



FINANCIAL FIRST ENCOUNTERS: AN EXAMINATION OF THE FRACTURED FINANCIAL LANDSCAPE FACING YOUTH TODAY

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EXECUTIVE SUMMARY

Young adults entering the work force and managing wages for the first time today face a financial services marketplace that is markedly more complex than the one their parents first encountered as young adults. Traditional bank and credit union business models are under stress, non-bank providers now offer an array of alternative products for managing cash, and national specialized providers dominate marketing and underwriting of most credit products. As a result, many individuals adopt an “a la carte” approach to financial services, in which they access a range of services from specialized providers. There are trade-offs inherent in this approach: consumers may be able to maximize the price or functionality of specific services being accessed, but this approach also makes it more challenging to develop a unified understanding of a household’s finances or manage one’s financial life in a coherent way.

The heavily fragmented nature of their initial relationships with financial services providers has implications for how youth will build their financial capability – the set of knowledge and practiced behaviors that will help lead them to positive financial outcomes.¹ For young people, the gradual development of financial capability throughout their first encounters with the financial services industry can greatly improve their prospects for building savings and their ability to establish credit. Institutional supports for saving have been one casualty of an “a la carte” approach as cash management products offered outside traditional banks often come without savings features or modeled savings behavior and as credit-granting has been largely delinked from saving for down payments. Additionally, tighter underwriting standards, coupled with recent legislation, may delay young adults’ access to mainstream loan products: this delay may protect young people from early negative experiences with credit, but young people still need onramps to healthy credit usage and the development of positive credit histories.

A more general consequence of product complexity, and of the fragmentation and transience of early financial relationships, is a failure to generate “anchoring relationships” with trusted institutions, such as traditional depositories, through which young people could reliably learn about and obtain the range of services they are likely to need. While their parents’ financial relationships are likely to have become similarly varied and specialized over time, fragmentation early on may be having developmental impacts on the way young people learn--and make decisions--about money.

To provide youth with opportunities to begin their financial lives with positive first encounters, future financial product innovations targeting youth, and the underbanked more generally, should be evaluated and promoted with an eye to the nature of the broader provider relationships through which they are delivered and the accompanying resources provided to promote financial capability. Fortunately, there are a number of areas of innovation that represent promising solutions to help put young people on the path to financial success.

¹ For additional detail and discussion of the Financial Capability concept and framework, see CFSI’s report “From Financial Education to Financial Capability: Opportunities for Innovation”: <http://www.cfsinnovation.com/publications/article/440486>

BACKGROUND

This paper evolved from a year of exploration into how young people first establish relationships with financial services providers and, more broadly, how they begin to build financial capability: i.e. competent management of money and payment transactions, building savings, judicious use of credit, and effective selection and management of financial products and services. At the Center for Financial Services Innovation (CFSI), we promote access to useful and affordable financial services by those who are unbanked or underbanked and for whom personal and household financial management can be a daily struggle. For our organization, these “first encounters” seem pertinent.

Like medical researchers we were asking questions similar to those often used to define wellness and illness in the fields of medicine and mental health: what are the “normal” paths of healthy physical and emotional development? In financial services, could we similarly identify a normative path by which most individuals first acquire access to transactional accounts and the knowledge to handle them, establish credit, and build savings? Could we identify ways in which youth strayed from this path or in which cultural or environmental factors kept them from following it? If so, were there simple interventions (in the form of new products, distribution strategies, education programs, or behavioral “nudges”) that could set young people at risk of deviating from the norm back onto the correct course?

Financial institutions have historically provided a viable path for young people to begin and progress through their financial lives. While not a necessary condition for establishing financial capability, a strong relationship with a bank or credit union can provide young people with access to a full suite of beneficial financial products and services and guidance on how best to use them. However, in evaluating results from CFSI’s 2008 Underbanked Consumer Study, we found that within the underbanked consumer² segment, 22% of 18-24 year olds and 40% of 25-34 year olds had once owned a checking account, but no longer did. As a checking account is generally seen as the cornerstone of a banking relationship, this suggests that these early experiences with a financial institution failed to serve as an effective starting point for their financial lives. Had something in these first encounters gone wrong? Or was there something transient or incomplete about the relationships in the first place?

