Profitwise
News and Views

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High Profile Predatory Lending Cases



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Profitwise
News and Views

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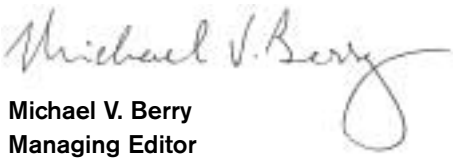
Dear Reader:

Welcome to *Profitwise News and Views*, your resource for consumer and community and economic development news and opinions in the Seventh Federal Reserve District. Formerly, the Chicago Fed's Consumer and Community Affairs division published two separate journals, *Profitwise* and *Economic Development News & Views*. The primary focus of *Profitwise* was consumer issues such as predatory lending, credit scoring, and identity theft. *Economic Development News & Views* focused on issues such as small business lending, labor trends, and tax incentives to assist underserved communities. Recognizing the interrelated nature of all economic development activities, we combined the two publications into one. We now bring both of these subject areas under one roof.

Our new format will provide relevant news from around the Seventh Federal Reserve District, and our regular and feature articles will cover economic development news, consumer issues, compliance topics, our research activities, and a timely and informative calendar of events.

As always, we welcome your comments and suggestions. Readers interested in submitting material for publication should contact us at CCA-PUBS@chi.frb.org for submission guidelines.

Sincerely,



Michael V. Berry
Managing Editor

Visit the website of the Federal Reserve Bank of Chicago at:

chicagofed.org

Around the District



Illinois

State creates Investment and Development Authority

Illinois is the fourth state to embrace an innovative community development program that joins government and private sector financial institutions to serve low-income communities. On January 7, outgoing Illinois Governor George Ryan signed the law creating the Illinois Investment and Development Authority that will be responsible for establishing a community development financial institution program to work with private sector lenders who will target financial services to under-served markets.

For more information on the Illinois Investment and Development Authority, see the press release at ***www.communitycapital.org/policy/cdfi_coalition.html.***

Indiana

Reality of poor differs from government's perception

According to a recent article in the *Hoosier Times,* the Indiana Community Action Association, which represents 24 agencies in the state, believes that a reality gap exists between what the U.S. government classifies as poor and the basic dollar figure it takes to subsist.

The article cites a "Basic Family Needs Budget" released by the Indiana Economic Development Council in September 2001. According to the budget, a single parent with two children making the official government poverty threshold income of $14,150 needs to make $27,947 or $13,797 more to meet basic needs.

The Indiana Economic Development Council's "A Basic Need Budget for Indiana Families" may be found on the Web at ***www.iedc.org****.*

Iowa

Iowa Bankers Association takes aim at state's title insurance laws.

Iowa is unique in that state law prohibits homebuyers from purchasing title insurance. Iowans are forced to use Iowa Title Guaranty for mortgage lender coverage. The Iowa Bankers Association (IBA) believes Iowa's current real estate process may not be competitive in today's marketplace. Changing current Iowa law is a legislative priority.

For more information on IBA's legislative agenda, contact the IBA at (800) 532-1423.

Michigan

Michigan posts large decrease in unemployment

According to the U.S. Department of Labor's Bureau of Labor Statistics (BLS), Michigan reported the largest year-over-year decrease in initial claims for unemployment insurance benefits of any state—down by 21,899 to 1,203. The most recent report covers the period of November 2001 to November 2002.

To view the BLS report, including a complete breakdown of initial claims and mass layoff notices issued under the Worker Adjustment and Retraining Notification Act, visit the Bureau's web site at ***www.bls.gov/mls/home.htm.***

Wisconsin

State law seen restricting municipal development activities

Twelve Wisconsin cities that have generated more than $1 billion in economic growth through tax increment financing (TIF) are unable to undertake more TIF borrowing under current law. The state's tax increment financing law includes two caps, and if both are exceeded, a city cannot create any new Tax Increment Districts."

The affected cities are: Appleton, Baraboo, Beaver Dam, Beloit, Cudahy, De Pere, Kaukauna, LaCrosse, Marinette, Sheboygan, Wausau, and Whitewater. Economic development professionals and elected officials in these and other cities in Wisconsin are concerned that this provision of state law will handcuff their ability to use this important economic development and job creation tool.

For more on the issue and a breakdown of Wisconsin cities' TIF districts, visit the archives at the Wisconsin Alliance of Cities web site at ***www.wiscities.org****.*

Predatory Lending Series

The issue of predatory lending continues to affect communities throughout the nation as deceptive and abusive lending practices remain in credit markets. Predatory lending was last highlighted in our Winter 2000 edition.[1] That issue focused on the Mortgage Credit Access Partnership program's continuing role in ensuring fairness in mortgage lending. This edition of *Profitwise News and Views (PNV)* launches a series of articles that will re-examine the issue of predatory lending within the home mortgage market. This installment provides an overview of efforts to address predatory lending through litigation. Further *PNV* editions will provide information on efforts among the states in the Seventh Federal Reserve District to address the problem, and a nonprofit's experience with counseling the victims of predatory lending.



By Steven W. Kuehl

High Profile Predatory Lending Cases

This article provides an update on litigation to address predatory lending. The Federal Trade Commission (FTC) has been a leader in the fight against deceptive and abusive mortgage lending and has consistently waged a vigorous enforcement effort to eradicate predatory practices by lenders. The National Association of Attorneys General (NAAG) has also been a major force combating predatory lending through a combined and coordinated effort by state officials. Further, some cases have been settled through a joint effort of the governmental agencies and private plaintiffs' counsel. In the past year, over $784 million in consumer redress was obtained for deceptive lending practices. Following are summaries of the highest profile cases.

Household Finance

In a historic settlement that will reshape mortgage lending practices, lender Household Finance Corp. agreed with state regulators to change its lending practices—and to pay up to $484 million in consumer restitution nationwide for alleged unfair and deceptive lending practices in the "subprime" market.[2] "This is the largest direct restitution amount ever in a state or federal consumer case," said Iowa Attorney General Tom Miller.

Attorneys general and financial regulators from 19 states and the District of Columbia began coordinating their efforts after identifying a pattern of complaints from borrowers. Many consumers claimed Household charged interest rates far higher than promised, and misrepresented points and pre-payment penalties. They also complained of deception about costly, often unnecessary insurance policies, and that loan fees were often misrepresented or not explained at all. In many of the cases, borrowers' monthly payments jumped dramatically [compared with prior payment schedules], and some consumers were put at risk of losing or did lose their homes. The multi-state investigation alleged that Household violated numerous provisions of state consumer fraud acts and financial regulations by misrepresenting loan terms and failing to disclose material information to borrowers.

State regulators said Household cooperated in the case when the states presented their concerns, working quickly with the investigators to craft a remedy to the practices identified by the states. The settlement includes Household International, Inc. (the parent company), Household Finance Corp., Beneficial Finance Corp., and Household Realty Corp. Household is based in Prospect Heights, Illinois.

Under the settlement, Household agreed to:

- Pay up to $484 million in restitution to consumers nationwide, depending on how many states participate
- Limit prepayment penalties on current and future home loans to only the first two years of a loan
- Ensure that new home loans actually provide a benefit to consumers prior to making the loans
- Limit up-front points and origination fees to 5 percent
- Reform and improve disclosures to consumers
- Reimburse states to cover the costs of the investigations into Household's practices
- Eliminate "piggyback" second mortgages.

"Owning a home to raise your family in is at the core of the American Dream," said then Illinois Attorney General Jim Ryan. "But because of the alleged deceptive practices in this case, many consumers found that dream turning into a financial nightmare. The states involved are working together to protect our nation's families."

