An Inclusive, Progressive National Savings and Financial Services Policy

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I. Introduction

How many of us walk by the signs for "Checks Cashed Here," "Money Orders for Sale," and "Payday Loans: Get Cash Quick" without thinking about the implications of those signs for the daily lives of lower-income households? Most of us can take for granted getting our paychecks directly deposited into our bank accounts, writing a check, or storing our money in an account. We often struggle to save for longer-term goals, such as our children's education, or retirement, but most of us, most of the time, do not worry whether our savings or insurance will be enough to get us through an illness, or even the loss of a job.

For most low- and moderate-income households, the picture is quite different. High-cost financial services, barriers to saving, the lack of insurance, and credit constraints may contribute to poverty and other socioeconomic problems. Low-income individuals often lack access to financial services from banks and thrifts, and turn to much more expensive alternative financial service providers such as check cashers, payday lenders, and money transmitters. Lack of access to credit and insurance means that many low-income individuals must live paycheck to paycheck, leaving them vulnerable to emergencies that may endanger their financial stability. The lack of longer-term savings may undermine their ability to invest in human capital, purchase a home, and build assets. More generally, heavy reliance on alternative financial service providers reduces the value of both take home pay and government assistance programs such as the Earned Income Tax Credit. Taken together, these barriers to access contribute to poverty and make it much more difficult for low-income households to make the investments necessary to join the middle class.

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Hence, this Essay calls for an inclusive, progressive national savings and financial services policy. I argue that we need to focus not simply on retirement, but also on shorter-term savings; not just on the wealthy or even the middle-class, but also on lower- and moderate-income households; and not just on building savings, but also on reducing indebtedness.

Taking a broad look ahead, we have a major public policy opportunity: to enact an integrated, universal approach to financial services, income, and wealth policies that taps into shared notions of the American dream. Such policies would help low- and moderate-income households more fully leverage their hard work into economic stability and future prosperity. I sketch what such an approach would look like. We also face significant public policy risks: a continued shift in tax burdens from the wealthy to middle- and lower-income households and future generations through continued borrowing to fund tax cut and through undermining social insurance through the privatization of Social Security in the name of the "ownership society." Low- and moderate-income households would pay a heavy price for such regressive tax and social insurance policies.

To develop a new national approach, we need to explore the interrelationships among financial services, savings, credit, and insurance. Policies that focus on one area while ignoring the others are unlikely to succeed. Financial services such as bank accounts can provide the gateway to saving or serve as an obstacle to saving, depending on the structure and pricing of products and services. Saving both assists in asset-accumulation and operates as a form of self-insurance. Insurance smoothes income and consumption, and protects savings and income against catastrophic shocks, but also acts as a substitute for savings and thus provides incentives not to save. Credit can assist asset accumulation, smooth income and consumption, and provide insurance against income shocks, but imprudent borrowing can destroy asset creation and block access to savings vehicles such as bank accounts. In each area, I analyze the basic problem and suggest ways of thinking about policy reform.

II. Financial Services

A. *The Costs of Exclusion*

Low-income households in the United States often lack access to bank accounts and face high costs for transacting basic financial services through check cashers and other alternative financial service providers.[1] These families find it more difficult to save and plan financially for the future. Living paycheck to paycheck leaves them vulnerable to medical or job emergencies that may endanger their financial stability, and the lack of longer-term savings undermines their ability to invest in improving their skills,

[1] *See generally,* Barr, *Banking the Poor I*, *supra* note *.

purchasing a home, or sending their children to college. High-cost financial services and inadequate access to bank accounts may undermine widely shared societal goals of reducing poverty, moving families from welfare to work, and rewarding work through incentives such as the Earned Income Tax Credit (EITC).[2]

Nearly 22% of low-income American families—over 8.4 million families earning under $25,000 per year—are "unbanked": they do not have either a checking or savings account.[3] Many additional families have bank accounts, but must rely on high-cost non-bank providers to conduct much of their financial business. I will refer to this population as the "underbanked," a term that admittedly makes a normative judgment about the desirability of connection to mainstream financial services.

In lieu of bank-based transactions, savings, and credit products, the unbanked and the underbanked often rely on the more costly alternative financial sector (AFS). AFS providers offer a wide range of services, including short-term loans, check cashing, bill payment, tax preparation, and rent-to-own products, most often in low-income urban neighborhoods. These AFS providers are currently the only means available for many low-income persons to access basic financial services, but they often come at a high price.

While check cashers offer essential services, the fees involved in converting paper checks into cash are high, relative both to income and to analogous services that middle- and upper-income families use, such as depositing a check into a bank account or electronic direct deposit. Check-cashing fees vary widely across the country, and between types of checks, but typically range from 1.5% to 3.5% of face value.[4] The industry reports that it processes 180 million checks totaling $55 billion annually, generating $1.5 billion in fees.[5] Almost all of these checks are low-risk payroll (80%) or government benefit (16%) checks.[6] While even payroll checks are not without some credit and fraud risk, average losses from "bad" checks at check-cashing firms are low. For example, the national check-cashing firm Ace Cash Express (ACE) reported in its SEC filing that 0.5% of the face value of checks bounce, but net losses after collection are 0.2%.[7] These figures compare favorably to the banking system: 0.64% of the face value of inter-bank checks was returned in 2000.[8] The high costs of check-cashing

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[2] *See* 26 U.S.C. § 32 (2006).

[3] Barr, *Banking the Poor I*, *supra* note *, at 130–31.

[4] *Id.* at 146–47.

[5] Fin. Serv. Ctrs. of Am. (FiSCA), About FiSCA, http://www.fisca.org/about.htm (last visited Nov. 14, 2006); Barr, *Banking the Poor I*, *supra* note *, at 142.

[6] Ed Bachelder & Sam Ditzion, Dove Consulting, Survey of Non-Bank Financial Institutions 9, 34 (2000), *available at* http://www.ustreas.gov/press/releases/reports/nbfirpt.pdf.

[7] ACE Cash Express, Inc., 2001 Annual Report, 19 (2001), *available at* http://www.acecashexpress.com/annual_reports/2001.pdf.

[8] Geoffrey R. Gerdes & Jack K. Walton II, *The Use of Checks and Other Non-Cash Pay-*

transactions may be related to labor costs of in-person transactions based on paper processing, but they appear unrelated to credit risk.

The high costs of alternative financial services raise several concerns. First, the costs of these basic financial transactions reduce take-home pay. A worker earning minimum wage, working full time, and making under $12,000 a year would pay $250 to $500 annually just to cash payroll checks at a check-cashing outlet, in addition to fees for money orders, wire transfers, bill payments, and other common transactions.[9] High fees for tax preparation, filing, check-cashing, and refund anticipation loans reduce the value of EITC payments by over 10%.[10] Bringing low- and moderate-income families into the banking system can help reduce these high transaction costs, substantially increasing the purchasing power of these families.

Second, without a bank account, low-income households face key barriers to increased saving. Promoting low-income household savings is critical to lowering reliance on high-cost, short-term credit, lowering risk of financial dislocation resulting from job loss or injury, and improving prospects for longer-term asset building through homeownership, skills development, and education.