Overall, our research suggested that many of today’s young underbanked are less likely to form relationships with traditional depository institutions in the long term than were their recent and not-so-recent predecessors. This raised some fundamental questions about what is happening in the marketplace overall: is there something in the experiences of this generation that generally predisposes more of them to manage their money outside of traditional banking relationships? Alternatively, has the retail banking industry evolved in recent years to become less welcoming (or at least more indifferent) to the youngest members of the workforce? Could both of these hypothetical trends be at work?

To answer these questions, we had very little empirical material to draw from. To arrive at comprehensive answers, we would need to observe a sample of young people over a five or ten year stretch and track their financial behaviors and institutional interactions over time. In the absence of such longitudinal research, we relied on conversations with researchers and business people. An imprecise methodology to be sure, but the results were deeply illuminating. The story of Sharon and her daughter Jessie provides one example of a typical response.

² For this and other mentions of “underbanked consumers”, we are referring to both unbanked consumers, who do not own a checking or savings accounts, and underbanked consumers, who may own one or both of these accounts, but also utilize alternative financial services providers such as check cashers or payday lenders.

JESSIE'S FIRST ENCOUNTER

The week after Jessie graduated from high school, her mother, Sharon, took her to Davenport Bank to open her own checking account. Sharon, a single mother in a small New England city, considered this event a rite of passage for her daughter. Sharon had banked at Davenport for many years. She had also gotten her mortgage with this regional bank, as well as two car loans, which she had repaid. Sharon had few occasions to visit Davenport's branches. Her salary was direct deposited and she used ATMs to get cash. She also paid her bills online. Her daughter had only been to a branch a handful of times: including once to open a passbook savings account for Jessie with money she'd received from family and friends on her first communion.

At the branch an Assistant Manager explained the seven different account options.

Mother and daughter agreed the "Flex-R" account would be best for Jessie. This option had five free checks per month, a Debit/ATM card, free online statements and a starter supply of 100 checks, with no minimum balance. Jessie would use the account while living at home that summer and fall, when she would be taking courses at the local community college before leaving to study full-time at Western State in January. Jessie had lined up a part time job and Sharon had agreed that Jessie would pay for her clothing, gas and upkeep on Sharon's old car, books, and school supplies, her cell phone, and her own entertainment while taking her courses.

Sharon helped fund the initial deposit with \$100 in cash and Jessie added her first paycheck for another \$140. Sharon was prepared to help Jessie keep track of her initial transactions and reconcile her monthly e-statement. Jessie didn't expect to write many checks, and had already used ATMs and debit cards.

Like many of her friends with teenagers, Sharon had diligently intercepted the solicitations credit card companies had begun mailing her daughter. A few offers got through, including two in envelopes from animal welfare groups Jessie had joined. Still, Sharon had convinced her daughter she wasn't ready for credit cards and that the debit card from Davenport would enable her to shop anywhere in town and online. Sharon had once bought Jessie a Visa travel card from AAA to cover Jessie's expenses on a youth trip to Mexico. Jessie used the card to get cash and to buy souvenirs. When a purchase had been declined, Jessie knew the card's balance was low. After withdrawing the remaining cash from an ATM, she ceased to use the card.

The store where Jessie began to work paid its employees either by check or in cash. Sharon encouraged Jessie to take a paycheck, deposit it at an ATM, and use her debit card. Sharon also suggested that Jessie begin saving a little bit of each check; these funds, along with her passbook savings, would be available for major purchases.

Initially Jessie's account worked well for her. She enjoyed using her debit card to shop online. She made several purchases, including a pair of shoes at Zappos that were backordered for three weeks. But Jessie found saving to be difficult. She tried to leave an additional \$10 in her account each week, but the pay from her part-time job was proving all too easy to spend. Then, in mid-July, Jessie was surprised by an email from Davenport stating she had overdrawn her account by \$117. She had forgotten about her back-ordered shoes. When these had finally shipped, the funds in her account had been just under the purchase amount. Under Davenport's overdraft protection policy, the bank had approved Zappos' authorization request and then charged a fee of \$35. Though Jessie had made a deposit the same day, these funds were not yet available to cover the purchase. Jessie had made an additional debit card purchase that day and a small ATM withdrawal. Each of these transactions had also triggered overdraft fees.

Sharon was upset when Jessie told her about the fees. Though a phone representative explained Davenport's overdraft policy, this was news to Sharon, who had had no recent experience of bouncing checks or debit card transactions herself; and both she and Jessie had assumed these would simply be declined if Jessie's funds were insufficient to cover them. Upsetting Sharon further: Jessie had over \$1,000 in passbook savings, but the bank hadn't offered to link these to Jessie's checking account.