Iowa Attorney General Miller said the historic settlement resulted from a crucial and unique partnership between state financial regulators and state Attorneys General. "Someday, I hope we will look back on this as a turning point in lending to low- and moderate-income Americans when there is a home at stake," he said. "The settlement is unprecedented, both in its amount and in the reform contained in the restrictions it places on questionable lending practices in the future. It is our intention that other lenders will have to live with the same reforms that are spelled out in this settlement."

The settlement was contained in consent decrees and filed in respective state courts throughout the country by the end of 2002. In Illinois, the complaints and consent decrees were filed on December 16, 2002 in the Circuit Court of Cook County. Each state must now design its own restitution plan, since some of the lending practices varied significantly from state to state. The details of the settlement and the process by which consumers can apply for restitution are being finalized and will be announced at a later date.

Consumers should not contact state attorney general or financial regulator offices at this time. Restitution plans for each state will be formulated, and then states and a settlement administrator will inform consumers about restitution terms and procedures under the settlement. According to the Office of the Illinois Attorney General, distribution of funds should begin by early third quarter 2003.

Citigroup Inc.

In March 2001, the FTC sued Associates First Capital Corporation and Associates Corporation of North America (Associates). The FTC alleged violations of the Federal Trade Commission Act through deceptive marketing practices that induced consumers to refinance existing debts with home loans carrying high interest rates, costs, and fees, and purchase high-cost credit insurance.[3] The FTC also alleged violations of several other federal laws, including the Truth in Lending Act, Fair Credit Reporting Act, and Equal Credit Opportunity Act, and with using unfair tactics in collecting loan payments.

Associates was one of the nation's largest "subprime" lenders. In 1999, the total dollar amount of all outstanding loans in Associates's U.S. consumer finance portfolio was approximately $30 billion. Citigroup acquired Associates in November 2000, and merged Associates's consumer finance operations into its subsidiary, CitiFinancial Credit Company. Both Citigroup Inc. and CitiFinancial Credit Company, Citigroup's consumer finance arm, were named as defendants.

On September 19, 2002, the FTC announced that it settled with Citigroup regarding the charges against Associates. In the largest consumer protection settlement in FTC history, Citigroup Inc. will pay $215 million to resolve FTC charges that Associates engaged in systematic and widespread deceptive and abusive lending practices.

"The Commission will not tolerate the fleecing of subprime borrowers through deceptive lending practices such as the packing of unwanted credit insurance on consumers' loans," said Timothy J. Muris, Chairman of the FTC. "As a result of this settlement, as many as two million consumers will

receive significant monetary relief in the form of cash refunds or reduced loan balances. I am pleased that Citigroup has agreed to remedy the grave injury caused by Associates and that Citigroup has announced new measures at CitiFinancial aimed at preventing these kinds of problems. If fully implemented, these are positive steps in an industry that for too long has been plagued by deception and abuse."

The settlement will provide $215 million in redress to consumers who bought credit insurance in connection with loans made by Associates between December 1, 1995 and November 30, 2000. The class action settlement will provide an additional $25 million to consumers whose mortgage loans were refinanced, or "flipped," by Associates during the same time period. Together, these settlements will provide $240 million in consumer redress for Associates borrowers. "Redress means that all of the settlement funds will be disbursed back to consumers who purchased credit insurance without knowing they were purchasing credit insurance," said Rolando Berrelez, Assistant Director of the FTC Midwest Region.

The federal district court in Atlanta (which is the court presiding over the FTC's case) has preliminarily approved the settlement pending final approval by the California state court of the class action and certification of the proposed settlement class. The California court is presiding over the class action and has given preliminary but not final approval. FTC attorneys expect the California court to issue final approval unless objectors to the class action succeed.

The FTC's settlement also requires CitiFinancial to provide annual reports to the FTC detailing its practices with respect to the sale and marketing of credit insurance and other add-on products, and the progress and status of steps taken to improve these practices. In addition, for three years, CitiFinancial must maintain documents relating to the sale and marketing of loans, credit insurance, and add-on products, and steps taken to improve these practices.

First Alliance Mortgage Company

First Alliance Mortgage Company (FAMCO), a debtor in bankruptcy, agreed on February 25, 2002 to a settlement of predatory lending charges that could provide nearly 18,000 borrowers with as much as $60 million dollars in compensation.[4] The suit was brought by the FTC; the states of Arizona, California, Florida, Illinois, Massachusetts, and New York; the AARP; and private attorneys for class action plaintiffs and for individual plaintiffs with unfair lending claims. The agreement settles charges that FAMCO and its chief executive officer violated federal and state laws in making home mortgage loans to customers.

Allegations against FAMCO were that it marketed its loans through a sophisticated campaign of telemarketing and direct mail solicitations. FAMCO targeted its loans to the "subprime" market, which includes homeowners with poor credit ratings who may not be able to qualify for conventional loans. Consumers who visited FAMCO's loan offices in response to the solicitation were subjected to a lengthy sales presentation known as the "Track." The allegations asserted that the "Track" presentation misled consumers about the existence and amount of loan origination fees and other fees that FAMCO charged—which amounted to 10 percent to 25 percent of the typical loan. Allegations also included misleading consumers about increases in the interest rate and the amount of monthly payments on adjustable rate mortgage (ARM) loans, and failure to provide a required disclosure booklet that explains how these loans work.

The settlement, including the bankruptcy liquidation plan which implements the settlement, was approved by the district court on September 9, 2002, and became final and effective on November 19, 2002. The FTC's Redress Fund Administrator began distributing approximately $44 million to borrowers on December 18, 2002. An additional distribution is expected to take place in 2003 as creditor claims against the bankruptcy estate are resolved, outstanding litigation settled, and expected tax refunds received.

Mercantile Mortgage Company, Inc.

The complaint charges that Mercantile Mortgage Company, Inc. (Mercantile), through its lending officers, engaged in numerous deceptive and other illegal practices to induce consumers to borrow from Mercantile.[5] A significant number of Mercantile's loans were 15-year loans requiring a large lump-sum "balloon" payment at the end of the term, usually 80 percent of the loan amount. According to the complaint, Mercantile misled borrowers by misrepresenting or concealing the balloon payment. In addition, the complaint alleges that, in many instances, Mercantile failed to disclose the balloon payment on the Home Ownership and Equity Protection Act (HOEPA) disclosures, as required by HOEPA, or failed to provide the HOEPA disclosures at all.

The complaint also alleges that Mercantile made misrepresentations about the key terms of its loans, including the interest rate, monthly payment, and prepayment penalty, and that Mercantile violated both the Truth in Lending Act and the FTC's Credit Practices Rule. The complaint also contains an allegation from the U.S. Department of Housing and Urban Development (HUD) that Mercantile violated the Real Estate Settlement Procedures Act by giving and receiving illegal kickbacks for referring loans. In accordance with the complaint, on July 18, 2002, the FTC, HUD, and the State of Illinois announced that Mercantile agreed to settle charges that it deceived borrowers about the terms of their loans.

The settlement required the company to make a $250,000 payment for consumer redress and create a program to offer refinanced loans on favorable terms to certain borrowers with balloon loans. "Many consumers who were deceived will be able to get a free refinance," stated Allison Brown, an FTC attorney who worked on the case. "These consumers will get 30-year fixed rate loans, and they will feel secure knowing that their payment will remain level over the life of the loan."

Conclusion

As federal and state officials continue to examine and take legal action regarding the problem of predatory lending, they will be policing the practices of a growing subprime marketplace. Subprime lenders produced a record $60 billion in mortgages during the third quarter of 2002 and likely will produce a record breaking $220 billion for calendar year 2002. In 2001, the industry produced $180 billion in residential subprime loans, also a record.[6] Regulators have in the past year obtained record settlement amounts to redress the victims of predatory lending. They have crafted settlements with an eye toward setting better standards for the subprime mortgage lending industry. Prime examples of these higher standards are: improved disclosures to consumers, particularly regarding credit insurance and up-front points and origination fees; and limiting prepayment penalties to only the first two years of a loan.