Third, without a bank account, it is more difficult and more costly to establish credit or qualify for a loan. A bank account is a significant factor—more so, in fact, than household net worth, income, or education level—in predicting whether an individual also holds mortgage loans, automobile loans, and certificates of deposit.[11]

B. Barriers to Banking the Poor

While the banking system works extraordinarily well for most Americans, many low- and moderate-income individuals face five key barriers to account ownership.

First, regular checking accounts may not make economic sense for many low-income families. Consumers who cannot meet account balance minimums for an account at a bank often pay high monthly fees. In addition, nearly all banks levy high charges—averaging $25 per item[12]—for bounced checks or overdrafts, charges that low-income families with lit-

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ment Instruments in the United States, 88 FED. RES. BULL. 360, 360, 364–65 (2002).

[9] *See* Arthur B. Kennickell et al., *Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances*, 86 FED. RES. BULL. 1, 9–11 (2000); BACHELDER & DITZION, *supra* note 6, at 34 fig.6.5.

[10] ALAN BERUBE ET AL., BROOKINGS INST., THE PRICE OF PAYING TAXES: HOW TAX PREPARATION AND REFUND LOAN FEES ERODE THE BENEFITS OF THE EITC (2002), *available at* http://www.brookings.edu/es/urban/publications/berubekimeitc.pdf.

[11] Jeanne M. Hogarth & Kevin A. O'Donnell, *Banking Relationships of Lower-Income Families and the Government Trend Toward Electronic Payment*, 85 FED. RES. BULL. 459, 463 (1999).

[12] JEAN ANN FOX & PATRICK WOODALL, CONSUMER FED. OF AM., OVERDRAWN: CONSUMERS FACE HIDDEN OVERDRAFT CHARGES FROM NATION'S LARGEST BANKS 11 (2005), *available at* http://www.consumerfed.org/pdfs/CFAOverdraftStudyJune2005.pdf.

tle or no savings face a high risk of paying and can ill-afford. Moreover, banks, unlike check-cashing outlets, hold checks for days before crediting the deposit of funds; for low-income customers, the wait may not be practical. These features of traditional bank accounts are key drivers in keeping the unbanked out of the banking system.

A second barrier comes from difficulties that many unbanked persons may have qualifying for conventional bank accounts because of past problems with the banking system. Chex Systems, a private clearinghouse that most banks use to decide whether to open accounts for potential customers, records data on more than 22 million bank accounts that have been closed for prior problems, such as customers writing checks with insufficient funds or failing to pay overdraft fees.[13] While some individuals with past account problems undoubtedly pose high risks, many people could responsibly use online, electronic, no-overdraft bank accounts. By eliminating the possibility of overdraft associated with conventional checking, such debit card accounts could help consumers avoid high fees *and* help banks avoid the risk of non-payment. Few banks, however, offer such accounts, and most that do have begun doing so only recently.

Third, while many urban communities contain adequate numbers of banks, in some low-income neighborhoods, banks, thrifts, and credit unions are not as readily accessible to potential customers as such institutions are in higher-income areas.[14]

Fourth, for some low-income households, lack of financial education is a significant barrier to personal financial stability.

Lastly, some immigrants may face difficulties regarding proper documentation for opening an account, either because they lack such documentation, or because they fear that depositories will police immigration laws.

C. Toward Inclusive Financial Services

The critical issue, in my judgment, is the financial services mismatch: bank products are not structured to provide access to lower-income households. To transform the market for low-income financial services, I propose a tax incentive for financial institutions to offer low-cost electronic accounts for low-income persons.[15] Financial institutions could receive a tax credit equal to a fixed amount per account opened. Roughly speaking, the amount of the credit would be calculated to cover the average administrative cost to an average bank of offering the account, taking into consideration research and product development, account opening and closing

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[13] eFunds, Annual Report (Form 10-K), at 3 (Mar. 8, 2006).

[14] *See* Robert B. Avery et al., *Changes in the Distribution of Banking Offices*, 83 Fed. Res. Bull. 707, 723 (1997).

[15] *See generally* Barr, Banking the Poor II, *supra* note *; Michael Stegman, Savings for the Poor: the Hidden Benefits of Electronic Banking (1999) (advocating a shift towards e-banking).

costs, marketing and financial education, and the training of bank personnel. Although new data on account opening costs would be required, data from the late 1990s suggests that the tax credit could perhaps be set between $50 and $150 per account opened.[16]

A tax credit could help catalyze banks, thrifts, and credit unions to experiment with a wide variety of techniques to expand access to banking services to low-income households.[17] Banks could avoid the risks associated with individuals with credit problems, and thus eliminate high fees, by offering electronically based accounts that use online debit cards instead of paper checks, and thus pose little risk of overdraft. Banks may experiment with accounts with savings features, including separate savings "buckets" within accounts.[18] Similarly, banks could provide low-income individuals with a convenient and low-cost means of paying bills and wiring funds. Automated money orders, online bill payment, debit card-based foreign country remittance, and other low-cost transactional services can help low-income families improve both their savings and their credit.

In addition, a tax credit for financial institutions has the potential to help spur technological innovation in financial services. Possibilities abound. ATM networks and financial institutions could develop shared technological platforms or create "surcharge-free alliances" among debit networks in order to serve low-income customers. As access to the internet expands in low-income communities, e-finance can increasingly be made available at internet kiosks. Companies that are exploring ways to expand the use of cellular phones to transact financial services for high-income clientele could be encouraged to focus attention on expanding bank account access through pre-paid cellular phones used by low-income persons. Stored-value cards could be used by the unbanked to conduct an array of transactions at low cost.

Efforts to bank the unbanked could also focus on EITC recipients. Currently, the United States Department of the Treasury runs a small Electronic Transfer Account (ETA) program to enable Social Security and other benefit recipients to open low-cost, privately offered bank accounts to receive their benefit payments by direct deposit rather than paper check.[19] With congressional authorization, Treasury could expand ETAs to cover tax refunds, so that low-income taxpayers receiving the EITC could more

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[16] *See* Dove Associates, ETA Initiative: Optional Account Features, Economic Waterfall Analyses (1998); Dove Associates, ETA Conjoint Research 60 (1999), *available at* http://fms.treas.gov/eta/reports/conjoint.pdf.

[17] Credit unions, which are not-for-profit corporations, could not directly take advantage of tax credits. It is possible to structure the tax credit so that for-profit subsidiaries or credit union service organizations could receive the tax credit for their services in offering the accounts on behalf of the credit unions.

[18] A "savings bucket" is an electronic sub-account that allows individuals to set money aside for savings.

[19] Barr, *Banking the Poor I*, *supra* note ∗, at 176.

readily open bank accounts into which the IRS could directly deposit their refunds. Moreover, Congress should appropriate more funds for Treasury's First Accounts pilot program to support innovative efforts to reach EITC recipients without bank accounts.[20] The IRS should establish partnerships with large employers to encourage employees to open bank accounts and establish direct deposit of paychecks and tax refunds. Moreover, the tax preparation firms themselves should partner with banks to develop and offer individual, low-cost, electronically based bank accounts for their clients into which tax refunds can be directly deposited. Such accounts might help to promote savings and reduce reliance on expensive check-cashing services and refund anticipation loans. Tax preparers would gain a new marketing tool and might see better client retention.