Sharon felt badly for not having been able to help Jessie avoid the fees. She helped restore the balance in the account, but this didn't prevent Jessie from incurring two more overdrafts over the summer, both on debit card purchases. Having the debit card in her wallet made it tempting to use. By the end of the summer, mother and daughter agreed it would make more sense for Jessie to take her pay in cash, rather than by check. Jessie would use a pre-paid debit card to shop online and manage her cash. Sharon was left with a vague sense that the world had changed.

The Changing Financial Landscape and First Encounters

The story of Sharon and Jessie depicts one young person's introduction to a financial institution and her struggle to develop her financial capability. Jessie's first encounter with Davenport Bank, intended as a rite of passage by her mother, resulted in disappointment; and is likely to color her future attitudes and interactions with financial services products and providers.

Young people are particularly dependant on their families and peers for information, advice, and behavioral cues about how to manage their money, on what financial services to obtain and how to use them. Their first institutional relationships also provide powerful contexts that help define what financial behaviors young people will view as normal, what menu of products are available to them, and how those products are used.

However, generational shifts in the marketplace have changed the nature of these first encounters, making them more varied, less likely to "stick," and less likely to involve a traditional bank like Davenport. These shifts reflect changes in financial institutions and the products they offer, the wider array of nonbank financial services available to the younger generation, and changes in the experiences and expectations of young people like Jessie.

On the institutional side:

- *The variety and complexity of account features and pricing have greatly expanded.* Banks now offer a wide range of account products with different features and price points designed to meet the needs of different consumer segments. For consumers the sheer number of options can be bewildering, while fee structures may not be readily discernable.

- *Electronic commerce and a proliferation of payment methods further complicate personal cash management.* Through their experiences with prepaid gift and debit cards, and with online purchases, young people learn how to buy things through a variety of media and means of payment. With multiple payment methods (i.e. check, ACH, online debit and off-line debit, ATM) and varying clearing times, it's harder for Jessie to track her available balances than it once was when her mother used a paper register to log checks and cash withdrawals.

- *Overdraft protection fees may have affected young people's confidence and trust.* Until made an opt-in by recent Federal Reserve rules changes, such fees on debit card transactions disproportionately affected young account holders who were apt to use debit cards for retail payments and to keep low balances in their accounts. In a 2008 study, the FDIC found that 46% of checking account holders aged 18-25 had incurred non-sufficient funds activity; by comparison, only 32% of adults aged 26-61 had done the same.³ Banks often did not disclose these fees verbally to accountholders, leading to surprise and mistrust when young people first incurred them. For those who are in entry-level or part-time jobs like Jessie's, such fees can represent a large percentage of earnings.

JUST AS TRADITIONAL BANK ACCOUNTS HAVE EVOLVED DRAMATICALLY, SO HAVE THE EXPERIENCES AND OPTIONS YOUNG PEOPLE BRING TO MANAGING THEIR FIRST WAGES.

- *Young people have more alternative financial services available to them, and more retail channels through which to obtain them.* Jessie and her peers have already had experience with gift cards, travel cards, and prepaid debit cards acquired through AAA, retailers such as Target and Wal-Mart, or their local supermarket. These have given them the experience of using account-based transaction products without necessarily associating them with a bank. At the same time, money services such as check cashing, bill payment, remittances, prepaid cards, and prepaid phones have become readily available at familiar mass merchandizing retailers, where youth may find these delivered with predictable levels of customer service and transparent prices.

- *Both employers and post-secondary schools are providing affiliated debit accounts.* A growing number of employers disburse wages via payroll cards, a familiar debit card variant.⁴ Such cards are often used in the entry-level, part-time jobs in which many young people work. In a similar development, two- and four-year colleges are issuing campus debit cards to disburse student loan proceeds and wages for work-study jobs. Both of these debit accounts provide young employees and students with alternatives to traditional checking accounts.

³ Federal Deposit Insurance Corporation, "Study of Bank Overdraft Programs," November 2008.

■ *Many young people transition from school to work gradually.* Both working and continuing their educations, their jobs are most often part-time and low paying, and neither they nor their parents expect these jobs to cover all of their living or school expenses. Accumulating savings during this period is unlikely, and family divisions of responsibility often involve the student/worker covering some expenses with parents making up the balance.