Financial education serves as a strong antidote to predatory lending practices and various concerned agencies have made available free publications specifically for homeowners and potential homebuyers. Suggested references follow.

Home Mortgages: Understanding the Process and Your Right to Fair Lending. Looking for the Best Mortgage: Shop, Compare, Negotiate
www.federalreserve.gov/consumers.htm
www.fdic.gov/consumers/looking/index.html

Consumer Protection At Home
www.ftc.gov/bcp/menu-home.htm

Financial Literacy Resources Directory
www.occ.treas.gov/ftp/advisory/2001-1a.pdf

Adjustable-Rate Mortgages
www.ots.treas.gov/pagehtml.cfm?catNumber=28

Predatory Lending
www.hud.gov/local/fl/buying/predatorylending.cfm

Sound too good to be true? It may be a bad loan
www.cityofseattle.net/civilrights/documents/Predatory-Lending-Brochure-02.pdf

A Guide to Predatory Lending
www.ag.state.nv.us/agpubs/pred_lend.pdf

How to Spot Predatory Lending– Your Rights as a Borrower
www.newyork.bbb.org/predatory_lending/predatory_lending.html

Predatory Lending Prevention
www.dre.ca.gov/predatory2.htm

Notes

[1] See www.chicagofed.org/profitwise/2000/pwJan00.pdf.

[2] The settlement was announced on October 11, 2002 in Chicago. For more details, see www.naag.org/issues/20021011-multi-household.php.

[3] See www.ftc.gov/opa/2001/03/associates.htm.

[4] See www.ftc.gov/opa/2002/03/famco.htm.

[5] See www.ftc.gov/opa/2002/07/mercantilediamond.htm.

[6] See Paul Muolo, Subprime Market as Hot as Prime, National Mortgage News, December 9, 2002, Vol. 27; No. 12; Pg. 1.

Steven W. Kuehl *is the consumer regulations director for the Consumer and Community Affairs Division at the Federal Reserve Bank of Chicago. Mr. Kuehl conducts seminars, workshops and frequently writes on matters dealing with consumer banking regulations. Mr. Kuehl served as a senior examiner on consumer regulations compliance and the Community Reinvestment Act with the Federal Reserve Bank of Chicago, and later managed a technical advisory service program targeted to banks in the Seventh Federal Reserve District. Prior to joining the Fed, he was an examiner for the Office of Thrift Supervision. Mr. Kuehl earned a B.S. in Finance and Economics from Carroll College and a Juris Doctor degree from Chicago Kent College of Law.*

Research Methodologies Identify Deal Flow

Finding the Intersection Between Compliance and New Markets



By Mari Gallagher

Can banks "do the right thing" and make money? Metro Chicago Information Center (MCIC) held two events on December 6, 2002, to help answer that question[1]. The first event, hosted by the Federal Reserve Bank of Chicago, was a half-day Community Banking Forum attended by 100 community banking representatives interested in the relationship between the Community Reinvestment Act (CRA) and new market opportunities. The second event took place later that day in Rogers Park and drew over 40 community development practitioners, nonprofit and for-profit lenders, and city planning representatives to exchange advice and learn about MCIC's latest research tools and techniques for quantifying community needs and market dynamics.

Featured at both events was market profiling work conducting by MCIC for TELACU Community Capital (TCC), a certified community development financial institution (CDFI) serving small businesses in Orange and Los Angeles Counties in California, one of the most dynamic lending markets in the country.

TCC retained MCIC in April 2002 to conduct a phone survey and market analysis of small businesses in Spanish and English. The survey produced 400 properly completed surveys[2]. The results of the survey and market analysis are helping TCC and its financial partners assess the viability and needs of its target market. It is also helping them identify deal flow in three distinct markets:

- The micro-business market, with annual company revenues of $100,000 or less, an important but high-risk segment of TCC's traditional portfolio. Armed with strong market data, TCC will now be able to identify sustainable businesses more quickly. This segment comprised 11 percent survey respondents.
- The small-but-stable business market, with annual company revenues of $100,000 to $1 million. This segment comprised 56 percent of survey respondents and is the anchor of TCC's long-term portfolio strategies.
- The ready-to-take-off business market, companies with annual revenues of $1 million or more. This segment comprised 33 percent of respondents, many of whom indicated only loose ties to banks. TCC sees this segment as an untapped opportunity for new bank referrals and partnerships.

Approximately half of all survey respondents intend to pursue capital or credit in the next three years for business expansion, new technology, and other uses, and 53 percent expressed interest in receiving a follow-up call from TCC. The findings also suggested that most respondents do not have strong ties with traditional lenders.

"This is an excellent example of a research study that generates valuable, strategic information for banks, not-for-profit lenders and community development practitioners," said MCIC senior researcher and consultant Mari Gallagher. "Pooled surveys are a cost effective way to address multiple user needs and broader public policy issues." While the TCC study did not originate as a pooled survey, banks are finding value in the findings, especially data and cross tabulations generated from probing questions on small business attitudes about and experiences with specific, traditional lenders.

Building a Business Pipeline

Based on the survey findings, MCIC developed a formula for identifying additional small business prospects within the original sample of 8,500 businesses that fit TCC's risk tolerance band. "Because the original sample was developed with such care, the data just kept getting better and better the more we drilled down," said Riddle. In addition to business profiles by size, MCIC also developed special sub-profiles, such as Latino and women-owned businesses. Prospects for each target category include company name, CEO, detailed business data, and tract designation (low, moderate, middle, and upper income). "We have a special commitment to lend to viable but under-banked businesses in low-to-mod income tracts." Riddle continued, "Now we know exactly where those businesses are."

With nonprofit and for-profit lenders asking how to locate and reach their customers, new opportunities emerge for a broader group of change agents to collaborate on market information and intervention strategies.

Leveraging These Findings Further

TCC's parent, The East Los Angeles Community Union (TELACU), was also able to build off this foundation of work. TELACU is a nonprofit community development corporation founded in 1968 to address economic inequality. Today, the TELACU umbrella includes a family of for-profit and nonprofit companies that comprise more than $400 million in assets. Together they are one of the most prominent and catalyzing forces in the Latino banking, real estate, community development, education, and philanthropic communities.

TELACU retained MCIC in August of 2002 to develop a small business profile suited to New Markets Tax Credits (NMTC) opportunities based on quantitative, third party data and analysis, NMTC project criteria, and TELACU's community development mission and impact goals. TELACU's objectives were to:

- Assess NMTC market demand
- Develop a "pipeline" of immediate NMTC business targets
- Leverage existing community development and alternative lending partnerships and investments.

Industries considered suited to expansion were more heavily weighted than those deemed less likely to successfully expand, particularly where expansion might require land, building, and equipment acquisition. This refined sample was then manually reviewed record-by-record. Industries that might be considered volatile or not suited to NMTC opportunities were excluded. MCIC identified 226 ideal candidates for the NMTC program in select areas of Los Angeles and Orange Counties located in eligible tracts. Combined, their average gross annual revenue is $2,263,786 and the median is $1,600,000.

Financial Services Needs in the Chicago Metro Area

The Community Banking Forum also featured MCIC findings from its recently released 2002 Metro Survey. The survey asked 3,000 households in the six-county area about their attitudes and practices regarding financial services, among other topics.