Moreover, Treasury and the IRS have now agreed to permit refunds to be direct deposited into more than one bank account.[21] Once refunds are permitted to be split into more than one account, tax preparers could compete by offering tax preparation services that are paid for not out of the proceeds of refund anticipation loans (RALs), but out of the tax refund itself, via direct deposit. If this reform is combined with public and private sector efforts to bring EITC recipients into the banking system, the remaining portion of the refund could be direct deposited into the client's own bank account or other saving vehicles. Initial results from a pilot refund-spitting and saving program run by the Community Action Project of Tulsa County and the Doorways to Dreams Fund showed promising savings results.[22]

More fundamentally, to bring unbanked taxpayers into the financial system, Congress should establish a new opt-out, direct deposit, tax refund account. Under the initiative, the IRS would encourage savings and expanded access to banking services by opening bank accounts on behalf of unbanked EITC recipients and then directly depositing EITC payments (and other tax refunds) into those accounts. Banks would register with the IRS to offer a no-overdraft, debit card-based bank account to individual taxpayers. The IRS would draw from the roster of banks from the taxpayers' local area in assigning the new account. The recipient would retain the right to opt-out of such direct deposit tax accounts, but the default position would be to open a new account in her name. By reaching low-income households at a critical financial decision-making point in

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[20] Details of the First Accounts program may be found at U.S. Treas. Dep't., First Accounts, http://www.ustreas.gov/offices/domestic-finance/financial-institution/fin-education/first accounts/ (last visited Dec. 1, 2006).

[21] Press Release, Internal Revenue Service, IRS Expands Taxpayers' Options for Direct Deposit of Refunds (May 31, 2006), http://www.irs.gov/newsroom/article/0,,id=157853,00.html.

[22] *See generally* PETER TUFANO, ET AL., THE RETIREMENT SECURITY PROJECT, LEVERAGING TAX REFUNDS TO ENCOURAGE SAVING (2005), *available at* http://www.people.hbs.edu/ptufano/RSP_BST.pdf.

their year, such a strategy may help bring these households into the banking system and give them an important opportunity to save.

In addition to federal reforms, states should integrate access to financial services as a core element of welfare-to-work strategies. High-cost alternative financial services undermine state-led efforts to improve workforce participation because such financial services reduce effective take-home pay. The lack of structured savings mechanisms makes it less likely that new entrants into the workforce will use savings to insure against liquidity crises from job loss, injury, or other family emergencies, and makes it more likely that such crises will push families back onto the welfare rolls. Moreover, lack of saving will reduce the ability of low-income families to invest in homeownership, skills development, or their children's education.

Many states currently use Electronic Benefit Transfer (EBT) cards—a form of debit card—to administer social insurance programs in lieu of cash, vouchers, or paper checks. Most states do not link EBT cards to the recipient's bank account, but use a state-owned master fund. To move welfare and other benefit recipients into the financial system, states should encourage account ownership by shifting from EBTs to individually owned bank accounts. States could also negotiate with debit card networks to create surcharge-free alliances for EBT-card holders. In so doing, states would increase the effectiveness of their welfare-to-work strategies by bringing low-income families into the banking system in preparation for their entry into the workforce. States should permit former welfare recipients to retain accounts after they move into the workforce to decrease reliance on check-cashing services and encourage direct deposit. Given the high turnover rates of households on and off welfare, permitting families to retain EBT-issued bank accounts may be important to those families' financial stability.

III. Savings

A. *Saving and Dis-Saving*

Savings policy can be informed by theoretical models of household decision-making tested against empirical data regarding savings behavior.[23] The dominant rational choice model is the "life cycle" theory, which suggests that savings are used to smooth consumption over one's life.[24]

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[23] This section draws from Michael Sherraden & Michael S. Barr, *Institutions and Inclusion in Savings Policy*, *in* Building Assets, Building Credit: Creating Wealth in Low-Income Communities 286 (Nicolas P. Retsinas & Eric S. Belsky eds., 2005) and Michael S. Barr, Financial Services and Saving: Theory and Evidence from the American Dream Demonstration, Address at Washington University Conference: Taking the Measure of the American Dream Demonstration (Apr. 2005).

[24] *See* Milton Friedman, A Theory of The Consumption Function: A Study By the Nat'l Bureau of Econ. Research (1957); Franco Modigliani & Richard Brumberg,

An extension of the rational choice model posits that precautionary motives also influence saving; that is, rational individuals with full foresight save as a form of insurance in the face of uncertainty.[25] Behavioral models suggest that although these rational choice theories may be useful at the aggregate level, individual choices regarding saving are profoundly affected by psychology: mental accounting, starting points, endowment effects, and other frames.[26] For example, groundbreaking empirical research has demonstrated the importance of default rules in determining whether and how much individuals will save in employer-sponsored retirement plans.[27] But more empirical research is needed about saving by low- and moderate-income households.

Low-income families are largely excluded from society's basic mechanisms to encourage savings, and often lack access to even basic institutional savings vehicles. Two-thirds of tax benefits for pensions go to the top 20% of Americans, while the bottom 60% receive only 12% of the tax benefit.[28] Most low-income workers work for firms without savings plans or are not covered by such plans.[29] As noted above, 22% of low-income households lack even a bank account, a critical entry point for saving.[30] Bank accounts are not structured to be low-cost and low-risk for low-income households. High minimum balances, credit checks to open accounts, high bounced check and overdraft fees, and long check-holding periods are not designed for the lives and finances of low- and moderate-income households.[31] And given their low levels of assets, most banks have historically not wanted them. The lack of sufficient income to afford saving and lack of supply in savings products for the poor, coupled with low rates of return offered to the poor given their low levels of wealth, all depress saving among low-income households.

Yet evidence suggests that some low- and moderate-income households can and do save. For example, a high portion of low- and moderate-income

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Utility Analysis and Aggregate Consumption Functions: An Interpretation of Cross-Section Data, *in* POST KEYNESIAN ECONOMICS 388 (Kenneth K. Kurihara ed., 1954).

[25] *See generally* Christopher D. Carroll, *The Buffer-Stock Theory of Saving: Some Macroeconomic Evidence*, 1992 BROOKINGS PAPERS ON ECON. ACTIVITY 61 (1992).

[26] *See generally* DANIEL KAHNEMAN & AMOS TVERSKY, CHOICES, VALUES, AND FRAMES (2000).

[27] *See e.g.*, James J. Choi, et al., *Defined Contribution Pensions: Plan Rules, Participant Choices, and the Path of Least Resistance*, 16 TAX POL'Y & ECON. 67 (2002); Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149 (2001); Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. S164 (2004).

[28] Lawrence H. Summers, Remarks at the Department of Labor Retirement Savings Education Campaign (July 18, 2000).

[29] Peter Orszag & Robert Greenstein, *Toward Progressive Pensions: A Summary of the U.S. Pension System and Proposals for Reform*, *in* INCLUSION IN THE AMERICAN DREAM: ASSETS, POVERTY, AND PUBLIC POLICY 262, 264–68 (Michael Sherraden ed., 2005).

[30] Barr, *Banking the Poor I*, *supra* note *, at 130–31.

[31] *Id*. at 178.

workers participate in 401(k) plans if offered the chance to do so.[32] Some 73% of federal employees earning $10,000 to $20,000 participated in the Thrift Savings Plan as did 51% of those earning under $10,000.[33] About 30% of families in the bottom income quintile saved in the year prior to 2001.[34] Automatic enrollment in employer-sponsored pension plans boosts participation and asset accumulation among low-income, as well as Black and Hispanic, employees.[35] When welfare benefit asset limits are raised, low-income households may respond by saving more, although the empirical evidence is not strong.[36] This evidence provides some support for the notion that low-income households can save, and that savings are at least in part shaped by institutional mechanisms that encourage saving.