■ *Young people have simply had less personal exposure to their parents' banks and credit unions than their parents did to their grandparents' institutions.* ATMs, direct deposits, and online banking have taken routine transactions out of the branch for many depositors. This has brought cost savings, some of which banks have passed on to consumers. But sophisticated parents who use these remote banking services may, like Sharon, end up limiting their children's exposure to banks, or at least the experience of visiting a branch.

Overall, the rapid evolution of financial services technology, products, and channels presents young people with more choice in how they can manage their money. Many attributes of traditional bank accounts are now available through non-bank products and channels. At the same time, product complexity, surprising fees, and lack of familiarity with banks are leading more young people to consider non-bank alternatives for managing their first wages. These provider relationships differ markedly in their duration, breadth of offering, and the nature of daily interaction, from those they might have had with traditional retail depository institutions. Given the increasing complexity of the financial services landscape, young people today have a greater need for relationships and resources to guide their financial decisions and improve their financial capability.

⁴ In a study of the prepaid industry, Aite Group LLC found that there were 1.7 million payroll card users in 2009 with \$19 billion being loaded onto the instruments. They project these numbers to increase to 5.4 million card users and \$60 billion in load volume by 2014.

⁵ According to the Federal Reserve's Survey of Consumer Finances, the percent of families with heads of household under 35 that reported indebtedness grew from 80 percent in 1989 to 83.5 percent in 2007, with the average amount of debt doubling from \$51.0 thousand to \$100.7 thousand in 2007 dollars.

Industry Fragmentation: The Impact of "a la carte" Financial Services

At some point in most young people's lives access to affordable credit becomes essential for acquiring assets that will help them build careers and invest in wealth-building assets such as education, automobiles, and eventually, homes. Over the two generations leading up to the late 2000s, young people in the U.S. have taken on progressively more debt earlier in their lives.⁵ But unlike Jessie's mother Sharon, who obtained her mortgage and car loans from the bank where she sends her paycheck, young people find that where they deposit their earnings has little if any impact on their ability to access credit or on its cost.

In the lending categories that matter most to young people—credit cards, auto loans, and student loans—credit-granting is dominated by specialized, national “mono-line” lenders that market their services directly through the mail or online (credit card solicitations) or through third party distribution (auto dealers and educational institutions). For example, the retail branches of banks and credit unions have recently been responsible for originating only 20 percent of auto loans.⁶

For better or for worse, young borrowers' decisions to take on debt are increasingly occurring outside of any institution with which they have another broader financial relationship. This is one of many factors that makes it more challenging to identify all available financing options, or learn how to best use credit products while maintaining self-sufficiency and building wealth.

Until recently, the specialized lenders have succeeded in part because they have been the most aggressive marketers to key youth segments and the most willing or able to take risks on them. Prior to the recent resumption of direct student lending by the federal government, student lenders relied on government guarantees or on the projected earning power of future graduates to underwrite student borrowers. Auto lenders relied on the credit histories of young car-buyers, or the credit histories of their parents, to underwrite first car loans.

⁶ Raj Date and Brian Reed, “Auto Race to the Bottom: Free Markets and Consumer Protection in Auto Finance,” Cambridge Winter Center for Financial Institutions Policy, November 16, 2009.

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Industry Fragmentation: The Impact of
“a la carte” Financial Services

Credit card issuers have until recently provided young people with their principal on-ramps to mainstream credit. Issuers of private label store and gas cards proved adept at issuing entry level, low credit line cards to young people who lacked credit history. This was supported by retailers seeking to attract customers to their stores and gas stations. Likewise, teenagers from households in affluent zip codes or attending four-year colleges could also rely on receiving direct-marketed credit card offers from national issuers in the mail or on campus.

Tighter underwriting by national card issuers may change this practice. So might the Credit CARD Act, which is intended to limit revolving credit offers to youth under 21 who do not have either a source of repayment income or parental co-signers. One short-term outcome of these developments may be that young people's access to credit will be delayed for several years. Another may be that access to mainstream credit will become even more class-based: those who do not have parental co-signers with good credit, live in the right zip codes, or attend a four-year college are likely to find credit harder to come by.

Meanwhile, non-mortgage consumer credit has increasingly been made available outside the context of a broader customer relationship. In the past two decades, national monoline credit providers have gained market share and large retail depository institutions have largely adopted a product-oriented view of their businesses. These providers have relied almost exclusively on the same national credit bureaus and scoring systems to assess creditworthiness. Few seem to have developed products or underwriting criteria that allow them to become on-ramps to mainstream credit for young people who lack credit history. While they might have distinct advantages with their own depositors, who can observe employment earnings they being deposited weekly or use savings balances as security deposits or down payments, the institutions' internal “siloing” appears to reflect the prevailing separation of deposit-taking from credit-granting in the external marketplace.