The study found that, during the past 12 months, 37 percent of Chicago respondents used a currency exchange to purchase money orders, compared to 23 percent in the metro area, 18 percent in suburban Cook County, and 11 percent in the collar counties. When divided by income and race, distinctions become greater. Low-income households represent 51 percent of all Chicago respondents that use currency exchanges to purchase money orders. Thirty-six percent said the reason was more convenient hours and locations. Only seven percent mentioned the need to get cash faster.

The 2002 Metro Survey also asks detailed questions on practices concerning checking and savings accounts, IRAs, mutual funds, wire transfers, home ownership, and other indicators and can be sorted by race, income, and custom geography. An accompanying CD-ROM contains the new 2000 Chicago Ward map, a comprehensive list of publications available for download, and a variety of Metro Survey tabulations. Additionally, users may link directly to MCIC websites mcic.org and the interactive data and mapping website mcfol.org.

MCIC has initiated discussions with Chicago area banks and other entities concerned with small business lending about conducting a study, similar to the TCC study, in the six-county Chicago metro area.

Notes

[1]MCIC is a nonprofit research and consulting firm founded in 1990 by the MacArthur Foundation and the Chicago Community Trust.

[2]The survey results have a sampling error of ±4.9 percent at the 95 percent confidence level.

For more information on standard or custom Metro Survey tables or MCIC's research and consulting services in the financial services sector, call Mari Gallagher, Senior Consultant and Director of Communications, at (312) 580-2591.

***Mari Gallagher** is a senior consultant with the Metro Chicago Information Center. Ms. Gallagher previously directed the Emerging Neighborhood Markets Initiative, a two-year Chicago pilot project spearheaded by Social Compact. Ms. Gallagher earned an M.A. from the University of Illinois, School of Urban Planning and Policy, and a B.A. in Political Science from DePaul University.*

FLLIP's "Your Money & Your Life" Financial Education Program Reports High Marks after First Year

By Steven G. Anderson and Dory Rand

Participants in the Financial Links for Low-Income People (FLLIP) coalition's Your Money & Your Life financial education program achieved significant knowledge gains and gave the FLLIP curriculum and instructors high marks, according to a new report.

Professor Steven G. Anderson, Professor Min Zhan, and Jeff Scott of the School of Social Work, University of Illinois at Urbana-Champaign, issued the report as part of an ongoing two-year evaluation of FLLIP's Financial Education Program (FEP) and Individual Development Account (IDA) program.

FLLIP is a statewide coalition of banks, credit unions, advocates, government agencies, bank regulators, adult educators, private industry and sponsors of IDA programs dedicated to expanding financial education and asset-building opportunities for low-income people in Illinois.

While government agencies, bankers, employers, community and consumer groups, nonprofit leaders and others recognize the need for financial education, and many have begun to implement programs, program evaluation is rare.[1] Federal Reserve researchers note that "demonstration of program effectiveness is critical to maintaining the current level of interest in and resources devoted to financial literacy education."[2]

FLLIP's financial education program and its ongoing evaluation are unique.

- FLLIP includes sites that combine IDAs with financial education, as well as sites that solely provide financial education.[3] Both IDA and FEP participants receive training in the same core curriculum that allows for comparison of the IDA and FEP sites.
- The Your Money & Your Life curriculum, developed by University of Illinois Extension and the FLLIP coalition, stresses the active engagement of participants in learning activities. It is written at a fifth-grade level and in a manner that takes into account the often limited educational attainment of program participants.[4]
- FLLIP employs a decentralized strategy of program development and training delivery. Instructors in FLLIP's nonprofit partner organizations receive four days of curriculum training as well as guidance on how to administer the evaluation.

During the first year of the program, FLLIP instructors gathered demographic and financial information from participants and administered pre- and post-training knowledge surveys.[5] In addition, participants who completed training were asked 12 questions designed to assess their satisfaction. The FLLIP evaluation also analyzed the marketing and implementation of the FLLIP programs.

The report documents that participants in both the FEP and IDA programs have significant financial knowledge deficiencies.[6] On average, only 63.4 percent of the pre-training survey items were answered correctly. Given that nearly all survey questions are true-or-false, this ratio is slightly better than might be expected by chance. IDA participants (who were more likely to be employed, have higher income, be more highly educated, have checking and savings accounts, be married, and be older) scored higher than FEP participants before and after completing the course.

Questions on the pre-training survey were grouped to provide indices of participant understanding across several financial education dimensions:

- Predatory lending and poor financial practices
- Public[7] and work-related benefits
- Saving and investing
- Basic banking practices
- Credit use and interest rates.

Knowledge deficiencies were found on each of these financial management dimensions. The lowest knowledge levels were found for public and work-related benefits and for savings and investing.

FLLIP graduates demonstrated significant knowledge gains.[8] The average number of correct responses for all FLLIP graduates increased almost 15 percent to 78.3 percent on the post-training survey. Significant gains were found in each of the five knowledge areas included in the surveys, with the largest gains occurring in knowledge about public and work-related benefits.

FLLIP FEP sites experienced challenges recruiting and retaining participants. The FEP dropout rate was approximately 40 percent. Dropouts in the IDA sites, where participants have strong incentives to remain, were lower. As a result of lessons learned from the evaluation, FLLIP produced a recruitment and retention toolkit, provided additional guidance to instructors on evaluation, developed new marketing tools, and changed the way it contracts with partner organizations. (FLLIP now uses performance-based contracts.)

FLLIP FEP partners have experimented with improving incentives available to FEP participants. For example, offering participants calculators, notepads, pens, and folders for materials was seen by some community partners as worthwhile. One FEP site's graduates received incentives ($5 deposit and waiver of minimum balance fees) to open savings accounts with a local bank. However, a clear understanding of how these and other incentives affect retention is a challenge for those interested in the continuing development of financial education programs.

The training content, style of delivery, trainer preparation, and trainer presentation received high marks from FLLIP participants who completed training.[9] Almost all participants rated both the quality of the training and the performance of the trainer as 'excellent' or 'good.' Excellent ratings were high with 85.7 percent of participants rating trainer performance and 78.1 percent rating the quality of training as 'excellent.'

The second year of the evaluation will measure the effectiveness of FLLIP's efforts to help participants make long-term changes in their financial behavior. It will also evaluate FLLIP's efforts to increase recruitment and retention.

Researchers will conduct telephone interviews with a random sample of participants six to twelve months after completion of the FLLIP course to determine its longer-term effects. The telephone interviews will cover some of the subject matter taught in the course (to gauge long-term learning), as well as questions such as whether participants have paid down debts, opened bank accounts, started saving, or changed other financial behaviors.

The second year of the evaluation will also include additional pre- and post-training knowledge surveys, more extensive analysis of the learning that may be attributable to the training, and analysis of knowledge levels according to selected participant characteristics, such as educational level. FLLIP also plans to increase incentives and opportunities for FEP graduates to open savings or checking accounts with mainstream financial institutions.

It is our hope that the evaluation results will contribute to the identification of best practices and policies that connect families and individuals with the tools they need to survive and, perhaps, to thrive, in Illinois's vibrant and complex financial marketplace.[10]

FLLIP launched the two-year pilot program in partnership with the Illinois Department of Human Services. The National Center on Poverty Law, a nonprofit organization based in Chicago, coordinates the coalition and administers the pilot program.[11]

Notes

[1]S. Braunstein and C. Welch, Financial Literacy: An Overview of Practice, Research and Policy, Federal Reserve Bulletin (November 2002), p.449 (www.federalreserve.gov/pubs/bulletin/2002/1102lead.pdf).

[2]Ibid., 456.