Consistent with behavioral economic research on default rules and framing, the American Dream Demonstration (ADD), a pilot program to encourage Individual Development Accounts (IDAs), shows that properly designed institutional mechanisms can and do encourage low- and moderate-income families to save.[37] ADD demonstrated the effectiveness of facilitation, incentives, and other institutional constructs: these include providing incentives and expectations through matching contributions and savings goals, using direct deposit to facilitate savings plans, and using opt-out techniques to ease participation.[38] However, ADD also demonstrates that small-scale, nonprofit-oriented efforts at extending financial services are generally not cost-effective; only a national program, emphasizing integration with mainstream banking services and use of technology, can cost-effectively improve access to savings services.[39]

B. Policies To Encourage Saving and Asset Accumulation

What will it take encourage savings? We need to find ways to integrate savings policies for the poor into the product offerings of financial institutions. Financial institutions need to be able to earn a profit from these activities, and lower-income households are unlikely to be the first place

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[32] Orszag & Greenstein, *supra* note 29, at 269.

[33] U.S. Dep't of the Treasury, TSP Participation and Contribution Rates (1998) (mimeo on file with the author).

[34] Ana M. Aizcorbe et al., *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, 89 Fed. Res. Bull. 1, 4 tbl.1 (2003).

[35] *See* Choi et al., *supra* note 27, at 78; *see also* Madrian & Shea, *supra* note 27, at 1160.

[36] *See generally* Elizabeth T. Powers, *Does Means-Testing Welfare Discourage Saving? Evidence From a Change in AFDC Policy in the United States*, 68 J. Pub. Econ. 33 (1998); James P. Ziliak, *Income Transfers and Assets of the Poor*, 85 Rev. Econ. Stat. 63 (2003).

[37] *See* Sherraden & Barr, *Institutions and Inclusion in Savings Policy*, *supra* note 23.

[38] For details regarding the components of an institutional approach to savings, see generally, *id*.

[39] Peter Tufano's innovative "Doorways to Dreams" project provides an excellent example of using the internet to reduce costs. Information on this project can be found at http://www.d2dfund.org.

firms look for assets and cross-selling opportunities.[40] As noted above, we should establish a new tax credit to financial institutions to provide low-cost bank accounts and savings products for low- and moderate-income households.

In this regard, the Savings for Working Families Act is one promising approach. Under the Act, financial institutions offering IDAs would receive tax credits annually offsetting up to $500 in bank-provided matching funds and $50 in bank account administration costs. The current legislation, drafted with an overall cap on accounts, would provide for up to 900,000 new IDAs at a cost of $1.3 billion.[41] The cap on the number of accounts may limit financial institution interest in developing the infrastructure necessary to support these accounts, and it should be removed. If permitted to operate without a cap, this legislation could help us to move from small-scale, nonprofit-focused efforts to large-scale, financial-institution-driven financial products that meet the longer-term savings needs of low-income families. Nonprofits could continue to play important roles by providing financial education and by recruiting and screening participants.

Employer-based savings plans are also critical. As mentioned above, employers can encourage savings among low- and moderate-income workers by changing default rules so that employees contribute automatically to savings plans unless they affirmatively choose to opt out. Moreover, in 2001, Congress enacted a "Saver's Credit," which provides a progressive tax credit matching up to 50% of up to a $2000 annual contribution to a low- or moderate-income person's retirement account.[42] But 80% of those eligible for the credit cannot take advantage of it because the credit is not refundable.[43] A useful step would be to make the Saver's Credit refundable, so that low- and moderate-income households with little or no income tax liability could benefit.[44] As proposed by Mark Iwry and his colleagues, Congress should also enact an automatic IRA program so that workers who want to save for retirement but do not have a 401(k) plan at work have a ready mechanism to save.[45]

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[40] *See* Daniel Schneider & Peter Tufano, *New Savings from Old Innovations: Assets Building for the Less Affluent* (Cmty. Dev. Fin. Research Conf., Working Paper, 2005), *available at* http://www.people.hbs.edu/ptufano/New%20Savings%20from%20Old%20 Innovations%203-15-051.pdf.

[41] Savings for Working Families Act of 2006, H.R. 4751, S. 922, 109th Cong. (2006).

[42] *See generally* Peter Orszag & Robert Greenstein, Address to Kennedy School of Government Conference: Building Assets, Building Credit: A Symposium on Improving Financial Services in Low-Income Coummunities (Nov. 18–19 2003).

[43] Leonard B. Burman et al., *Distributional Effects of the Defined Contribution Plans and Individual Retirement Arrangements* (Urban-Brookings Tax Policy Ctr., Discussion Paper No. 16, 2004), *available at* http://www.urban.org/UploadedPDF/311029_TPC_DP16.pdf.

[44] *See* William G. Gale et al., *The Saver's Credit: Issues and Options* (Brookings Institute Retirement Security Project, 2004).

[45] *See* Mark Iwry & David John, *Pursuing Universal Retirement Security Through Automatic IRAs*, (Ret. Sec. Project, Working Paper, Feb. 2006), *available at* http://www.retirementsecurityproject.org/pubs/File/AutoIRAworkingpaper.pdf.

These initiatives can serve as building blocks to a real national savings policy, one that is universal, progressive, earned by working, and provides savings opportunities in addition to the essential social insurance embodied in Social Security. The federal government should provide a progressive match through the tax code for households who save. Larger matches should be provided to those at the lower end of the income spectrum; the present system does precisely the opposite, providing the lion's share of the benefits to the wealthiest taxpayers, whose saving behavior is least affected by tax incentives. Progressive matches can be provided through refundable tax credits or through tax credits to financial institutions that provide the match.

While retirement savings are important, low- and moderate-income households need to save for a much broader range of purposes, from emergencies to homeownership. These households need an easy mechanism through which to save, and greater help in building up their savings. In addition to providing matching funds and improved access to accounts, Congress should encourage financial institutions to structure accounts to encourage long-term savings. Financial institutions could offer low-cost bank accounts to low- and moderate-income individuals that include a "savings bucket." The program could make these funds harder for individuals to withdraw, or simply designate them as for a special purpose. Participants would set up an automatic payroll deduction plan at work to place a specified amount from each paycheck in this savings bucket when their paychecks are directly deposited. The financial institution would agree to match the amount placed in this savings bucket, and the tax credit mechanism would fully offset the amount of the match provided. The financial institutions could make it somewhat harder to access funds held in these savings buckets, but participants could use the funds for the full range of their savings needs as they themselves determine: for emergencies in the event of illness or job loss; for school expenses; to save for a major purchase, such as a car or appliance; or for homeownership or entrepreneurship. Such an account would help low-income households save for the short to medium term, as well as begin to create a path toward other forms of saving, including, potentially, for retirement.

By contrast to these inclusive approaches, the current Administration has proposed a dramatic expansion of tax-advantaged savings vehicles and privatization of a portion of Social Security into individual accounts. These "ownership society" proposals share some of the rhetoric associated with the advocates of IDAs and with the asset-building movement generally, but the similarity ends there. The essential normative claim of IDA advocates is that all of us ought to be included in this ownership society. Policies that undermine our common stake in society go in the wrong direction.