Savings: A Casualty of Industry Fragmentation?

The diminishing appeal of traditional bank accounts among young people and the more general fragmentation of deposit-taking from credit-granting in the marketplace may also have had a negative impact on the propensity of many consumers, particularly young people, to save.

One factor contributing to this trend is the near-total absence of savings and investment accounts in the product offerings of non-bank money services and from most employer-, retailer-, and college-sponsored prepaid accounts. Such accounts are still the principal mechanism by which young people can begin a habit of savings, and they are central to most public efforts to promote savings among youth. A few leaders in prepaid debit products (such as NetSpend and H&R Block) have attached interest-bearing savings features to their spending accounts. However, it is unclear whether the transaction-oriented retail channels in which these features are offered—check cashing and tax preparation outlets—will be effective in promoting their use.

Another contributing factor may be the prevalence of revolving credit as an on-ramp to mainstream credit. By doing away with the down payments once required to obtain term loans, the discipline of saving for them may also have been lost. Revolving credit's wide availability may have eclipsed wide-spread thrift plans—Christmas Clubs and Vacation Clubs—that banks once sponsored and in which young people once observed their parents' participation.

A final factor, and perhaps most important, is that most saving by older adults is done through the workplace rather than the retail bank branch. Most employer-sponsored savings and retirement programs—like most credit products—are provided through national, specialized firms. While local banks and credit unions can encourage their customers to sign up for direct deposit and to designate a portion of their pay checks toward savings accounts, many workers choose to participate in employer-sponsored 401K plans.⁷

⁷ Based on 2006 Current Population Survey data, approximately half of wage and salary employees working for an employer or union that sponsors a retirement plan participate in the programs (Craig Copeland, “Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2005,” Employee Benefit Research Institute, Issue Brief No. 299, November 2006).

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So while depositories have ceded the role of encouraging savings to employer-sponsored retirement plans, such plans are often not offered with the entry-level—or part-time—jobs in which many young adults start their working lives. When they are offered, participation by younger employees may be limited: young employees are least concerned about retirement and more concerned about saving for more immediate needs such as down payments on car purchases or rental deposits.

The Missing Hub: Fragmentation's Implications for Underbanked Youth

Our inquiry into how young adults start their financial lives began by assuming that financial institutions have the potential to play key roles in fostering financial knowledge and engendering healthy financial behavior — key components to establishing a young person's financial capability. Our understanding of changes in the structure of the financial services industry and in the early experiences young adults have with money suggests traditional depository institutions' role in providing the information and the product set required to support financial capability have been overstated.

If retail depository institutions are no longer the main sources of credit or custodians of savings for consumers, are banks and credit unions essential to young adults' access to and mastery of these means of asset-building? If youth are already obtaining access to the payment system—the means of storing funds securely and the ability to make secure payments in person, online, or through the mail to most businesses and individuals—through various prepaid accounts offered through retailers, schools, and employers, then why are we concerned about their relationships with financial institutions?

While most young people first go to banks in order to get checking accounts, it is easy to envision a growing number of them skipping such relationships for their cash management needs. Reflecting comfort with alternative accounts, nearly half (45%) of the underbanked who are 18–24 and a similar percentage of those who are 25–34 (46%) said they would prefer a prepaid debit card account to a checking account if the costs were comparable.

Is not having such banking relationships stunting young people's savings rates? Without clear comparisons between the respective gross and net (after changes in debt) savings rates of banked and underbanked youth, this is difficult to answer. But, given that most savings takes place through the workplace, it is not clear how banking relationships make a difference.

Will eschewing checking accounts inhibit young peoples' access to credit? Not likely. The credit card and student lenders who serve as the onramps to the credit-and-reporting system for most Americans do not seem to require their cardholders and borrowers to have a checking account. True, only 33% of underbanked young adults have a credit score and only 14% report having used credit cards; this contrasts sharply with the roughly 83% of college students who report having a credit card.⁸ But it seems likely that college graduates' relatively high access to credit mostly reflects monoline issuers' targeting credit offers to the campuses and affluent zip codes where many college students live. Issuers bypass underbanked youth, not because they are underbanked, but because they are less likely to live in affluent neighborhoods or to attend elite colleges.

