products and services, and opportunities to bring these consumers into the financial mainstream. Many of these individuals had already found their way to socially minded financial institutions, although many had not.

Highlights from these interviews include:

- **Instability and volatility in income and finances are the norm.** The overriding context and dominating factor that emerged from interviews is the profound uncertainty and unpredictability of people's lives due to their work situation and lack of a safety net. Financial gaps and severe shortfalls are the rule, not the exception. The concept of "emergency" or unanticipated expenses does not apply to this market, as shortfalls are a constant. This instability and volatility of income makes traditional credit products with recurring monthly payments fundamentally incompatible with families' cash flows. Without adequate income, there is no capacity or cushion to withstand additional risk.

- **Traditional budgets are little help in managing household finances and flows.** Inadequate, unpredictable, and wildly fluctuating incomes confound the usefulness of traditional budgeting tools to provide useful guidance. Moreover, the information provided by budgets is insufficient; consumers want actual help with their financial needs, especially in areas they find unfamiliar and intimidating, such as negotiation with credit bureaus and creditors.

- **Trust and relationships remain key to achieving greater financial stability.** What participants in the Federation study most valued from a financial institution was a trusted relationship, not a particular innovation or product. Although they use products, what they seek and need is guidance and advice. The trust they seek is not simply in the institution but in their own ability to manage the products they use.

- **Technology alone is not the answer.** People felt there were already many, and often too many, technological options and doubted their ability to sift through the details and implications of each. Similarly, although participants regularly accessed information online about financial matters, they rarely felt comfortable making decisions on their own through web or mobile banking. Financial institutions that can help people solve immediate problems earn trust and patronage. Institutions that push new products, even those that may provide long-term benefits, are viewed with suspicion. This has been mirrored by the experience of community financial institutions that introduce mobile and online technology: they provide the greatest benefits for managing and serving existing members but require considerable effort upfront to get consumers to use them.

The uncertainty and complexity in these consumers' needs for financial products and services reveal how our current approach no longer fits the reality of many consumers. CDFIs, policymakers, and others who seek to deliver the right financial services to support lower-income and underserved communities must go back to the drawing board. To better match clients' realities, product innovations must include flexible or customizable underwriting and repayment plans that fit the volatility of the household cash flow during the year. Real-time advisors integrated into service delivery can build trust and help make financial education and counseling relevant and actionable. Ongoing research should incorporate the voices of emerging populations, such as immigrant communities, to expand the reach and deepen the impact of services and relationships. At the same time, those serving lower-income communities must recognize the importance of scaling up operations to reach more households and communities.

The Federation is working with credit union innovators to design just such strategies. Federation consultants engage with credit union leadership on a social audit, called the Emerging Markets Review, that assesses credit union products, services, and operations to better align with emerging markets or emerging needs within existing markets. Efforts to integrate financial counseling and coaching into credit union operations (rather than as separate or affiliated activities) help build trusted relationships and ensure that counseling can better link customers with the products and services that will yield the greatest financial outcomes for the consumer and institution. Innovative microloans that support immigrants during the legalization process are now being tested to determine whether they are effective vehicles for bringing communities with high concentrations of unbanked and underbanked consumers into safe and productive financial services at a pivotal moment of moving out from the shadows.

These are only a few of the emerging innovations among community financial institutions to advance the financial health of low-income and low-wealth households. The financial realities facing these households have changed dramatically during the past decade, and CDFIs have an important opportunity to evolve in response to these changes. By keeping the consumer at the center, with a firm focus on building and retaining trust, and understanding those we serve, CDFIs can ensure that these innovations continue to proliferate, as well as create a guide for the broader financial sector on how to best serve these households.

■ ■ ■

CATHIE MAHON *is the president and CEO of the National Federation of Community Development Credit Unions. The Federation has a 40-year history of bringing safe and affordable financial products and services to underserved and untapped markets across the country. Mahon previously led the New York City Office of Financial Empowerment under Mayor Bloomberg. She has been a consultant to the Aspen Institute and the Annie E. Casey Foundation, and served as the first director of the Asset Funders Network. She began her career representing Central American immigrants as the coordinator of legal services at the Central American Refugee Center in Los Angeles.*