Individual accounts diverted from Social Security, as Peter Diamond and Peter Orszag have shown, will undermine the progressivity and social

insurance functions of Social Security.[46] Moreover, it will expose households to individualized market risk, significantly increase administrative costs, and harm the solvency of the Social Security Trust Fund, in whose name the proposal is offered. Moreover, the Administration's proposal would likely significantly reduce benefits from the combined individual and Social Security accounts. A universalist, progressive savings policy is opposite from Social Security reform proposals that undermine social insurance in the name of individual accounts.

IV. Credit

A. Theory

Liquidity constraints—whether based on price or access—can affect consumption, savings, work incentives, insurance, and time horizons for financial decision-making. Yet little empirical work has been done until recently on the credit constraints facing low-income households.[47] Some recent evidence does suggest that households are unable to access unsecured credit in order to avoid hardships when they suffer a spell of unemployment, suggesting that credit constraints still plague low-income households.[48]

While low- and moderate-income households do need access to credit, there are dangers to these households from assuming too much credit on the wrong terms.[49] In theory, low-income households would be more risk-averse with respect to taking on credit than higher-income households because their income is likely to be volatile and they have little assets on which to fall back. Low-income households might be less risk-averse in taking on offered credit than other households, however, precisely because they have less to lose by going bankrupt.[50]

For the purposes of this Essay, I only want to highlight four credit segments that illustrate how some products and practices can prove to be disadvantageous for low- and moderate-income households. In each case, I suggest how both regulatory responses and private-sector initiatives might help to change market structures in positive ways.

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[46] *See generally* Peter A. Diamond & Peter R. Orszag, Saving Social Security: A Balanced Approach (2003).

[47] This section draws from Barr, *Banking the Poor I*, *supra* note *; Michael S. Barr, *Credit Where it Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. Rev. 513 (2005); and Michael S. Barr, *Modes of Credit Market Regulation*, *in* Building Assets—Building Credit: Creating Wealth in Low-Income Communities 206 (Nicolas P. Retsinas & Eric S. Belsky eds., 2005).

[48] *See* James X. Sullivan, *Borrowing During Unemployment: Unsecured Debt as a Safety Net* 19–20 (2005), *available at* http://www.chicagofed.org/cedric/files/2005_conf_paper_session2_sullivan.pdf.

[49] *See* Barr, *Credit Where it Counts*, *supra* note 47.

[50] Little empirical evidence is available to sort out these competing theoretical claims. In a later work, my co-authors and I use data from a survey we recently conducted, the Detroit Area Household Financial Services Study, to unpack these claims.

B. Credit Cards

In the consumer lending arena, creditors have made advances in risk-screening and monitoring to push further into the market and have developed techniques for loss-mitigation that make it more profitable to serve higher-risk customers. Many more households have gained access to credit cards that in prior generations would have been denied credit entirely or would have turned to even more expensive forms of credit.

Some of these techniques, however, raise serious questions about whether they are net socially beneficial. For example, credit card disclosures may be systematically designed to prey on common psychological biases that limit consumer ability to make rational choices regarding credit card borrowing.[51] Behavioral economics suggests that consumers will underestimate how much they will borrow and overestimate their ability to pay their bills in a timely manner.[52] Credit card companies may price their credit cards and compete on the basis of these fundamental human failings.[53] Nearly sixty percent of credit card holders do not pay their bills in full every month.[54] Excessive credit card debt can lead to personal financial ruin. Credit card debt is a good predictor of bankruptcy.[55] Ronald Mann has argued that credit card companies seek to keep consumers in a "sweat box" of distressed credit card debt, paying high fees for as long as possible before finally succumbing to bankruptcy.[56]

Now that President Bush and the Congress have given us new bankruptcy legislation[57] in order to promote borrower responsibility, it is time to focus on creditor responsibility. Credit card companies currently provide complex disclosures regarding teaser rates, introductory terms, variable rate cards, penalties, and a host of other matters that are confusing to consumers.[58] Credit card companies are not competing, it appears, to offer the most transparent pricing.

Regulatory and legislative steps could help prod the credit card industry into better practices. The Office of the Comptroller of the Currency intervened to require national banks to engage in better credit card prac-

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[51] *See generally* Oren Bar-Gill, *Seduction by Plastic,* 98 Nw. U. L. Rev. 1373 (2004).

[52] *Id.* at 1395–96.

[53] *Id.* at 1394–95.

[54] Brian K. Bucks et al. , *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, Fed. Res. Bull., Mar. 22, 2006, at A1, *available at* http://www.federalreserve.gov/pubs/bulletin/2006/financesurvey.pdf.

[55] Ronald J. Mann, Charging Ahead: The Growth and Regulation of Payment Card Markets Around the World 60–69 (2006).

[56] Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2006 Ill. L. Rev. (forthcoming 2006).

[57] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub L. No. 109-8, 119 Stat. 23 (codified at 11 U.S.C. § 101 et seq (2005)).

[58] *See, e.g.*, U.S. Gen. Accounting Office, Report 06-929, Credit Cards: Increased Complexity in Rates and Fees Heightens the Need for More Effective Disclosures to Consumers (2006).

tices and to provide greater transparency on minimum payments,[59] and the Federal Reserve is reviewing changes to its regulations under the Truth in Lending Act (TILA), in part in the wake of TILA amendments contained in the bankruptcy legislation.[60] Improved disclosures might help.

Congress, however, should step in and do more. For example, Congress should at the very least require that minimum payment terms be accompanied by clear statements regarding how long it would take, and how much interest would be paid, if the customer's actual balance were paid off only in minimum payments, and card companies should be required to state the monthly payment amount that would be required to pay the customer's actual balance in full over some reasonable period of time. These tailored disclosures may help consumers make better informed choices about payments. Congress should also provide for clear notice and a mandatory cure period of six months before credit card companies can raise rates for failure timely to pay balances owed to another card company under "universal default" rules so that consumers have a chance to adjust their behavior before higher rates are applied.

In addition, Congress, bank regulators, industry, and consumer organizations ought to form a task force to debate more far reaching reforms of an industry in need of a fresh look. For example, perhaps there should be an "opt-out payment plan" for credit cards, under which consumers would be required automatically to make the payment necessary to pay off their existing balance over a relatively short period of time unless the customer affirmatively opted-out of such a payment plan and chose an alterative payment plan with a longer (or shorter) payment term. Given what we know about default rules and framing, such a payment plan may be easier to follow, resulting in lower rates of default. In any event, an optimal payment plan may encourage card holders to alter their borrowing behavior or their payoff plans. Moreover, credit card companies would find it difficult to argue publicly against reasonable opt-out payment plans and, in the face of such plans, to maintain a pricing model based on borrowers going into financial distress. While there are undoubtedly problems with such an approach, it would at least have the virtue of engaging all the relevant players in a conversation about fundamental changes in market practice.

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[59] *See, e.g.*, Office of the Comptroller of the Currency, OCC Bull. 2003-1, Credit Card Lending: Account Management and Loss Allowance Guidance (2003); Office of the Comptroller of the Currency, OCC Advisory Letter 2004-4, Secured Credit Cards (2004), *available at* http://www.occ.treas.gov/ftp/advisory/2004-4.doc; Office of the Comptroller of the Currency, OCC Advisory Letter 2004-10, Credit Card Practices (2004), *available at* http://www.occ.treas.gov/ftp/advisory/2004-10.doc.