[3]Participants at IDA and FEP sites face dramatically different incentives for program involvement. Those participating at the IDA sites receive $2 in match from the program for each $1 they save for identified savings purposes, up to a maximum of $2,000 in matched funds. In contrast, participants at sites not offering IDAs generally receive few, if any, tangible incentives. One exception is that Temporary Assistance for Needy Families (TANF) recipients who attend training at the FEP sites receive child care and transportation assistance and can count class hours toward their "work activity" requirement.

[4]Program eligibility rules require that all FLLIP participants have incomes at or below 200 percent of the poverty level. Data from FLLIP applications indicates that 35.4 percent of participants receive TANF benefits. Just under half of all program participants have checking accounts, and only 40 percent have savings accounts. Nearly half of program participants have not attended college, and one-fourth have not completed high school or received a GED.

[5]The application, survey questions, executive summary, and full report are posted on the FLLIP Web site at www.povertylaw.org/advocacy/fllip/fllip.cfm.

[6]Overall, 30 FLLIP sessions were completed during the first year of the program, with 300 participants beginning and 179 completing the FEP core curriculum.

[7]Unlike most financial education curricula, Your Money & Your Life includes a chapter on public benefits that can help low-income people make ends meet as well as information about asset limits for program eligibility and direct deposit options available to recipients of public assistance.

[8]While complete pre- and post-training knowledge survey data only were available for 86 FLLIP participants at the time of this report, knowledge gains for this group are encouraging.

[9]All participants who completed training were asked 12 questions designed to assess participant satisfaction. First year satisfaction data are available for 105 participants.

[10]Braunstein at 457.

[11]See *Economic Development News & Views*, Fall 2001

For more information on FLLIP or for a complete list of FLLIP's funders, supporters and nonprofit partner agencies, please visit ***www.povertylaw.org.***

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CEDA Community Development Fund ATM Demonstration Project



By Harry Pestine

In January 2003, a community development financial institution (CDFI) placed automatic teller machines (ATMs) in the financially underserved communities of Ford Heights and Robbins, Illinois. This move is particularly noteworthy, as the ATMs are operated by a nonprofit organization, the Community Economic Development Association of Cook County (CEDA), and not by a regulated financial institution. CEDA's Community Development Fund (CDF) mission allows them to create, retain and develop small businesses and economic institutions that improve the economic stability of low- to moderate-income communities.

Of the over 400 financial institutions located in the Chicagoland area, there are virtually no banking services or financial institutions located in Ford Heights or Robbins. Until now, residents of Ford Heights and Robbins have had to leave their communities in order to access money and complete simple financial transactions.

"We conducted a community survey on financial services needs and the survey revealed ATMs would benefit the community." said Bernita Lucas, Southeast CEDA executive director. "The best initial step in providing more banking options was through an ATM; however, a full service financial institution is needed. I see this project as a vehicle that can address the critical financial void and bring great opportunities to communities in need," said Lucas. "Our goal is to give residents access to financial services and the banking system," said Yevette Newton-Boutall, CEDA CDF executive director.

Besides accommodating major credit and debit cards, the ATMs will also accept the Illinois Link card, giving residents access to social security and other electronically distributed government payments. The demonstration project uses a tracking system to measure use of the ATMs by number of transactions and dollar volume. The tracking information will be used to show a need for more financial services in the community.

In Ford Heights, the organization placed the ATM in the police station. "This is the first electronic ATM service in the history of this community, so we felt the police station was the most accessible and secure means of housing the ATM. We believe this service will offer a sense of pride and will allow the use of a service that is taken for granted by others," stated Veria Ely, community development director for the Village of Ford Heights. In Robbins, the ATM machine is located in the CEDA Southwest Building.

Local Partners

ShoreBank will partner with the Center for Economic Progress in the project. They will provide the people of Ford Heights and Robbins with checking and savings accounts as well as two free hours of financial literacy counseling and tax preparation services to qualified individuals.

ShoreBank plans to publicize the new ATMs and banking services at information fairs throughout the township. Additionally, Ford Heights will place advertisements in water bills.

For additional information contact, Ms. Bernita Lucas, Southwest CEDA, at (708) 371-1220.

***Harry Pestine** is the Community Affairs Program Director for Illinois, in the Consumer and Community Affairs Division, Federal Reserve Bank of Chicago. Mr. Pestine is an economic development specialist and a Community Reinvestment Act examiner for the Federal Reserve Bank of Chicago. Prior to joining the Fed, Mr. Pestine worked in the governor's office of economic development in Illinois for 12 years. Mr. Pestine has also been an instructor for the Neighborhood Reinvestment Institute, the National Small Stores Institute, and was an alternate voting member on the board of the Illinois Development Finance Authority.*

Financial Institutions and Participation in Individual Development Account Programs

By Robin Newberger

This article considers the roles that banks and credit unions play as part of the delivery mechanism for Individual Development Accounts (IDAs) within the geographic district covered by the Federal Reserve Bank of Chicago.[1] IDAs began as a theory put forth by Michael Sherraden in the early 1990s to address the wealth-building component of anti-poverty strategies in the United States.[2] IDAs are savings accounts matched with outside contributions that are designed to help lower-income families accumulate money for homeownership, education, job training, and business development. In most cases, IDA programs operate through partnerships between nonprofits that recruit and counsel participants and financial institutions that hold the savings accounts. The participants attend classes on financial topics and make regular deposits of earned income. Appropriately earmarked deposits and interest are matched by government, foundations, the community and/or financial institutions.

The IDA field has grown from three programs in 1995 to over 350 programs in 2001 (Schreiner 2001). Programs are flourishing in each of the states within the Federal Reserve Bank of Chicago's district. The expansion is due, at least in part, to the fact that a savings strategy for low- and moderate-income individuals appeals to a range of constituencies. Community groups support IDAs because matched savings help their target populations reach goals like buying a house or attaining higher education. Federal and state governments have allocated funds for IDAs as they further the agenda of welfare reform to build the assets of lower-income families.

IDAs also offer a mechanism for drawing so-called "unbanked" households (people without bank accounts) into the financial mainstream. The impediments to having a bank account are a policy concern in so far as these households may pay more in fees, face a loss in personal security, forego an opportunity to build a credit rating, or accumulate less savings. In addition, IDA programs showcase the importance of financial education and related support services for clients who seek to maintain financial assets.

The Consumer and Community Affairs division (CCA) of the Federal Reserve Bank of Chicago has chosen to include greater economic literacy, the use of mainstream financial services, and asset-growth among low- and moderate-income households in its mission to promote sustainable community development. The CEDRIC Web site, founded and maintained by the CCA division, contains a repository of research and other documents on consumer education, alternative financial services and community development. The Federal Reserve Bank of Chicago has also launched its own projects for fostering mainstream financial access for the unbanked and improving the population's understanding of fundamental financial concepts.[3] In addition, the Community Affairs staff is encouraging the study of community development programs at the level of implementation.[4]

The effectiveness of the IDA model is being measured in two national evaluations that look at impacts on individual participants, design features, and community effects. Financial institutions are also stakeholders in the IDA strategy. IDA programs, as currently structured, could not exist without depository institutions that hold the deposits and track account balances. It is therefore worthwhile to understand the contributions made and received by financial institutions from their own perspective.

Overview of Findings

A diverse group of financial institutions, most of which have no explicit community development mission, hold IDA accounts in the district. Banks tend to limit their IDA-related activities to conventional depository functions such as holding accounts and mailing statements. A larger proportion of credit unions dedicates resources to program operations,

reflecting the prevalence of low-income credit unions in this study. The most frequently cited motivation for involvement by both banks and credit unions is their desire to help the communities in which they do business. Fewer banks list business-related interests as a reason for involvement. A higher proportion of credit unions cite opening new markets and cross-selling products as their motivation.

