Federal Reserve Forum on Consumer Research & Testing: Tools for Evidence-based Policymaking in Financial Services
Panel Three: Exploring key consumer issues

Jennifer Tescher:
Good afternoon. I'm Jennifer Tescher. I'm the founder and director of the Center for Financial Services Innovation and I have a confession to make. I have no slides. I may be the only one this entire day. So remember what John was saying earlier about attention, you know, pay attention to me. This is my attempt to gain your attention. I may have to start doing a tap dance. It is after lunch after all. Thank you to Jeanne Hogarth for inviting me and for putting on just such a fabulous event. It's such a pleasure to come to an event where there's such an interesting cross sector dialogue. There are very few times where you get to have this kind of dialogue and also to talk about something that really matters, to talk about--it's also so refreshing to be sort of beyond the what and be talking about the how and the whys that relates to consumers. So I'm really pleased to be here.

On top of not having slides, Mike has pretty much said everything I was gonna say so I got nothing, but I'm gonna wing it here and I'll find something to say. Let me tell you. I think what my primary point is of my remarks. I'm gonna move us to the second bullet point on the agenda under panel 3, which is what the financial services marketplace might look like in the years ahead and what advanced work we should be doing. So I'm a little bit the bridge between the two previous speakers and now myself and Rene and I think the short story is the world had already changed a lot before the big, the great recession and now since then, the financial services marketplace has changed even further dramatically and will continue to change even more in the next 5 to 10 years. And it's not just about banks anymore. We all know that, but I think that's happening in a far more rapid fashion than you might realize. And the point is that rather than make a series of values based judgments about whether that's a good or a bad thing, we need to understand how consumers think about it. We need to understand how consumers are making the choices about from whom to purchase services, which services to buy, and whether those products and services are actually of benefit for them both in the short and the long term. That's gonna help us ultimately figure out what the right policies are, what consumers need to be protected from versus what kinds of activities really need to be encouraged because it actually works better for consumers. So I'm gonna try to paint a little bit of a picture of the landscape. I'm gonna go way high up and try to paint picture of the broader context in which we're operating and then I'm gonna talk a little bit about what the financial services landscape looks like these days and what it will likely continue to look like over the next 5 to 10 years. I'll talk a little bit about what that means for the average consumer and then give three examples of how this plays out specifically from a policy and regulatory perspective.

So the Center for Financial Services Innovation is really focused on financially underserved consumers. We're about trying to transform the financial services marketplace to improve the experience for these consumers, so that they have better options both in the short term and in the long term. And I think the most refreshing thing about this conference is that we've all kind of accepted the fact that we're human. I think someone said earlier, like we're not even really talking about irrationality which really bugs me, just the word. We've accepted that this is just who we are because we're human beings and that is absolutely true for the underserved. They are no more or less rational than you or I. The only difference is that the consequences of their bad decisions are just more severe because they have less of a cushion. And so we need to understand what their wants and needs are, you know, so that we get it right for them, but I think it's important just to state that they're, you know, no more or less knowledgeable or rational than you or I.

We're talking about a huge number of people here depending on whether it's the FDIC survey, our own survey. We're talking about 30 to 40 million households. That's a big number and I can--I'm fairly certain that I don't have any quantitative evidence that that number has grown significantly in the last 12 to 18 months because of the condition of the economy and because of the transformation going on in the financial services industry. And when we're talking about underserved consumers, we're really talking about two groups: consumers who don't have some kind of basic transaction account or who have one, but for whom it's not meeting of their day-to-day financial needs and they're using a much broader array of products and services to get by. One of the things that I'm gonna talk about a little bit later is the fact that with the rapid pace of change in the financial services marketplace, even these definitions and these words about banked, underbanked are starting to lose their meaning a little bit because of the broad array of choices in the marketplace.

So there are growing numbers of consumers who are, in some way, disaffected or disconnected either by choice or by invitation. And this current climate of increasing consumer protection in the financial services world. There are lots of really great things about that, but there are some unintended consequences in that it is likely that the traditional banking system as we know it will be less inclusive in the next, you know, 5 to 10 years until banks get creative enough to reinvent their business model, which may be asking a lot. The good news is that there's tremendous innovation in the financial services marketplace well beyond what the banks are up to and might just give them a run for their money, and prompt the banks, I think, to do things they might not have been willing to do otherwise.