[60] *See* Press Release, The Federal Reserve Board, Request for Comment on Second Advance Notice of Proposed Rulemaking Concerning the Open-End (Revolving) Credit Rules of Regulation Z (Oct. 11, 2005), *available at* http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20051011/default.htm.

C. Payday Loans

Payday lenders provide short-term (usually two-week) consumer loans to low- and moderate-income working people who have bank accounts but lack credit cards, have poor credit history, or are tapped out on credit limits. Payday loans carry high implicit annual interest rates, with an average APR of over 470%. At an average loan size of about $300, the average fee just for a single, two-week loan is about $54.[61] Many borrowers, moreover, take out payday loans repeatedly throughout the year, often because they cannot repay their earlier payday loans. The typical payday loan customer takes out anywhere from seven to eleven loans per year, with added fees for each loan renewal or "rollover."[62] These borrowers can get caught in a "debt trap," with payday lending fees eating up a significant portion of their income net of essential living expenses.

Bank regulators have now shut down bank–payday lender partnerships because of safety and soundness concerns.[63] In addition, bank regulators and the Federal Trade Commission should use their authority under the Federal Trade Commission Act to take action against payday lenders and their partners that are engaged in unfair and deceptive trade practices.[64] Regulators should pay particular attention to the problem of short-term balloon payments, repeated refinancing, and inadequate or misleading disclosures under the TILA.[65] Congress should also enact legislation mandating that payday lenders report borrowers' performance to the credit bureaus, so that borrowers can pursue alternatives based on their credit history.

At the state level, regulation of payday lenders has been largely ineffectual to date, at least in part because payday lenders partnered with federally regulated banks and thrifts that could rely on federal pre-emption of state usury laws. Moreover, state rollover laws have been largely ineffective because they can be easily evaded. Thus, some states are now focusing on more effective legislation that would provide for longer minimum terms for payday lending to reduce the likelihood that repeated refinancing of payday loans becomes a debt trap. Other states are using payday loan registries and mandatory data reporting requirements to give greater effect to anti-rollover laws.

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[61] *See* Barr, *Banking the Poor I, supra* note *, at 154–55; *see generally*, Michael A. Stegman & Robert Faris, *Payday Lending*: *A Business Model That Encourages Chronic Borrowing*, 17 Econ. Dev. Q. 8 (2003).

[62] *See* Stegman & Faris, *supra* note 61. In a recent study, half of payday loan customers were found to take out more than six loans per year. *See* Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* (FDIC Center for Financial Research Working Paper No. 2005-09, 2005), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery-Samolyk.pdf.

[63] *See* Barr, *Banking the Poor I*, *supra* note *, at 160–61.

[64] *See* 15 U.S.C. § 45 (2006).

[65] 15 U.S.C. §§ 1601–1667 (2006).

Over the long term, there is room for greater private sector competition from the banking industry in changing market practices. To date, bank overdraft plans have been costly, poorly disclosed,[66] and ill-suited to low- and moderate-income households living on the financial edge. Such overdraft plans may be a contributing cause to payday lending, not an alternative. Instead, banks could compete with payday lenders by offering lower-cost, longer-term, and lower-risk loan products. In principle, one such alternative might be a bank line of credit offered to account holders. In theory, lines of credit could be provided at lower cost than payday loans because there is no need for face-to-face interaction. The transactions can take place automatically at low risk and at low cost to banks. Moreover, repayment of the loan could be scheduled so that regular minimum payments (through automatic debiting of the customer's account) repay the loan over a reasonably long time period, say six months, rather than the current payday loan of two weeks or bank overdraft practice of thirty days. An intermediate-term bank loan of this type could fill an important market niche in serving low- and moderate-income households' financial needs. Adding an automatic savings feature to the repayment schedule on this bank account-based line of credit, as described in Part I, might also help households develop a savings cushion that would make it less likely they would need to take out a payday loan in the event of emergencies.

D. Refund Anticipation Loans

Tax refund loans are widely used by low- and moderate-income households. About two-thirds of EITC claimants use commercial tax preparation firms. In addition to seeking help with return preparation and filing, many EITC recipients also use refund anticipation loans (RALs) and related products facilitated by tax preparers. The RAL is repaid when the IRS issues the borrower's expected refund.

Tax preparation services and refund loans can consume a significant portion of an EITC recipient's refund. The purchase of a RAL for an anticipated $1,500 refund costs roughly $90. For EITC recipients filing electronically and choosing to take out a RAL, total fees would consume an average of 13% of the EITC or nearly 8% of the total refund from the EITC and other credits. These fees total $1.75 billion annually for low-income households. In addition, for the estimated 22% of EITC recipients, or four million households, who lack a bank account, the additional fee to cash a $1,500 RAL check issued by the bank partner of the tax pre-

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[66] The Federal Reserve Board provided inadequate guidance in this area by treating overdraft policies as a deposit product, rather than a loan subject to TILA. *See* Truth in Savings, Regulation DD, 12 C.F.R. § 230 (2005).

parer would be at least $30—and often much more—at a check casher, despite the low risk of the government checks.[67]

There are likely three main reasons why low-income households use their refunds without waiting approximately four to six weeks for a paper check from the IRS. Second, even banked customers receive cash proceeds from their loans eight to ten days sooner than with direct deposit, and taxpayers often use RALs to pay off late or mounting bills faster. Third, taxpayers who do not have the funds to pay for tax preparation services up front find RALs and similar products necessary simply to pay preparers to file for their refund. Tax preparation fees are deducted from the proceeds of the RAL. Thus, the need to have their returns professionally prepared drives some households to take out RALs independent of their desire to obtain a quicker refund.

The IRS, in responding to congressional pressure to increase e-filing and decrease EITC errors, has helped to create the market for RALs by providing tax refund and offset information to preparers and by delaying EITC refunds to conduct basic anti-fraud and error detection. The IRS now bears a special responsibility to help end RAL abuse. After much encouragement and many years, Treasury and IRS will now permit refunds to be direct deposited into more than one bank account.[68] Tax preparers could compete by offering tax preparation services that are not paid out of the proceeds of RALs, but are paid directly from a split-off portion of the tax refund. This would eliminate any risk of nonpayment to the preparer and eliminate one reason to take out a RAL. The remaining portion of the refund could be direct deposited into the client's own bank account or other saving vehicles. As discussed above, efforts to bank the unbanked may serve to drive down demand for RALs.

E. Subprime Home Mortgage Loans

The expansion of lending by subprime home mortgage specialists to a broader range of borrowers is generally a positive development, but serious problems in the subprime sector threaten to undermine progress for low- and moderate-income households.[69] Many households turn to subprime home mortgage loans to consolidate other consumer debt, only to find themselves still unable to make ends meet. Bankruptcy and foreclosure rates are much higher for subprime borrowers, and the choice to convert unsecured debt into a secured (mortgage) loan may end up being a bad choice for many of these households.

