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

Michael Staten:
What I'm gonna do here, what I decided to do based on our organizing call, is just pull together a bunch of observations and sort of bring together and to help us think a little bit about what--how consumers are changing, how different segments are changing, and how regulation or product design or financial education audit change along with it or at least anticipate how we ought to change a long with it given what we know is happening in the market place. So I'm gonna shamelessly borrow from the material that I've drawn or found from all sorts of sources including many people in this room including some people in our own panel, alright. And just try and walk you through and use this as sort of a think piece so that we can set the table, set the landscape, if you will, going forward. And I'm actually gonna try and steal two topics. I was asked to talk a little bit about youth and emerging adults as we call them as the next generation of financial services customers. It's sufficiently challenging. We heard this morning for us who are young to sort of visualize ourselves 30 and 40 years down the path and what retirement needs would be. But I would suggest that it's also challenging for those of us in the room who've reached a certain age to look back and imagine what the world looks like through the eyes of 20-year-old. And it's a lot different than it did it looked when we were 20, I can tell you that. And so I wanna talk a little bit about that. So the point is how do youth today just entering the market place view the world, view their choices, what kind of financial services do they wanna use, how can we prepare them to handle the next--the increased complexity of the market place. But then I'm gonna steal a second topic too assuming I have time at the end and I wanna talk a little bit about households and financial distress 'cause that really hasn't been dealt with much today and I think that's my one chance on this panel to get some material in on that. There are a whole lot of offers of help out there for financials, for households in financial distress. A number of them have bad consequences. And there's a great deal of consumer confusion in the marketplace as to exactly what's available, who's doing what, what are the implications for me as somebody who's either facing a mortgage I can't pay or overloaded with credit card debt or whatever it happens to be. There's demand for some sort of debt relief, suite of debt relief products and their supply, but some of the supply is better than others. And I think this is one area where public policy can probably play a huge role but it needs to be driven by research because we simply don't know much about what's happening to folks as they go through those options. So we'll turn to that--you get kind of two for here in--in this little segment.

Alright, I'm--in the interest of shamelessly borrowing, okay, I'm gonna start with some material that I saw presented first at a conference that we organized. We had a speaker come in from CFSI to talk a little bit about their emerging first encounters project with youth and financial services. What they were seeing in the marketplace. The whole point of that project was to sort of look at the circumstances that lead young people to establish relationships or not with financial institutions. If relationships don't form what's preventing it, what's the obstacle there? If they start and then they stop, what 'caused them to fail and how can--what can we do to sort of increase the odds of success?

Alright, so for today's consumers under the age of 25, the landscape looks much different than it did when we came through that particular milestone. The financial services industry is much more fragmented. There's a far more complex array of financial products and distribution channels out there than when we were young. The bank is not necessarily top of mind in the minds of young people when young adults think of financial services. There're a lot of non-bank providers and channels. We'll talk just a little bit about that. Young people have less exposure to traditional financial institution branches because their parents don't use 'em as much. We've all drifted away from visits to the branch. You know, we're doing online banking now. And so there's a little bit more of a disconnect there than there was 20 or 30 years ago. And certainly young people are more comfortable with technology and generable--in general and so much more comfortable with alternative delivery channels that technology has made possible for financial services. Both in an absolute sense just overall in terms of their use and certainly relative to their parents. So it's a different--it's a different kind of market.

There're few examples here and I don't wanna touch too much on Rene's turf here that he'll talk about in terms of comfort with payment mechanisms, but we know now that they have reloadable general purpose cards. The stored value cards come in all sorts of shapes and variety and sizes and flavors. It's very common place for university students around the country to carry one of these kinds of cards in their pocket. This happens to be our University of Arizona Cat Card for the Arizona Wildcats. For me all it does really is I swipe it, I can get into the building. I can use it for security reasons and other sorts of identification reasons. But you can also--there's a whole slew of bugs logos on the back from financial institutions. So this is a stored value card. You can actually, if you want to, you can have this program to be your debit card with Wells Fargo. But you can just load value on it as well. It's got the mag-stripe on the back. And so, young people are very comfortable, certainly at the college level, just using this kind of a payment device, the stored value payment device. The only time I ever typically use that is with a Starbucks gift card or something like that. That's about as far down that path as I'm willing to go. So it makes me nervous to have a lot of money on a little plastic card. I don't know why. I'm just kind of an old dog that way. But that's not the case for my son and for many of our kids out there and they're very comfortable using that. That's another disconnect with a traditional financial institution because this thing and the stored value feature of it is just issued by the university of Arizona. You don't have to have a Wells Fargo account to load value on this. You can, you can do some other things with it but you certainly don't need to.