If having a relationship with a depository institution offers young people relatively few advantages over non-bank debit accounts in managing cash, in obtaining access to credit, or in beginning a habit of savings, why is the notion of being “banked” as an important prerequisite for building financial capability so persistent? Financial literacy curricula taught in high schools and in social services agencies stress the virtues of managing a checking account and balancing a check book, along with lessons in expense budgeting, setting savings goals, and managing the use of credit. Likewise, the FDIC's interactive “Money Smart” programs treat bank branches as centers for managing money, with separate units on how to obtain products through the branch's various personnel: acquire checking accounts from a branch manager, manage deposits and savings with a teller, and apply for car loans or a credit card from a loan officer.

⁸ CFSI, “CFSI Underbanked Consumer Study,” 2008 ; United College Marketing Services, “College Credit Card Statistics,” 2006, <http://www.ucms.com>.

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The financial institutions depicted in these curricula and by the educators and agencies that sponsor them, are arguably backward-looking. They do not reflect the fragmented and specialized financial services industry as it interacts with consumers today. But they may depict something of value that has to a considerable degree been lost: relationships with retail financial institutions through which young consumers can obtain a relatively broad range of financial services, useful information about these products, and advice about which ones in combination can best meet the needs defined by their personal earnings, assets, and financial goals. Intuitively we still want to view the retail bank or credit union as a trusted financial “hub.”

Much research addressing issues of consumer financial capability and access has focused on individual products: how they are priced, where they are made available, and the criteria used by providers to accept or exclude potential users. Recent efforts to understand personal financial decision-making have often focused on consumers’ understanding and “literacy” about specific products’ risks and benefits, or—influenced by behavioral economics—on how choices can be affected by the context and framing (e.g. through disclosures, immediate cues about norms, default options, presentation of alternatives, etc.) pertaining to various financial products.

In fact, institutions themselves create powerful meta-contexts that frame consumers’ understanding of their choices, determine what options and information are made salient to them, and provide cues about what is normal. For young adults who are particularly dependent on providers for information about how financial services work and for behavioral cues about what choices are the norm, fragmentation in the institutional landscape may have had more dramatic impacts on their ability to develop financial capability than changes in any individual product.

A young person who once entered a retail branch to withdraw cash at the teller line could not help but notice the passbook savings and CD rates once posted nearby. These both reminded him to save and suggested that other people did, in fact, build savings in the branch. Likewise, they might learn about basic connections between how one aspect of their institutional relationship might affect another: i.e. that the bank offered credit cards and car loans whose availability rates depended on one’s

demonstrated character and length of relationship with the bank (connection between deposits and credit) or on the size of one’s down payment (connection between savings and credit).

Today’s a la carte financial services environment can fragment the contexts (relationships) in which consumers make decisions about transactions, savings, and credit. One result of this may be a fragmentation of their thinking about their finances overall and, in particular, about the relationships between their cash transactions, savings, and credit. For example, borrowers may not be as easily able to recognize how taking on more debt may also make them less wealthy in the long run or when a bank CD earning 3% can best be used to pay off their revolving debt to a monoline card issuer costing 24%.

Another consequence of fragmentation in the marketplace is that the specialized service providers optimize profitability of products in the short term rather than focusing on customer relationships in the long term. For example, banks and credit unions can be compelled to encourage the incursion of high overdraft fees to extract profits on traditional deposit accounts when the product is viewed on a stand-alone basis. In this respect they no longer differ significantly from prepaid debit accounts which are short-lived and make money on the velocity of and volume of spending, not on the accumulation of savings. Similarly auto lenders and their dealer originators maximize earnings on the size of loans and interest spreads, rather than on affordability or repeat business. Credit card issuers have similarly built their business models to encourage customers to revolve balances and use up their credit lines. This short-term focus can result in a lack of product features and support that emphasize the financial health of the consumer, making it harder for young people to learn how to use financial products to their benefit.

The financial services providers depicted by financial educators and the growing number of local “bank-on” programs, which encourage the unbanked to open accounts with traditional depositories, stand in contrast to this fragmented reality. They are the idealized banks and credit unions of a generation ago: relationship optimizers that have regular and frequent interactions with their customers, that have their customers’ best and long-term interests at heart, and whose customers — particularly young customers in need of guidance when it comes to managing their money — readily consult them on a variety of financial matters and decisions.