So for the last year, we have been engaged in an exercise funded by the Mott Foundation to look at the future of financial services 7 to 10 years from now and you might imagine this is quite a difficult activity to be engaged in this moment where, you know, no one knows what's gonna happen in the end of next week or next quarter, let alone 7 to 10 years from now. But in some ways, all the more reason to step back and try to take stock, and try to see where the world is going. The Mott Foundation asked us to do this because they wanted to give some perspective to the broader asset-building community so that they could be more planful in charting their course about how to best serve consumers. We think this information also has value for financial services practitioners, for academics, for everybody. So I'm gonna just talk about a couple of additional key trends beyond the ones that are either obvious to you or have already been talked about.

So we're gonna see tremendous demographic changes. You've heard about both ends of the barbell from our two previous speakers, older Americans and emerging adults, I like that. I should just mention because it really hasn't come up today at all and we would be remise not to mention this but high levels of immigration are gonna continue to drive population growth and that Latinos will account for 25 percent of the US population by the year 2035, that they're gonna account for half of the projective growth in the immigrant population. So, just as we're thinking about different segments of consumers who behave differently, we really need to add a layer of race and ethnicity on top of and sort of country origin on to the analysis.

There's a series of interesting cultural paradigms that I think often get overlooked and we're thinking about macro trends, but I wanted to mention them here. One is this post 2008 increase in the personal savings rate. I think the jury is still out about whether that's a long term phenomenon or not. In fact, over the course of the last year when we've been in audiences like this, we'll often ask the room to vote and will say, "Do you think that consumers are gonna return to their high-spending ways or that, you know, gonna continue to save? And, you know, people will kind of stand up and sit down, and I won't make you do that today, but people are very divided on this question consistently over the last year. I think that the trend so far holds some promise, but I think it's too early to say. But given the current interest, the current increased interest in saving, I think there's a dare there for all of us to play with as we're really thinking about motivation and decision making.

Increasing home ownership rates may or may not--may no longer be a primary policy goal. Even if there are primary policy goal, it may be less attainable. What's gonna replace that? How is the next generation going to get ahead or achieve financial prosperity? What does that look like? And then another important cultural paradigm is around the expectation of technology and its ability to facilitate sort of that always on immediately available information, right. I've been amazed at how few people have been checking there, you know, “CrackBerries” today, but the notion that we should be able to get immediate information or what we want, when we want it, the second we want it, that has real, I think, potentially positive implications for disclosure and for how we're communicating with consumers real time, but it does raise significant--it raises the bar for providers and the services they're offering.

Oh, I wanna spend a minute talking about technology trends. I wanna give you some percentages here. We're in the camp that believes that technology use is pervasive and there are absolutely still pockets of America, particularly in very low income communities where there is a significant disparity, but that disparity will go away. It is already going away. It will go away and the conversation about whether disclosure should be in paper or electronic, it's gonna happen. We just have to get there, you know. It's not even a choice anymore. It's happening faster than we can imagine. 2008 Pew survey: 56 percent of those with incomes under 30,000 at least occasionally use internet or e-mail. That was up from 30 percent in the year 2000. It's a very dramatic increase in just an 8-year period. Mobile phone usage, 68 percent of the underbanked, 44 percent of the unbanked own a mobile phone, 52 percent of consumers projected to own smart phones by 2014. These are pretty dramatic, dramatic figures. The other dramatic figures are around payments and I promise, Rene, I won't steal your remarks, but electronic payments have had tremendous growth and will continue to grow over cash and checks in the coming decade. Here is an interesting statistic, a 2010 survey showed that 36 million households used online bill payment up from just 4.7 million in the year 2000. That's a huge growth in the course of a decade and I think we'll see similar growth in the decade to come. You've heard a bit about prepaid from Mike, that's a topic we spent a lot of time talking about. I'm gonna return to it in a minute, but the growth in prepaid has also been staggering. Mercator projects 292 billion dollars will be loaded on general spend open loop prepaid cards in the year 2012, up 383 percent from 2008, so also dramatic growth.