Serious abuses in the subprime market have included repeated loan "flipping" by brokers eager to earn fees; "packing" additional products into

[67] Berube, *supra* note 10, at 7.
[68] *See* Press Release, *supra* note 21.
[69] *See* Barr, *Credit Where it Counts*, *supra* note 47.

loans; hiding fees; lending without regard to the borrower's ability to repay; and employing a wide variety of unscrupulous sales practices.[70] For some households, subprime refinancing may simply be more expensive than it needs to be. Between 10% and 35% of subprime borrowers could have qualified for a less expensive prime mortgage.[71] Subprime borrowers are more likely than not to remain subprime borrowers, rather than accessing the prime market—even after accounting for credit risk.[72] African American and Hispanic borrowers end up paying higher broker fees than white borrowers in the subprime market.[73]

In response to unscrupulous lending practices in the subprime home equity mortgage market, Congress enacted the Home Ownership and Equity Protection Act of 1994 (HOEPA).[74] For some "high cost" loans, HOEPA imposes restrictions on certain contract provisions and provides for enhanced disclosures and enhanced remedies for violations. Unfortunately, mortgage transactions are exceedingly complex, and HOEPA's record has been mixed.[75] In response, Treasury and HUD proposed a four-part approach to curbing predatory lending, although many of these approaches remain to be implemented.[76]

In my judgment, it is possible to move forward with additional reforms to combat abusive lending while preserving the expansion of access to home mortgage credit.[77] For example, one key area in need of reform is the regulation of mortgage brokers, who face little or no effective oversight at the federal or state levels. Banning yield spread premiums—currently the dominant form of broker compensation—and replacing them with flat fees could take some of the sting out of broker abuses by eliminating an important incentive for brokers to seek out higher-cost loans for customers. Enacting legislation that requires lenders to track and report loan characteristics and performance by individual mortgage brokers could help to improve consumer shopping, increase regulatory oversight, and shame bad lenders, thus making it harder for abuses to occur. State and federal regulators should work together to drive abusive practices out of the broker industry.

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[70] *See* Dep't of Hous. & Urb. Dev. & U.S. Dep't of the Treasury, Curbing Predatory Home Mortgage Lending: A Joint Report (2000) [hereinafter Joint Report].

[71] Freddie Mac, Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families (1996), *available at* http://www.freddiemac.com/corporate/reports/moseley/mosehome.htm.

[72] Marsha J. Courchane et al., *Subprime Borrowers: Mortgage Transitions and Outcomes*, 29 J. Real Est. Fin. & Econ. 365, 374–76 (2004).

[73] Howell E. Jackson et al., *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 Stan. J. L. Bus. & Fin. (forthcoming 2007).

[74] Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 108 Stat. 2190 (codified at scattered sections of 15 U.S.C.).

[75] *See, e.g.*, Joint Report, *supra* note 71, at 106.

[76] *See id*. Using its existing authority under HOEPA, the Federal Reserve Board has issued a rule addressing the harmful sales practices and abusive terms often associated with high-cost mortgages. *See* Truth in Lending (Regulation Z), 12 C.F.R. § 226 (2001).

[77] *See, e.g.*, Barr, *Credit Where it Counts*, *supra* note 47.

V. Insurance

Low- and moderate-income households face risks to their health, income, employment, and household structure. Although further empirical research is needed, it is likely that low- and moderate-income households are underinsured and face steep costs of insurance for important life risks. Insurance is functionally linked to saving, credit, and income. It helps smooth consumption and protect asset accumulation, while also preventing or minimizing cascading shocks. For example, an auto accident without insurance can lead to a job loss which can have devastating consequences for family finances. For low-income households, insurance is likely to be costly relative to income net of necessary living expenses, and traditional government-provided social insurance has become, in many spheres, increasingly unavailable. Low-income households might employ formal insurance mechanisms, such as unemployment, disability, and health insurance, as well as informal mechanisms, such as borrowing from friends and family. They may also self-insure through saving, holding durables, or other means. Empirical research can contribute to our understanding of the extent to which low-income households are underinsured and can begin to tease out the links among insurance, savings, and credit as substitutes in providing a cushion against hardship for low- and moderate-income households. Many financial hardships can be understood as insurance failures. Given space constraints, this Essay only sketches broad ideas in a few basic areas and offers suggestions for future research.

A. *Income Insurance*

The biggest risk to household financial stability comes from loss of a job. There are no private insurance markets to cover this risk. Federal and state safety net programs do provide some insurance against job loss for low- and moderate-income households. State Temporary Assistance to Needy Families (TANF) programs, while time-limited, do offer respite at minimal levels of support for low-income, low-asset households. Unemployment insurance offers some measure of insurance for job loss, but unemployment insurance generally provides low rates of income replacement. Moreover, many low-income workers who have worked in temporary or seasonal jobs have difficulty qualifying for unemployment payments, or qualify only for drastically reduced payments. Furthermore, in severe economic downturns, unemployment insurance is likely to run out for low-income workers, who are likely to be less educated and require more time to reenter the labor market. Unemployment insurance reforms could increase coverage for low-wage workers.

While more fundamental forms of income insurance are certainly possible, it may be more practical to build on what already exists. For example, the EITC can be thought of as a form of income insurance, in the sense

that workers who wind up in low-paying jobs have their income supplemented by the EITC. A single mom with two children working full time at the minimum wage would earn almost $11,000 per year and receive an EITC of nearly $4,500, an increase in her take home pay of approximately 40%. The EITC has helped to lift millions of people out of poverty and has made it easier to make ends meet for more than 20 million households. The EITC also encourages workforce participation. Given its positive effects, a significant expansion of the EITC ought to undergird our policies regarding low- and moderate-income households over the next decade. EITC expansion would provide significant additional income insurance for low-income households. Such an expansion is critical to maintaining our social fabric as returns to low-skilled labor continue to stagnate while returns to capital and high-skill labor continue to grow.

B. Health Insurance

More than 45 million Americans, nearly 16% of the population, lacked any government or private health insurance in 2003.[78] A third of the uninsured earn under $25,000 a year and another third earn between $25,000 and $50,000.[79] Government health insurance does help other households: over 35 million low-income households do have access to Medicaid,[80] and the state-administered Children's Health Insurance Program (CHIP) makes health insurance available for about three million children in many working poor households who are above the poverty line but cannot afford health insurance.[81] But many families still find themselves uninsured or underinsured as they move into and out of eligibility for employer or government-funded health insurance coverage. Many have difficulty finding doctors who will accept Medicaid payments and must rely on emergency room care for basic medical services.[82] Most uninsured low-income workers are not offered health insurance at work, and in most states working parents are "ineligible for Medicaid if they work full time at the minimum wage . . . ."[83]

We have forgotten about the promise of fundamental health insurance reform, but that does not mean the problem has gone away.[84] The federal

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[78] U.S. Census Bureau, Income, Poverty, and Health Insurance in the United States: 2003, at 15–16 (2004).

[79] *Id.* at 17.

[80] *Id.* at 14.

[81] *See* Judith Feder et al., *Covering the Low-Income Uninsured: The Case for Expanding Public Programs*, Health Aff., Jan.-Feb. 2001, at 27, 27–39.

[82] *See* Lisa Duchon et al., The Commonwealth Fund, Security Matters: How Instability in Health Insurance Puts U.S. Workers at Risk (2001), *available at* http://www.cmwf.org/usr_doc/duchon_securitymatters_512.pdf.

[83] Feder, *supra* note 81, at 29.