Payroll cards, again, 18 to 24-year-old CFSI found were twice as likely to use those as anybody else. So just a willingness to use different technologies for payments. A greater acceptance of non-checking payment alternatives is really what we're saying here. Some percentages here prefer prepaid if you're asked. If the cost were the same which account type would you prefer to use. A preference for the prepaid debit card to the checking account, you know, twice as likely for 18 to 24-year-olds as for 35 and over. So that's a change in landscape.

Credit card sort of the bastion. We all worried--you know some of us worried for a decade or more about college students and credit card usage. Well I'll tell you what, much to my surprise having followed this for a long time, just in the last 6 years the trend is going away from college students picking up credit cards in their own name. Now it's the case in the survey and this survey was just before the CARD Act was fully implemented in spring of this year. It's a survey that student monitor does every year. And so maybe a third of students in 4-year undergraduate institutions had credit cards in their own name as of 2010 and that was down from about half in 2004. And so something is replacing this. I mean it's not so they're not buying things, it's not so they're not using plastic to use in debit cards and they're using this prepaid cards that I just spoke about. So it's starting to--the credit card usage in terms of that cohort up to at least age 21 or 22 that this chart reflects here, credit card usage is starting to decline. We've seen the high water mark I think.

Alright, retailers are in the financial services game big time. I mean, you know, 20 years ago that was the case 'cause they were starting to come out with cobranded credit cards et cetera, et cetera and Sears and all the rest of them. Now they're simply--you're skipping the credit card and going right to these prepayment cards, the stored value cards. And young people are comfortable using those outlets for their financial transactions. Question, which location do you prefer most for making financial transactions? For the 18 to 24-year-old group twice as many responded supermarket, a club, or super store to bank or credit union branch. Now that's a sea change in terms of where you feel best about doing financial transactions. I don't know whether it's bank phobia or simply bank irrelevance. You don't need the bank if Wal-Mart can do all of this for you and if you're patronizing Wal-Mart. And that's I think what it comes down to. Could be a little bit of bank phobia because it's also the case that the automatic overdraft protection or the--you know, the NSF type fees disproportionally affects young users and it could leave a bad impression of deposit accounts in general. You know, so why bother. Just scan across the percentages there are much higher incidence of these fees on 18 to 25-year-olds including you know 70 percent of NSFs that are sort of debit-driven ATM type transactions. So they're getting pinched when they overdraft and they're using the depository institution product and that maybe part of the back pedaling from I'm just not gonna--I'm not gonna go that route. I'm not gonna incur those fees, right?

Bottom-line on all this, young people seemed to expect less and maybe get less from retail financial institutions, sort of the traditional depository institutions. They have a far more--far broader range of products and channels to pick from and they can pick them a la carte. It's not unusual for them to have and they expect to have multiple relationships for payments, for cash management, credit savings, and not necessarily with banks for any of that. Relationships that they do have become more transient and they're technology-driven and it depends on where they go to school, you know, like Cat Card kinda thing, where they work, where they shop, what kind of phone they use and what kind of apps that are on the phone. That's what's driving a lot of those relationships these days.

Alright, all of that, I think, poses a challenge for--well, a number of challenges. Financial institutions as they seek sources of new customers, you know, young people are typically the pipeline of new customers. Now, they're not grabbing into that pipeline, dipping into that pipeline as well or as effectively as they did in the past, certainly not as--surely as they did in the past. Challenge for regulators. You know, the folks in this building and other buildings in Washington who are trying to figure out what to do with this broader choice set that young consumers face, wider range of services and outlets, and disclosure opportunities and disclosure environments. Somebody mentioned earlier, you know, how do you do a proper disclosure on an iPhone, you know, that sort of thing. It's a whole different world out there. It's a challenge for financial education efforts as well that are intended to build financial capabilities. Are the products and the delivery channels that we see out there changing so rapidly that last decades financial education materials are simply perceived as irrelevant because they don't touch on all that stuff? That's a problem for those of us who have a fairly significant investment in developing those financial education materials.