So now let’s talk a little bit about what the broader financial services marketplace looks like. The short answer is banks and credit unions, already relatively conservative institutions are going to be even more conservative in the coming decade as they continue to sort out their loan portfolios which aren't looking so good. There's still significant credit constriction in this country. They're scared and for good reason. And I think that all of the regulatory changes that have come and that are still to come are causing banks to have to completely rethink their business models and, at the very least, rethink the suite of products and services they're gonna offer in their bank lobbies and how they're going to price those products, that's going on right now, today. And we will feel that over the next 5 to 10 years. Banking is gonna get more expensive for many people. For those of us who still have enough money to have minimum balances, it may be cheaper or the same, but for many people, it will become more expensive and then for others, it will--some services just will not be available anymore. The folks will be invited out or they will no longer qualify.

However, there is a tremendous amount of disruptors in the marketplace, all kinds of providers. And so let's not generalize. Let's try to unpack a little bit about what these other providers look like. So first, there are what I will call the “unsavories”. That's not my opinion, that's, I think, general public opinion. These are providers that existed, you know, over the last 10 years. Check cashiers, payday lenders, and the like, they come in many flavors, but they have been around for awhile and they're still here. Then there are retailers, retailers like Walmart, but they are just the tip of the iceberg. There are many, many, many other retailers who see themselves as now being in the financial services business. They're often partnering with other banks or other providers who are manufacturing the products and they're in the business of distributing those products. They really turn banking on its head because for them, if they can sell another Twinkie or, you know, they can get people to come and make repeat visits to their store for shopping, it may be okay if that financial product or service just breaks even or doesn't make a lot of money. There's another reason for them to wanna encourage people to do financial transactions in their store.  That actually can be a good thing for the consumer, particularly, if they're passing on some of that savings to the consumer.  Some of what's out there in terms of what retailers are offering, they are dramatically undercutting many traditional check cashiers out there particularly being able to cash people's checks and provide other services.  So this potentially could be a real win for the consumer.

There are a variety of technology players.  I think Silicon Valley, now that they've kinda done the internet is looking at financial services and saying, oh, that doesn't look so hard, we can do that.  I think they are sometimes dramatically underestimating but, nonetheless, you get people like Jack Dorsey, the founder of Twitter who about a year ago came out with what he calls Square, this little piece of plastic you plug in your iPhone that allows anyone to all of a sudden become an acceptor of credit card payments.  So you know, I own a traveling, you know, taco stand or I have a home-based business, or you know, any you can imagine, any number of those things, and now, all of sudden, I can accept credit and debit card payments.  He's had some challenges, I would say, particularly around security issues and some regulatory issues, but that's just one of many, many, many examples of folks who aren't necessarily aiming at the consumers that I'm most interested in, but their inventions, their ideas have a lot of resonance for the consumers that I'm most interested in and could be applied in a very interesting way to the consumer market that I'm most interested in.

There's also a whole host of other startups, right?  Two companies that didn't exist 10 years ago just went public this year selling prepaid cards, Green Dot and NetSpend.  Green Dot is actually trying to now buy a bank.  These are, again, companies that just didn't even exist and the category didn't exist more than 10 years ago and now, brand new companies and I could go on and on, and on.

As a result of this change, products are getting, in some ways, more complex and who owns the customer relationship is also getting more complex.  This could be both a good thing and a bad thing for the customer.  I think it's harder to understand and unwind the chain and of the three or four people, or companies that touch your prepaid card kind of where does the buck stop and where might you go if there's a problem, and is the consumer protection being applied at the right place in the chain, just as an example.  But I also think that for the average consumer, they don't really care.  What they really care about is getting their needs met.  So we wanna be careful that folks have enough information to shop and understand what they're buying and understand what they're using, understand what to do if there's a problem but also, not overburden the transaction so much that people are unable to make decisions.

So let's talk a little bit more about what this means for the consumer.  I've kind of already started down that path.  So the first is what does it mean to be banked in this world?  You know.  What if your bank is Walmart or some other place?  You view that as your core financial institution. Mike got at this a little bit.  You know, 20, 30 years ago, you went to the bank and that was the place you went.  You went and you got your checking account there, your savings account.

When you wanted advice about whether to buy a car loan or to get a mortgage, you know, you sat down at the banker and they gave you advice, and they sort of helped to stage it out and that was your person, you know. We don't really have those kinds of hubs anymore or said differently, there are lots of different options for who that anchoring institution might be in your life, that anchoring institution from a financial perspective. And so sort of here's a bundle of hypotheses that all need testing. How important is having an anchoring institution or having a hub? How important is that role? You could say a la carte is great. Choice is great. Consumers can patch it together themselves or you could say, no, it's really hard to patch together to ultimately end up on a pathway that's sort of aims upwards towards financial prosperity. You really need someone to help you tie all the pieces together. There's another argument that says without a hub, there is less practice or help in making long-term decisions versus short-term decision. You don't have anyone guiding you. I think there's a really important set of questions to answer here because I don't think we know enough about this to have a policy opinion about this and we should ultimately need to have a policy opinion about this, but there are lots of possibilities for who could be the anchor.I just think we need to figure out how important that anchoring role is.