In considering what financial product and distribution innovations might best help support both financial access and the development of financial capability among the young people, attention should be paid to the quality of the institutional relationship(s) involved. This doesn't mean trying to turn back the clock or to suggest that only traditional depositories can fill the lost role of personal financial hub. If a retailer, local high school, or employer, could successfully help young people obtain a more unifying picture of the disparate aspects of their finances, they'd be filling a needed role. Outside of reconsidering the role of relationships, an opportunity exists to build tools and resources that help young people develop the financial capability needed to use the variety of financial products in a way that improves their financial health. Regardless of the provider or the context of delivery, financial products can be designed and delivered with features and guidance to help users demonstrate the types of positive financial behaviors that put them on the path for a stable financial future.

Re-envisioning the Hub: Prospects for Research and Innovation

There is really no magic wand that can be waved to restore the anchoring relationships with retail financial institutions that parents imagine they once had and hope that their children can replicate. We can, however, examine the wide range of innovations taking place in consumer financial services products, marketing, and distribution to consider how resources can be designed and relationships can be built to provide young people with the support they need to become financially capable.

To this end, the sorts of questions we might ask of product providers, their distribution partners, and the products themselves might include:

- In the natural course of product delivery does the provider or channel provide sources of information (printed or online content, knowledgeable individuals, partner organizations) that enable the user to make informed decisions about their use of the product?
- Are products designed to encourage positive financial behavior? Are they equipped with mechanisms to help users achieve their financial goals?
- Does the innovation promote a more durable relationship with the provider or channel? Does it create a basis for genuine trust?
- Does the relationship have the potential to be expanded to include other financial products and services that can help improve customers' financial health?
- Does the relationship provide a regular and easily

accessible flow of information about the users' financial situation that can help them make better long term decisions? Does the customer use this information?

Going forward, it will be worth paying special attention to a few key categories of innovation that show promise of replicating the role of an institutional hub in customers' lives and point to the creation of tools and resources effective in helping young people develop positive financial habits.

- *Shift toward a financial capability framework in developing products and support programs.* Whether they are delivered within the context of anchoring relationships or integrated into parts of the fragmented financial services landscape, products and services designed to boost financial capability can provide additional support to help youth develop sound financial habits. These interventions represent an expansion on financial education efforts, which focus on what consumers know, in order to more directly impact what consumers do. By linking access to products with guidance or mechanisms (e.g. automatic savings contributions) that demonstrate how they can be used to the benefit of the user, financial services providers can “nudge” young customers toward better financial decisions. Providing these resources not only serves to help youth establish healthy financial management practices, but also fulfills customer demand for them. A recent survey showed that 37% of consumers aged 18-30 felt the need for help in managing their finances – this percentage was higher than that in all other age groups.⁹
- *Cash management products and services that encourage and reward accumulation of some minimal level of savings.* These encourage relationship longevity and go beyond frequent-user discounts or minimum balance thresholds that result in fee waivers. Savings matches used in IDA accounts fall in this category, as do rewards for participating in automatic savings programs or “beginning saver” interest rates. Not only do these types of features provide young customers with motivation to enter into account relationships, but they also encourage users to develop the habit of saving for unexpected emergencies and future financial goals.

⁹ Philip Farah, James Macaulay, and Jorgen Ericsson, “The Next Growth Opportunity for Banks: How the Post-Crisis Financial Needs of Younger Consumers Will Transform Retail Banking Services,” Cisco Internet Business Solutions Group, February 2010.

continued, Re-envisioning the Hub: Prospects for Research and Innovation

- *Services that link deposits and savings to building and accessing credit may make intuitive sense to young people.* These include credit offers contingent on account longevity, using direct deposit, or achieving savings goals; the last is arguably a feature of secured credit cards and of direct car loans or term loans that require substantial down payments. Use of transaction account data, including patterns of deposits and recurring payment transactions, to build alternative credit scores that would qualify account-holders for credit lines would also result in deeper and more durable provider relationships.
- *School-based and employer-based distribution can piggyback consumer financial services with other relationships of trust.* Bank-at-school and save-at-school programs are slowly being revived after decades of dormancy and promise to link financial education curricula with financial practice and peer environments in which savings is encouraged and rewarded. Likewise, borrowing from the employer-based credit unions that saw their apogee in the concentrated workplaces of America's manufacturing heyday, large service employers can partner with banks or credit unions to provide online and mobile financial services targeting their national dispersed workforces.
- *Focused services and curricula that take advantage of the importance of cars to young peoples' aspirations and economic lives.* Learning to drive represents an important 'teachable moment' that schools, employers, and financial institutions can take advantage of to encourage young people to plan for car ownership. For young people in areas where cars are essential for obtaining jobs, getting to school, or having a social life, such a car-centric program implicitly makes connections between income, transactions, savings, and credit; and it may give institutions a way to recapture auto loan origination share from dealers.
- *Technological tools that promote their user's financial capability have a particularly high appeal with young consumers.* Survey data has shown that 18-30 year old consumers have shown higher adoption of online financial advice tools and are more likely to have posted a question about financial matters to an online forum.¹⁰ Young adults' nearly ubiquitous attachment to their