I borrowed this cartoon from Carolina Reed. I don't know where she got it. At the Federal Reserve Bank of San Francisco about two weeks ago, several of us in the room were in a conference out there that we convened about a couple dozen people just to talk about evaluation and financial education and devoted a whole day and a half to this. And--But I think this kind of captures the problem for financial educators these days for all educators frankly. It's a whole new world out there for classroom-based education. And with the opportunity to pull down information on from the internet to have these applications on your phones and other technology that folks are walking around with, social networking, it suggests that it's very easy for presenters or educators to be perceived as completely irrelevant and completely out of touch and consequently ignored. And we have to combat that. We got to figure out ways to relate, right? Prevalence of social media and teens lives. Chart here, this is from the Pew internet study, percent of teens who own a cell phone by income group. Even the lowest income groups, 60 percent of teens. So it's just expected now that teens have cell phones. Percent of online teens on social networking sites upwards of 80 percent for those who have reached high school. I mean, this is the way they're talking to each other. This is the way they relate to each other. This is probably the way we need to be relating to them, with financial education messages, with financial products messages as well. And I suspect that the financial institutions aren't too far behind this or they're figuring out how to catch up.

We talked a little bit--a couple of people earlier this morning, Margaret and others talked about financial education emphasis shifting to creating financial capabilities. This is just a little chart here that sort of lists five or six different capabilities, you know, covering--being able to cover monthly expenses with income tracking your spending, you know, gaining exercises and financial knowledge and that some percentages of folks who don't do it in the adult population have been drawn from several different surveys lately. I think the point of financial education is--or should probably be to be--not so much to be transferring knowledge or creating knowledge but to create the decision making ability among young people that allows them to confront that complex array of financial products, ever expanding array of financial products. And I suspect that maybe we aren't as effective as we could be currently with the current financial education programs that we have. You know, we may not be teaching the right thing, you know, sort of that issue between specific content versus just focus on skill development and decision making and practice in decision making. Abstract versus experiential learning. You know, it seems that maybe the jury is gonna come down on the side of experiential learning to keep the lessons relevant and again, to give them practice at decision making and really just training young people to think through options and evaluate the options. That's probably the highest priority rather than just, you know, setting the new credit regulations in front of them and say, "This is--You know, this is the way it is," and then marching through, you know, some other sort of transfer of information type approaches.

There's the issue of financial literacy versus economic literacy. Not enough of both. Again, if we're gonna be--if we're thinking in terms of training people to think, probably we shouldn't emphasize just financial education, there's got to be a fair dose of economic indoctrination I guess into the economic way of thinking to help them evaluate the options that they face.

Teacher confidence of skills. In this particular area has been documented to be lacking and they recognize it themselves and they say so themselves. It's affected by their own personal experience, but that of course affects the product that students get as a result. So that's a challenge.

And I think we need to figure out how to capitalize on out of school learning or teaching opportunities, too. So web-based applications, phone apps, social media, all of those things that students or young people are going to be doing anyway, maybe it's important to try and get the financial education messages into those channels rather than just through the classroom.

Learning theory actually provides a lot of support for more interactive, more experiential type learning. We had at that conference a couple of weeks ago, a professor from the school of education at Berkeley come over and talked to us about sort of a survey of the latest thinking and the education community about the most effective way to, you know, engage in production of more capable, I guess, students. And all of these things sort of fall on there and it suggest really much more--a much more challenging type of financial education curriculum than perhaps we are accustomed to assembling and putting out there in a sort of a passive setting for teachers to present to students and students to just sort of absorb. Much more hands-on interactive, constructivist theory if you're familiar with theories and education type of program.

Alright, so, you know, a couple of ideas for research agenda on youth financial education. We know it's a joint product of teacher's curriculum and student engagement. We ought to be comparing different approaches across widely adapted curriculum. If we can do it in randomized control experiments, that would be great. I don't think we'll ever hit the gold standard in this particular area. But a lot of the things that Adair said earlier, almost of none of the things that Adair said earlier have been applied to evaluation and financial education. And even though application to some of those things would help us move beyond where we are right now in terms of figuring out what the heck works. I think we need some demonstration projects that look at the effectiveness of peer-to-peer learning, which seems to becoming much more important with this crowd of young consumers that are coming up, especially through online social media networking and devise programs for youth financial education that also help to engage parents. This is sort of starting that family dialogue perhaps more than we've been doing currently.