I talked a lot about function over form, right? I think consumers increasingly--it's not about where you got it or what the product is. It's what it does for you. The framework, as we think about policy regulation, needs to be around functions, around transactions, saving, borrowing, planning, not so much around my checking account, my credit card. And often, all of these functions are being blended together in new and interesting ways. So if your interest is saving and you recognize that the economics of small savings is very difficult to do particularly in the context of a bank account, of a traditional checking or savings account, you get excited about the interactions and how you can load and bundle savings onto these other things, but it also creates some challenges.

And then this final point about the real time, just in time, you know, I want it anytime. I want it all the time. There's lots of great stuff we can do around alerts that you're already seeing around disclosures. I mean, imagine if the technology existed today so that when you were gonna overdraft, it told you and you could just choose yes or no each and every time as opposed to having to opt in or out of the entire service, you could opt in or out at the transaction level. I have some people who tell me "oh, too hard." Other people tell me "no, no, technology exists to do that." I eventually think that industry will figure that one out, but we increasingly have opportunities like that to communicate with consumers real time in a way that can be really, I think, helpful to them.

And then the last point is around complexity. We've heard this a number of times today. This is a very complex world and I don't know about you but like when my computer breaks or my car breaks down, or you know, I don't take out the dummies guide. I take it to someone who can fix it or who can give me some advice about that and we're increasingly gonna need to figure out what that model looks like in this space. I don't think we have figured that out yet. There’s a lot of interesting things going on on the internet that are providing interesting kinds of advice in a self-service fashion that I think hold a lot of promise.  These are the Mints and the Thrives and all the range of personal financial management tools out there.  I think one of the challenges with some of those tools is that many of these advice-giving engines also are referral engines for products and services.  And on the one hand, if you think about the financial capability framework that Margaret and others talked about today, we need to link information and experience because people aren't gonna sit in the class to go learn about how to shop and then five years later, necessarily apply the lesson.  We need to be coupling those things together if we wanna be responsive to how adults learn, but at the same time, it raises the problem that the previous speaker mentioned when she put up the triangle, right.  Our customer is clear about whether the internet provider is actually acting in their best interest or not.  How are those referrals or product suggestions being given and how is the company being compensated?  And I think we really need to understand what consumers expect and what they think.  I think there's a really interesting research project there to really understand the expectation that consumers bring to that encounter because until we understand that, we won't really know whether this is a disclosure issue or a fiduciary issue, or some other kind of issue and, again, what our policy perspectives should be on it.

I think similarly to Adair's research earlier, we really need to understand how consumers make decisions around small dollar credit and there are a growing number of innovators in the marketplace.  And I think her research demonstrates what we've been saying for quite some time, which is that APR is not a terribly useful standard.  But what is the right standard to allow consumers to effectively shop across, not just across kinds of small dollar loan products but across different kinds of providers.  It's a very tall order for regulators and policy makers, but one that I think we need to address.

And likewise, I think on prepaid cards, are they a good substitute for a checking account?  Do they function like a substitute?  Again, this is a question for consumers.  What do consumers think when they're choosing that product?  We've done some ethnographic research that would suggest that for many--that they are choosing it as a substitute for a whole host of reasons, but we need to better understand that as we start to make decisions about how we're gonna regulate prepaid and that's a real--that's a very immediate term issue.  We're working with the Philly Fed Card Payment Center with a very large data set of transactional data from prepaid cards to try to get a handle on the different kinds of segments of prepaid card users.  It would be really nice to find ways to couple that with actual consumer interactions, qualitative research to talk to consumers to really understand what their intentions are.

So the last thing I'll say that in addition to some other discrete research questions that I just raised, we have a desperate need for some kind of longitudinal data set or some kind of dedicated panel to really understand impact over time, change over time, and no one is in a better position to do that than the federal government.  So I challenge some of the federal government folks in the room to think about that one.  Thanks very much.