cellphones presents opportunities to experiment with new ways to inexpensively push, or provide on-demand, a rich and regular stream of information that will help them keep track of their money and financial goals. Facilitating balance inquiries and providing transaction alerts are early developments that young people use and find helpful. Additionally, personal financial management (PFM), such as Mint, for goal setting and tracking that can be accessed on PDAs or smart phones may have a higher likelihood of being used than their PC-based precursors.

Recommendations

Organizations and institutions of all sorts play a role in the lives of young people, creating opportunities to promote the development of their financial capability. Depending on the nature of their relationship, these entities can play a critical role in providing resources and support to help young people establish healthy financial habits. Recommendations for the various types of these stakeholders are provided below.

For Financial Educators, School and Public Officials:

- Partner with banks and other services providers. These providers may come to view your financial education curricula and services as a valuable channel partner. Integrating their products into classroom financial education will make lessons about budgeting, savings, and safety stick. In return you receive sponsorship and get a strong say in how introductory banking, credit, and savings products are explained, priced, and serviced.
- Partner with online personal financial management sites to deliver ongoing financial guidance and relevant products in ways that integrate with your financial education curricula.
- Leverage school and summer employment programs as opportunities to introduce young workers to their first accounts and direct deposit—along with a classroom financial “boot camp” component.

¹⁰ Farah et. al.

- Look for ways to tie payment accounts, savings, and credit products together. For example, promote payment-linked savings and closed-end loans that require (and reward) savings for down payments.
- Shamelessly exploit young people's fascination with cars and driving. Integrate lessons on credit and insurance into drivers' education. Direct students who aspire to car ownership to savings accounts for future car purchases and loan down payments.

For Depository Institutions and Diversified Financial Services Providers:

- Reach out to schools and employers to invite students and young employees into branches—or bring branch products to school lobbies or workplaces. Integrate products into financial education curricula and become sponsors of financial education courses. Offer simple accounts with debit card access that young people can easily sign up for at school or work and where they can easily deposit their first paychecks.
- Through your online banking and mobile banking interfaces, partner with trusted third party providers of information to provide Q&A content, access to impartial advice, and even competing product referrals. This is a risk, but young people will come to trust you and your brand the most.
- Offer and promote automatic savings, payment-linked savings, and closed-end loans as means of building credit by requiring savings for a down payment. Such products create conceptual links between the different parts of the consumer balance sheet; they will also help you regain share of wallet you may have lost to “mono-line” providers in recent years.
- Recognize the aspirations and anxieties of your customers who are parents of young adults: invite them to bring their teens into the branch, offer starter products that encourage kids and parents to talk about money—and plan the kids' financial future—together.

For Community Organizations and NGOs:

- Partner with banks to deliver age-appropriate starter products to young people receiving your financial education curricula.

- Integrate financial products such as starter accounts with direct deposit into youth employment programs.
- Partner with local bank branches—and retailers offering banking products—to provide referrals of young customers to your financial training services.

For Mono-line Credit Providers:

- Provide product disclosures and monthly statements that include information on how use of the product is likely to affect other parts of users' financial life as a means of helping young people better understand how to responsibly use credit.
- Partner with depository institutions to enable borrowers to build savings automatically by including an extra fixed amount with each monthly payment; give borrowers a choice to use the extra payment amounts to repay loans faster once they have reached a pre-determined savings goal (e.g. the down payment on the next car).

Young people today face an unprecedented degree of complexity in their interactions with the financial services industry. The wider array of options and the diminished relevance of the traditional depository as an anchoring institution create a landscape in which the path to financial security is challenging to pursue. Finding ways to resurrect meaningful institutional relationships – or replicate the benefits they provided within an a la carte model – and providing the resources needed to develop financial capability is critical to protecting the financial future of the youth. ■