Alright, issue number 2. I still have a couple minutes left. Household’s in financial distress. This slide I have to acknowledge came from my coauthors, colleagues at the Federal Reserve Bank of Philadelphia Bob Hutn and Steph Wilshusen, who is out there somewhere, there she is. We've been working on a number of projects and issues related to credit counseling and just generally debt relief options facing consumers over the last couple of years. And just to give a sense of the magnitude, I mean everybody is kind of familiar that in recent years bankruptcies have been sort of trending toward one, one and a half million or so and will probably eclipse that this year by the time this lousy year is out. But the volume of people that are truly financially distressed is much larger than what shows up in the bankruptcy numbers and so this number is sort of--this chart really is reflecting a body count, if you will, drawn from TransUnion's Trend Data product and so it's showing the number of consumers who have credit reports in these various categories. The top line is showing a 120 days late on any trade so that's 4 months or more late on any trade, and as of somewhere in late '09, early '10, that's at like 9 million, alright. And then these are not completely additive here, there is some overlap embedded in here but there is some additive that you can interpret from this because not everybody that declares bankruptcy has actually reached 120 days late. So you add all these up and it's consistent with what the counseling industry says is possibly 10 to 12 or 13 million people a year seeking some sort of assistance with--you know whether it's counseling or from some other source with their debt problems. And that's a big chunk of the market and what they face is a wide array of folks offering help from debt consolidation offers to creditor sponsored internal workout programs, the nonprofit credit counseling route which could result in a debt management plan for those who are qualified. You got debt settlement companies out there who are out pedaling the opportunity to settle for cents on the dollar. You've always got bankruptcy either chapter 7 or 13. So, this whole array of options facing consumers, consumers for the most part don't even know what the full set of options is, let alone distinguishing one kind of firm from another one. I would argue that only credit counseling in that list really provides much educational rehab value for consumers to prevent similar problems in the future and so that's a factor to consider when one thinks about what's the best alternative for consumers. And the market for debt relief is still shaking out. Regulatory policy is gonna play a key role in all of this.

Quick chart that just talks about counseling versus debt settlement. I think many of you in the room are already familiar with some of the problems with debt settlement. The one thing I'll point out in this chart is there aren't too many yeses in the items that talk about things that would prevent problems in the future or getting people to figure out or diagnose how they got into the situation to begin with to be able to begin to figure out how to avoid it in the future. The disadvantages of settlement products, you know, aside from no analysis of underlying problems, you've got consumers encouraged to stop paying creditors, that creates all sorts of adverse collection activity, negative impact on credit reports, settlements not cheap and it's typically paid upfront and so that's a problem especially when there's no guarantee of success and there's huge scam potential. Not all the settlement companies are necessarily scamming consumers but many of them are and have been.

But there's also a large gap in the ability of counseling agencies to serve the consumers who are financially distressed and they've got a product and it's a very standardized product that sets you up, creditors will cooperate and mutually forbear collection activity if the consumer can pay off 100 percent of that unsecured debt in up to 60 months. If you can't do that, if you got too much debt or too little income to be able to do that, counseling agencies can't really broker a product for you or a solution for you. That's when you're lured by the debt settlement guys who are offering to settle for cents on the dollar.

The other thing is even the folks who do qualify for counseling repayment plans are still lured by the TV ads or the settlement guys who say, you know, you can settle your 10,000 dollar debt for 4,000 bucks. That sounds like a good deal. They don't typically talk about the cost of doing that. This was a study, some statistics from a study put out by NFCC about a year and a half ago and this red part here indicates those who were declined for a DMP for insufficient income. That's 30 percent of all the visits that they had each year. Only 26 percent of the visits resulted in DMPs. So 30 percent were actually declined because they didn't have a product for them and that's a huge gap in the market.

Lastly, and I'll just wrap, consumers don't really know the difference between the debt resolution options out there. This is a little chart that NFCC generated after doing a survey of a thousand consumers out there and the red little circles there reflect people answering incorrectly about what they thought counseling agencies versus debt settlement companies could do on a whole host of margins. There's an awful lot of red up there and the reds, the numbers in the red or the percentages in there, the 40's and the 50's and the 60 percent, people have no idea what the difference is between these two kinds of organizations and I challenge you as my last slide. When you look at this list of 9 companies up here, I'm gonna tell you 5 of them are 501(c)(3) not-for-profit credit counseling companies, 4 of them are debt settlement companies but I'll bet you, you can't pick the 5 of the 4, alright? In fact, I could not. I have to actually call and ask my friends at the Philly Fed to help me out with a couple of them 'cause I wasn't sure either and that's the point, if we don't know then how is a consumer expected to know who the good guys are, who the bad guys are, and how the heck to choose. This is a major problem for consumers.

It's gonna require, I think, research on what the outcomes of different avenues are so that we have a sense of what's the best solution for consumers. I think it's gonna require product development that's gonna be a partnership between the industry and the regulators to figure out how to create products that are useful for consumers and not harmful for them to fill that gap, and it's gonna certainly involve greater investment in messaging and education of consumers as to what these options are. That will stop.

Let's see, 501(c)(3) counseling guys are MMI, Money Management International, Novadebt, GreenPath, InCharge, very important. The other guys are settlers.