Data Collection

The findings are based on short interviews with financial institutions that participated in IDA programs in the first half of 2001. Sixty-three financial "partners" were identified through conversations with selected IDA program operators, publicly available lists of programs that were awarded Assets for Independence Act grants, and discussions with state personnel in Illinois, Iowa, Indiana and Michigan. (The state of Wisconsin does not fund IDAs.) The conversations focused on how the institutions became involved, the functions they perform for IDA account holders, their incentives to participate, and how they structured their savings product. Representatives from state agencies and selected community-based organizations supplemented some of the explanations obtained from financial institutions. A number of financial institutions may not have been included because their programs were just getting started. Personnel ranging in positions from account representatives to presidents participated in the interviews.[5]

Data on participating banks is also drawn from the most recent public Community Reinvestment Act (CRA) performance evaluations, from the Federal Deposit Insurance Corporation/Office of Thrift Supervision Summary of Deposits database, and from Home Mortgage Disclosure Act reports available through the Federal Financial Institutions Examination Council (FFIEC). Data on credit unions is taken from the National Credit Union Association and conversations with credit union officials. Census tract income information for the banks' assessment areas (the geographic market where financial institutions conduct business) and branch locations comes from the FFIEC census reports.

A few caveats about the responses deserve mention. At the time of the interviews, programs were relatively young, many financial institutions had opened only a small number of accounts, and these institutions were still forming their impressions about IDAs. About 80 percent of banks have been offering IDA accounts since 1998 and more than 70 percent of the credit unions began offering IDA accounts as of 2000. Information on banks from the CRA performance evaluations may be dated as the most recent reports for a number of institutions were published in 1996, 1997 and 1998. CRA performance evaluations were not found for this study for four banks.[6] For the 44 banks with CRA reports, not all reports contain all the data analyzed in this study such as the percent of low- and moderate-income census tracts in their assessment areas. In addition, since a preponderance of institutions are in Indiana, the general perspective of the respondents, as summarized at various points in this paper, may be tilted towards issues specific to Indiana.

The remainder of the article is organized as follows. Section I compares the characteristics of participating institutions based on asset size, market share and mission. Section II lists the responsibilities of financial institutions in IDA programs. Section III presents the reasons financial institutions (among the sample) support IDAs. Section IV discusses the program design features that encourage participation.

I. Characteristics of Financial Institutions

Size and Market Coverage

Of the 63 financial institutions interviewed, 78 percent (49) are banks and 22 percent (14) are credit unions.[7] The participating banks divide fairly evenly between larger institutions with more than $1 billion in assets, midsize institutions with assets between $250 million and $1 billion, and smaller institutions with less than $250 million in assets. Among credit unions, asset size ranges from less than $1 million to more than $380 million. The preponderance of institutions dominate their markets in terms of deposits held. Over half of the banks rank within the top five in deposit market share in their assessment areas.[8] Eighty percent (35) rank within the top ten in their assessment areas.

An outside entity such as a local nonprofit or government agency approached over 80 percent (50 of 60) of the institutions with proposals to open IDA accounts. More than half of these institutions were contacted by nonprofits with which they had a previous relationship. The rest were approached because of their proximity to the target population, their known participation in IDA programs in other states, or their entry into a new market.

Institutional Mission

Most institutions qualify as "mainstream"—full service entities that provide a range of traditional banking services with no particular community development mandate. Ninety-three percent of banks (38 of 41) target assessment areas in which half or fewer of the census tracts are low- or moderate-income (Table 1). Sixty-three percent (27 of 43) show a lower or equal percentage of mortgage financing in low- and moderate-income census tracts than the average for all banks in the metropolitan area in which the institution is located (or is in close proximity). Most of the institutions assign a particular branch to serve IDA customers. Over 60 percent (26 of 42) of the banks and two thirds (6 of 9) of the credit unions that operate multiple locations offer IDA accounts at just one branch or office.

Institutions with a mission or business strategy to serve distressed communities and target low-income individuals

are relatively well represented in the sample. Eighteen percent of banks and credit unions (11 of 62) have a designation as a community development financial institution (CDFI), a community development credit union (CDCU) or a low-income credit union (LICU). One bank drafted and plays the lead role in carrying out the area's plan as a Federal Enterprise Community, and yet another focuses its branch on an immigrant neighborhood. In comparison, among all 1,635 banks in the district (including the banks and thrifts overseen by other regulators), nine banks, less than one percent, have a CDFI designation. Among all 1,591 credit unions in the district, 3.7 percent (59) have a CDCU or LICU designation.

In addition, 62 percent of banks (28 of 45) reported that low- and moderate-income IDA account holders fall within the spectrum of their existing customer bases, although some indicated that IDA participants represent the lowest-income group in this spectrum. Many of the institutions offer various deposit products with low or no opening balances, and have a history of participation in housing and economic development projects with local community groups and city government. Eighty-six percent of credit unions (12) say they serve low- and moderate-income individuals as part of their existing customer bases. Many of the institutions that do not think IDA account holders fall within their customer base describe the IDA participants as "unbanked"—having no previous relationship with a financial institution.

II. Responsibilities of Financial Institutions

IDA proponents have identified various ways for financial institutions to contribute to IDA programs, spanning from servicing accounts to contributing operating funds. In addition, federal banking regulators granted CRA credit for a range of IDA-related activities including making grants to IDA programs, providing staff to participate in the development of IDA programs, and making loans to IDA holders.

Table 2 presents the list of responsibilities reported by banks and credit unions. All but one hold deposits and send account statements. (One of the banks contributes only match funds, held outside of the bank.) In fact, 62 percent of banks and 21 percent of credit unions limit their involvement to holding deposits, sending account statements and holding match funds. These are functions that fall within the normal activities of depository institutions, although roughly a quarter of the banks must also assist program sponsors in allocating match funds to individual accounts (as technical assistance to nonprofits or as a mandate from the funding sources).

Their services depart from convention in that participating institutions do not assess charges on the accounts. All waive fees on balances below pre-set thresholds and pay interest (usually a basic passbook rate) regardless of the balance, with the exception of one bank that pays interest on balances of $100 and over. One bank pays in excess of the rate on non-IDA accounts. The majority of institutions require no minimum balance for opening an account, although eight banks require opening deposits of $1 to $30, and seven credit unions require opening balances of $5 to $25. Some institutions offer savings bonds or certificates of deposit rather than savings accounts. Thirteen percent of banks (6 of 47) also cash payroll checks at no charge and offer free ATM cards. One institution relaxes certain requirements to enable some IDA participants to open checking accounts.

Compared with the credit unions in the sample, a smaller percentage of the banks participate in activities that fall outside of standard depository functions. Thirteen percent (6 of 47) contribute to match funds in addition to holding deposit accounts. A seventh bank contributes match funds

Table 1: Income of Geographic Market/Number of Service Delivery Locations

Banks	N	Percent
Percent LMI geographies in assessment area		
25 percent or less	18	43.9
26–50 percent	20	48.8
51 percent or more	3	7.3
Observations[1]	41	

[1]The CRA performance evaluations of 7 banks do not include the census tract incomes of their assessment areas.
Sources: Community Reinvestment Act Performance Evaluations and 2000 Census of Population and Housing.

Banks	N	Percent
Bank-issued LMI home loans vs. average in MSA		
Lower	20	46.5
Higher	6	37.2
Same	7	16.3
Observations[1]	43	

[1]Five banks did not provide HMDA data since they are not located in metropolitan statistical areas.
Sources: Home Mortgage Disclosure Act disclosure and aggregate reports and author's interviews.