[84] *See* generally Theodore R. Marmor & Michael S. Barr, *Making Sense of the National Health Insurance Reform Debate*, 10 Yale L. & Pol'y Rev. 228 (1992).

government should continue to expand coverage for low- and moderate-income households through subsidies to state CHIP programs and through enhanced measures to sign up eligible children, so that all children in the United States have health insurance coverage. The same basic model can be used to expand health coverage for low- and moderate-income adults, as Judith Feder has argued, by gradually expanding CHIPs to cover low- and moderate-income adults and offering higher levels of subsidy and lower levels of copayments and deductibles for those least able to afford them.[85] Expanding health insurance to these households is important in its own right and also minimizes the risk that a major illness will cascade into other problems, such as job loss, eviction or foreclosure, and bankruptcy.

C. Home Insurance

Low- and moderate-income households also have more difficulty obtaining and paying for home insurance.[86] Insurance companies underwrite based on a variety of factors that are relatively disadvantageous for these households. For example, low-income households tend to live in smaller, older, less valuable homes, and these factors influences both rate and insurance availability. Neighborhood rating factors, such as crime, are likely to be worse for low-income households. Some insurance companies rate for credit risk, which is disproportionately likely to harm lower income households. Insurance agents tend to be located in and focus on communities outside of central cities.[87] There is also evidence, hotly contested, that insurers have based decisions on factors correlated with race, apart from objective factors regarding loss rates.[88] Given the link between race and income, such policies would tend to result in costlier insurance or less coverage in low-income communities.

State and federal policies could improve the market for home insurance. Building on existing voluntary reporting, requiring disclosure from all insurers of information about the location, race, gender, and income of applicants and policyholders could help firms and regulators monitor compliance with fair housing laws.[89] State Fair Access to Insurance Re-

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[85] *See* Feder, *supra* note 81, at 34 (proposing expansion of Medicaid and CHIP to low-income adults).

[86] *See generally* Insurance Redlining: Disinvestment, Reinvestment and the Evolving Role of Financial Institutions (Gregory D. Squires ed., 1997).

[87] *See* Robert W. Klein, *Availability and Affordability Problems in Urban Homeowners Insurance Markets*, *in* Insurance Redlining, *supra* note 86, at 43, 47–48; Jay D. Schultz, *Homeowners Insurance Availability and Agent Location*, *in* Insurance Redlining, *supra* note 86, at 83, 94.

[88] *See* Klein, *supra* note 87, at 45; D.J. Powers, *The Discriminatory Effects of Homeowners Insurance Underwriting Guidelines*, *in* Insurance Redlining, *supra* note 86, at 119, 133–39.

[89] The Fair Housing Act of 1968 (FHA), 42 U.S.C. § 3605 (2006), prohibits discrimination in housing transactions. HUD and the courts apply FHA to home insurance. *See* Nationwide Mut. Ins. Co. v. Cisneros, 52 F.3d 1351 (6th Cir. 1995); NAACP v. American

quirements (FAIR) and similar residual risk plans that provide access to home insurance for households that do not meet industry standards can be expanded, although potential problems from adverse selection—under which the worst risks would enter the plan—and crowding out—under which private plans would be supplanted by the residual plans—require further study.[90] A number of firms have agreed to increase marketing and outreach in minority communities as part of settlements of fair housing complaints,[91] and similar efforts could be undertaken to enhance competition for insurance provision in low-income areas. Community-based organizations can work with insurers to screen and monitor participants and provide local market information to diminish the extent to which stereotyping reduces access to insurance products.[92]

D. Savings as Insurance

Saving is a form of self-insurance. Yet low- and moderate-income households often have fewer assets and family supports on which to fall back. As Elizabeth Warren and Amelia Tyagi have shown,[93] if both parents are present in the household and working to make ends meet, when one of them loses a job, there is often no other household member who could then enter the workforce and make up for the lost wages. Other family members—parents, siblings, and the like—are likely to have low levels of assets on which they can draw to help their relatives. African American households are much more likely to have lower asset levels on which they can draw in emergencies than white households, and their extended families tend to have lower levels of assets as well. The asset safety net for these households is thin. As a result, low- and moderate-income households are also more likely to be liquidity constrained than other households and thus have a harder time using credit to weather hardships for which their insurance is inadequate. For example, households with assets can borrow during temporary unemployment in order to avoid hardships, but households without assets are unable to use credit to smooth income variance.[94]

Social Security is one form of insurance that does work for low-income, elderly households. Social Security (and Medicare) has helped to significantly reduce elderly poverty. Moreover, for some 20% of Social Security recipients, Social Security is their sole form of income. Social

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Family Mut. Ins. Co., 978 F.2d 287 (7th Cir. 1992); 24 C.F.R. § 100.70(d)(4) (2006). *But see* Mackey v. Nationwide Ins. Co., 724 F.2d 419 (4th Cir. 1984).

[90] *See* Klein, *supra* note 87, at 77–78.

[91] *See* William H. Lynch, *NAACP v. American Family*, *in* INSURANCE REDLINING, *supra* note 86, at 157, 177.

[92] *See* George Knight, *What's Working: Insurance as a Link to Neighborhood Revitalization*, *in* INSURANCE REDLINING, *supra* note 86, at 215, 231–32.

[93] *See* ELIZABETH WARREN & AMELIA WARREN TYAGI, THE TWO INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE (2003).

[94] *See* Sullivan, *supra* note 48, at 19–20.

Security also provides a form of lifetime income insurance, in the sense that returns to low-income workers are higher than returns to high-wage workers upon retirement. Yet, as discussed above, the current Administration is proposing to weaken the Social Security Trust Fund and undermine social insurance in the name of private accounts. Social Security is bedrock old-age insurance for low- and moderate-income households and must be preserved and strengthened, not undermined.

VI. Conclusion

Like the rest of America, low- and moderate-income people need a range of financial services to deploy the income earned from their hard work in the service of the financial stability of their households. Yet the financial services they get tend to be relatively expensive, and such households are often excluded from society's basic mechanisms to promote asset accumulation. These households often pay more for credit or are denied access to credit and often are underinsured against life's important risks. The "financial services mismatch" that I have described leaves such families adrift.

Just as the private sector is largely focused on upper income households, public policy is largely geared towards increasing the returns to capital for those who have accumulated assets, rather than towards increasing savings and asset accumulation among those who have been left behind. Rather than continuing to shift the tax burden from higher income taxpayers to middle income households and future generations and moving to private accounts carved out of Social Security, public policy should instead focus on increasing the income and assets of low- and moderate-income households in the years ahead.

I have outlined a series of steps in four key areas: financial services, savings, credit and insurance. For example: we can enact a tax credit to help bank the unbanked and engage the IRS in reaching millions of unbanked EITC and other tax refund recipients with a new opt-out, direct deposit, tax refund bank account. We can enact an employer-based, progressive savings policy with automatic enrollment that builds on existing retirement programs and the knowledge gained from IDA pilot initiatives regarding the savings needs of low- and moderate-income households for emergencies, asset building and other goals. We can work to reduce abuses in subprime credit markets, and establish an automatic, opt-out credit card payment plan to reduce financial distress, while continuing to provide households with the credit they need. And we can do better at helping low- and moderate-income households insure against life's risks. These initiatives are the core of an inclusive, progressive national savings and financial services policy.