Banks	N	Percent
Institutions with more than one branch/office	42	91.3
IDAs offered at a single location	26	61.9
IDAs offered at more than one location	16	38.1

Credit Unions	N	Percent
Institutions with more than one branch/office	9	64.3
IDAs offered at a single location	6	66.7
IDAs offered at more than one location	3	33.3

without holding any deposits. Of these, one indicated direct compensation from the U.S. Treasury Bank Enterprise Award Program for its work with CDFIs was the motivation, and another institution waited to allocate money until it identified other sources with which to supplement its own contribution. Thirty percent of the banks (14 of 47) report participation in financial literacy programs, which ranges from overseeing a money management workshop to providing space for a course.

As Table 2 shows, credit unions tend to take a broader operational and administrative role, reflecting the prevalence of in-house IDA programs at these institutions. Half of the 14 credit unions sponsor their own IDA programs, while 98 percent of banks in the sample do not. Each of these credit unions has a mandate to serve traditionally underserved customers or markets. Over half of credit unions contribute operating funds or recruit and screen participants, over a third sponsor a VISTA volunteer,[9] and 43 percent report involvement in the economic literacy component. In contrast to the banks, none of the credit unions in this study contributes matching funds.

Table 2: Functions Performed

Banks	N	Percent
Hold deposit accounts	46	97.9
Hold match accounts	40	85.1
Send account statements (monthly/quarterly)	46	97.9
Contribute match funds	7	14.9
Participate in financial literacy education	14	29.8
Program Administration:	2	4.3
Develop program design	1	2.1
Contribute operating funds	1	2.1
Recruit/screen participants	0	0
VISTA volunteer	NA	NA
Observations[1,2]	47	

[1]Does not include one bank that recently began its program.
[2]Respondents could give multiple answers.

Credit Unions	N	Percent
Hold deposit accounts	14	100
Hold match accounts	8	57.1
Send account statements (monthly/quarterly)	14	100
Contribute match funds	0	0
Participate in financial literacy education	6	42.9
Program Administration:	8	57.1
Develop program design	3	21.4
Contribute operating funds	7	50
Recruit/screen participants	3	21.4
VISTA volunteer	5	35.7
Observations[1]	14	

[1]Respondents could give multiple answers.

III. Motives for Participation

The literature in support of IDAs notes the following reasons financial institutions might want to partner in IDA programs:

- Better serve the local community
- Tap new markets
- Cross-sell products like mortgages, business loans or college loans
- Receive CRA credit
- Realize profit potential with the right mix of public, private and nonprofit support (Boshara 2001)

Community Outreach

Community outreach is by far the most common motive for becoming involved in an IDA program according to the institutions in this sample. Seventy percent of banks and 79 percent of credit unions list "contribution to the community," "relationship-building with the local service provider," or "mission of institution" as at least one of their motives. Many credit unions consider the IDA program an extension of their mission. Many banks mention that they want to help individuals build wealth. Other banks indicate that there is no reason not to participate. The commitment is relatively "easy" inasmuch as the bank incurs little or no risk (if the accounts can be easily monitored), existing savings products can be adapted to IDAs, staff do not need intensive training, and the banks do not have to choose from a pool of potential grantees.

In conjunction with the benefits of contributing to the community, banks receive CRA credit for their participation. Fifty-five percent of banks (26 of 47) mention CRA as a reason for participation; however, many others are reluctant to explain their involvement in quid pro quo terms. For large banks, CRA service credit is awarded for holding the IDA accounts and investment credit is awarded for contributing match funds. Forty-nine percent of banks (23 of 47) participate exclusively for community outreach, CRA credit, or both (i.e., they indicate no business motivation).

Cross-Sell Products and Target New Customers

Fifty-one percent of bank respondents (24 of 47) list cross-selling products and/or targeting new customers as a motive for holding IDA accounts. Six percent list these business motives to the exclusion of community outreach or CRA credit. Eighty-six percent of credit unions (12 of 14) aim to cross-sell or target new customers, and 21 percent (3 of 14) list these as their only motives. IDA participants have actually used other financial products—most commonly a checking account—at 28 percent of banks (13 of 47) and 50 percent of credit unions, although some of these institutions did not list cross-selling as a motive for participating in an IDA program.

Among those institutions that cross-sell, one bank reports that it made a mortgage loan to an IDA graduate, and three credit unions have offered secured loans to build a credit history. Among those institutions that target new customers, many see IDA accounts as giving an inroad into untapped markets including growing Hispanic populations and immigrant groups. Some state targeting new customers as a secondary consideration or phrase it in indirect terms such as improving the quality of life of the IDA account holder by turning them into a "regular" bank customer. For the banks that hope to cross-sell in the future, they focus on credit cards, car loans and other consumer products in addition to home loans.

Institutions that do not cross-sell cite a handful of reasons. Among them, many programs are relatively new and account balances are still low. Some institutions observe that IDA participants have barely enough resources to save for the match, let alone use other bank services. Some institutions suggest that cross-selling goes against their civic-minded motivation for participating in the IDA program. These institutions make a clear distinction between contributing to the community and deriving any business benefits from involvement.

Financial Bottom Line

In keeping with these results, no institution in this study lists profit potential as a motive for participating in an IDA program. Some institutions face higher costs with respect to their management of IDA accounts, sending statements every month rather than every quarter, and at times to both the local service provider and the individual account holder. Some institutions are required to complete and submit paperwork for the match funds, modify account-processing systems, and monitor authorized and unauthorized withdrawals. Dedicating match funds from the institution itself adds to the total costs.

The extent to which an institution's management information system is compatible with IDA tracking is another factor affecting costs. The institutions in the sample have tended towards using "off-the-shelf" savings products to set up IDAs, flagging the accounts with special codes, creating custodial accounts held jointly by the nonprofits and the individual, or designating the accounts for deposit only. Some institutions confine their IDA accounts to a single location precisely to avoid making system-wide changes to their MIS systems. One large bank chose not to hold accounts (but to contribute to operating and administrative expenses) in part because its centralized processing system could not easily track IDA accounts.

None of the institutions had performed a break-even analysis of the IDA accounts at the time of the interviews. Accounts do not cover costs as currently designed at 34 percent (15 of 44) of banks. Another 34 percent of bank respondents steer away from cost measurements given their community development reasons for participation. Two others indicated the accounts probably do not lose money for the bank. Among 13 credit unions, 23 percent (3) report that accounts do not cover their costs and another 23 percent (3) indicate they do not consider breaking even [a priority] given their goals. Another three are waiting to judge costs based on future lending opportunities.

In instances where financial institutions say costs are not covered, many acknowledge the possibility that a change in the design of the account could lead to more profitable results. These changes include greater automation and a larger number of accounts with higher balances. The higher the match rate, the shorter the time it takes for the accounts to break even. To paraphrase one respondent, a short-term deposit account is not a moneymaking product. Four credit unions also recognize that utilizing VISTA volunteers substantially reduces the costs of operations. At the time of the interviews, about half of the banks in the sample had opened 30 accounts or fewer, and over three-quarters of credit unions held fewer than 50 accounts each.

IV. Discussion of Major Findings and Conclusion

Variety of Institutional Partners

Looking at features such as size, branch location or organizational mission does not suggest a particular type of financial institution to partner in an IDA program. From the perspective of an account holder, institutional trustworthiness and the suspension of credit checks might be the most sought-after features of financial institutions—potentially outweighing the importance of geographical proximity or personalized attention. From the perspective of a local service provider, institutions with larger capital bases and mortgage departments with formal relationships with entities such as the Federal Home Loan Bank and Neighborhood Housing Services may be better equipped to offer the most competitive loans to IDA graduates. Institutions that reach widely dispersed populations through multiple branches may also work best for service providers that operate across several counties.

Local service providers, perhaps anticipating few other choices, have often approached the institutions with which they had a pre-existing relationship. Differences in state legislation and policy initiatives have also resulted in various types of institutions holding IDA accounts. For example, the Center for Urban Affairs program at Michigan State University recruits special-mission credit unions to administer IDA programs.[10] The federal government's Assets for Independence Act demonstration, offering the single largest pool of money for IDA service providers, comes with its own set of specifications for involvement by financial institutions. The relatively few CDFI-designated banks and low-income credit unions in the district may also explain why more local service providers have not opened IDA accounts at institutions with economic development missions.

Another way to account for institutional diversity is in the risks and rewards to participation. When start-up costs are relatively low and financial institutions can contribute by carrying out traditional bank functions, IDA programs offer an opportunity for all types of financial organizations to support community development. Any number of depository institutions could have a basic affinity to the IDA concept when the scale of programs is kept relatively small.

Reducing Costs and Institutional Participation

From what financial institutions report as their responsibilities and motives, fewer institutions might show an interest in IDAs if they were charged with helping bring the IDA concept to scale. Many activists in the IDA field recognize that cost-cutting measures and direct subsidies are useful incentives to encourage institutions to open larger numbers of accounts or contribute match funds. One group of researchers is already promoting efficient account processing as the way to increase the impact of the IDA strategy. This approach removes IDAs from the domain of retail depository institutions and experiments with accounts based on 401(k) processing systems (Tufano 2001). Another broad coalition of IDA activists supports federal tax credits to for-profit depository institutions to mitigate the costs of contributing match funds. The "Savings for Working Families Act" would cover 100 percent of matching funds (up to $500 per account holder per year), and provide $100 for each new account opened and $30 for each account maintained.

Business Opportunities and Institutional Participation

Cross-selling financial products tailored to the needs of IDA participants could create additional incentives for institutions to partner in IDA programs. A number of financial institutions in this sample have not begun to link IDA participation with appropriate financial products, in part because programs are relatively young and many financial institutions have opened only a small number of accounts. Another impediment may be intermediation by local service providers, whom many financial institutions see as their clients rather than the IDA-savers themselves. This perception can be reinforced in situations where depositors themselves rarely, if ever, visit the financial institution. (Bank personnel pick up deposits and open accounts directly at the local service provider's office, or depositors send their money by mail.)

The business potential of IDA accounts might be best appreciated in the context of how people with savings accounts but no checking accounts, and the "unbanked" population in general, conducts their financial transactions. A survey of banked and unbanked households in New York and Los Angeles revealed that only 12 percent of savings accounts holders used personal checks to pay their bills (perhaps using other household members' checking accounts). The remainder rely on money orders and cash, much like the unbanked (Dunham 2001). The profit potential of IDA participants depends in part on the availability and cost of products that this population accesses elsewhere—convenient check cashing, purchasing of money orders or wire transfers, non-English speakers for recent immigrants and bill paying services, among others (Rhine et al, 2001). A financial institution's involvement in an IDA program can offer an inroad into this client base by improving their qualifications for having a checking as well as a savings account, and potentially changing their attitudes toward services offered by banks and credit unions.

Notes

[1]The district includes Iowa and portions of Michigan, Illinois, Indiana and Wisconsin.

[2]See Assets and the Poor: A New American Welfare Policy.

[3]More information about the "unbanked" can be obtained at www.chicagofed.org/unbanked/purpose.cfm. More information about Project Money$mart can be obtained at www.chicagofed.org/consumerinformation/projectmoneysmart.

[4]The Community Affairs officers of the Federal Reserve System have jointly sponsored their third biennial research conference in March 2003 to address these and related issues. See www.chicagofed.org/CEDRIC.

[5]Some financial institutions had terminated their involvement in IDAs. Although beyond the scope of this paper, conversations with these institutions could provide a fuller understanding of the incentives and disincentives for participation.

[6]CRA information for those institutions was not located through their regulators' Web sites.

[7]The remainder of the analysis does not include one of the banks that provided money indirectly to a coalition of IDA programs. Also, the total does not count branches of banks that partner independently with nonprofits in their areas.

[8]Based on information from the FDIC/OTS database for 44 banks where the CRA performance evaluation gives information on the bank's assessment area.

[9]The Volunteers In Service To America (VISTA) program is a national program placing individuals with community-based agencies to address urban and rural poverty issues.

[10]A complete description of state IDA policies is available through the Center for Social Development at Washington University.

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1st Quarter 2003

Calendar of Events



Midwest Macroeconomic Conference

Federal Reserve Bank Of Chicago
May 16–17, 2003

The 11th Midwest Macroeconomics Conference will be hosted by the Federal Reserve Bank of Chicago on Friday, May 16 and Saturday, May 17. The sessions will begin at 8:30 a.m. on Friday and end at 5:00 p.m. on Saturday.

For more information, contact Jonas Fisher at: **midwestmacro@frb.chi.org** or **(312) 322-8177,** or **www.chicagofed.org/newsandevents/conferences/index.cfm**.

Greening Rooftops for Sustainable Communities

Congress Plaza Hotel, Chicago, IL
May 29–30, 2003

The First North American Green Roof Infrastructure Conference, Awards and Trade Show is being organized by Green Roofs for Healthy Cities, a network of public and private organizations working to develop the green roof industry for the past four years. The event will provide a unique opportunity to strengthen and broaden the growing constituency of policy makers, researchers, designers, manufacturers, Non-Governmental Organizations and consulting professionals who are involved in the green roof industry in North America. A trade show, guided tour of green roofs, presentation of papers and posters, and more will be featured at this conference. Co-hosted by the City of Chicago, with support from the Chicago Environmental Fund.

For more information contact: **www.greenroofs.ca/grhcc/conference.htm**.

Microenterprise Tools & Techniques Training Seminars

June 19 & 20, 2003–Providence, RI
September 18 & 19, 2003–Boston, MA

The Federal Reserve Bank of Boston will host several two-day training seminars for microenterprise lenders and technical assistance providers. This program was developed by MicroNet (Maine's association of microenterprise lenders) and the Federal Reserve Bank of Boston to help build the organizational, lending, and technical assistance capacity of microenterprise practitioners and organizations throughout New England.

For registration and information contact: **www.bos.frb.org/commdev/conf/micro/index.htm.**

The Consumer and Community Affairs Division of the
Federal Reserve Bank of Chicago & Proteus, Inc. invites you to attend:

An Informed Discussion of the Financial Assimilation of Immigrants

Des Moines Marriott – Downtown
700 Grand Avenue
Des Moines, IA

Tuesday, June 24, 2003
8:00 a.m. Continental Breakfast
Program begins 8:30 a.m. – 4:00 p.m.
Complimentary lunch will be served at 12:00 noon

A panel of experts on the topic featuring Terry Meek, Executive Director of Proteus, Inc. will address issues and opportunities surrounding the financial assimilation of immigrants, such as legal services, documentation and tax matters, use of the Matricula card, and employment and housing concerns.

Target audience:

- Employers of immigrant workers
- Researchers interested in immigrant and working poor issues
- Public and private agencies serving immigrants and lower-income workers
- Compliance and CRA officers of financial institutions.

Topics include:

- Serving the financial needs of immigrant populations
- USA Patriot Act impact on immigrant issues
- Legal services to immigrants
- Documentation issues surrounding the IRS, Social Security, and the Matricula card
- Financial assimilation as a tool to stem poverty and welfare dependence.

There is no charge for the event, and lunch is provided, however seating is limited. If you would like to attend this event, please reply via fax at (312) 913-2626 or on-line at CCAEvents@chi.frb.org, by Monday, June 16th and provide the following information:

1. Participant(s) name;
2. Title;
3. Organization;
4. Phone/fax #'s
5. E-mail address