Building Financial Strength in Rural Communities

A Report from the Southwest Center for Economic Integrity

Prepared for the Southwest Rural Policy Network

Kathleen Lalley
Kelly Griffith
September, 2011

Executive Summary

The Southwest Rural Policy Network has initiated a *Family Asset Development Campaign* that will provide underserved rural working families with help navigating the complex landscape of financial services and products. Research was undertaken to uncover insights into the financial needs, beliefs and experiences of low-income people living in rural communities. Thirteen Community Dialogues were held with groups of low-income residents of four rural towns. Key learning is summarized below:

Rural communities face a daunting set of challenges for both providers and users of financial services, including:

- **Banks, credit unions and even ATMs are less available** where population is sparse.
- **Underdeveloped technology infrastructure—particularly broadband—impedes adoption of on-line banking.**
- **Steady, full-time jobs are less available,** reducing access to financial products that require a reliable source of income or a consistent employer.
- **Higher poverty rates** reduce credit scores and access to financial products
- **Fringe financial services are prevalent**, creating a cycle of debt.

Shifting from an industry-centric view of customers to a consumer-centric framework can enhance efforts to serve the needs of low-income people. The commonly used framework for describing consumers--banked, underbanked, unbanked-- assumes that the most important characteristic about a person is their relationship with a bank. Implicit in this schema is the idea that a having a bank account is always the best solution, driving policy and social services in that direction. A more sensitive and useful framework that segments consumers on the basis of the needs that grow out of their relationship with money emerged from our discussions. In this consumer-needs based framework people fall into to five distinct categories:

1. **Adrift**: people who take a passive approach to money management. They often tell us “I just don’t know where my money goes.” They don’t keep track of their finances and rarely plan ahead.
2. **Overwhelmed**: people who have reached a crisis point and know they need help, but don’t know where to get it.
3. **Goal Oriented**: people who have taken steps to get their financial life under control. They are developing strategies and systems, but need more practical know-how.
4. **In Control:** people who feel confident that they can manage their money. They have systems for monitoring expenses and use a range of financial products and tools.
5. **Off the grid**: people who have largely opted out of the financial infrastructure. They don’t trust banks, want to remain anonymous and believe that cash is best.

Situation	Need	Desired Outcome
Adrift	Intervention	Awareness of a better way
Overwhelmed	A Plan	Confidence
Goal-Oriented	Coaching	Continuous progress
In Control	Updating	Aware of new products, changes
Off the Grid	Left Alone	Autonomy, anonymity

We believe this framework can be used to more effectively target educational and service efforts.

A new segment of financial services is emerging that has the potential to meet the needs of the rural poor better than either traditional banks or the risky fringe.

- **Uncertainty dominates the financial lives of the rural poor,** making money management a huge challenge. Banks, which increasingly rely on fees that seem opaque and excessive to many consumers, have become just another source of uncertainty and harm. The result is a lack of trust that keeps potential customers away.

- **Local retailers are stepping into the gap** between banks, which have become too expensive and untrustworthy and fringe providers that focus on creating dependency through debt. Retailers ranging from the local gas station to Walmart are offering basic financial services such as check cashing, pre-paid debit cards and bill payment. They are creating a middle-tier of financial services that fall between the banks and the fringe. There is variability in the quality of their offerings. But at their best, they are providing low-income consumers with money management tools that are simple, safe and effective in meeting their needs. Most importantly, customers have greater ability to control the process, reducing the uncertainty that has damaged their relationship with banks

- **It will be critical for regulators and consumer protection advocates to** monitor the direction of this emerging segment of the market. Prepaid debit cards are a key component and so far consumer protection on this product lags behind traditional credit and debit cards. Tax preparation and the associated high-cost refund anticipation products are also moving into this retail segment.

Rural communities illuminate the issues facing low-income people everywhere. Low population, high poverty and weak infrastructure in rural areas create extreme challenges. By understanding how people and institutions respond to these challenges we gain insights that will help anyone trying to deliver financial services or provide financial counseling to low income consumers, regardless of their location.

Our Learning Approach

The exploratory nature of this project required a research approach that allows in-depth, open-ended questioning of our respondents. So we initiated a series of Community Dialogues—small group discussions with low and moderate income people living in four rural communities. These two-hour conversations gave us the opportunity to question people about their money-managing experiences, their successes and frustrations, and their interactions with financial institutions. The free-ranging discussions also provided our respondents with an opportunity to raise issues they felt were important and to provide answers to questions we might never have thought to ask with a more structured research instrument.

In total we conducted 13 community dialogues with 48 individuals. Our sample reflected the demographics of the communities:

1. Men and women ranging in age from teens to senior citizens
2. Singles living alone or with family; parents with children; retirees
3. Spanish and English speaking Latinos; Native Americans; Anglos
4. Employed full or part time; recently laid-off or had hours reduced; chronically unemployed; retired
5. Banked; underbanked; unbanked
6. Living within their income; financially strapped; deeply in debt

In addition to talking to users of financial services, we also spoke with financial professionals in our four communities. Our objective was to understand their experiences serving a rural community, the challenges they face and the opportunities they see for improvement. These conversations were held with:

- 6 bank managers/presidents representing community, state and national banks
- 2 credit union managers
- 5 community services providers

The research was conducted between January 28 and June 7, 2011 in four rural communities: Nogales, AZ; Ajo, AZ; Gallup, NM and Cortez, Co.

This report was produced by the Center for Economic Integrity for the Southwest Rural Policy Network with funding from the Rural Policy Action Partnership Network Support Grant. The Southwest Rural Policy Network thanks the Rural Policy Action Partnership, a grant making subsidiary of the W.K.Kellogg Foundation but acknowledge that the findings and conclusions presented in this report are those of the authors alone, and do not necessarily reflect the opinion of the Partnership or the Foundation. This report was written by Kathleen Lalley, lead researcher and Kelly Griffith, Center for Economic Integrity. The authors wish to thank Southwest Rural Policy Network Member Organizations for making this research project possible.

©Southwest Center for Economic Integrity
September, 2011

Challenges Facing Rural Communities

Research and analysis of underserved communities generally focus on metropolitan areas. And many of the conclusions drawn undoubtedly apply to rural communities as well. However, rural communities present unique challenges to those seeking to provide financial services. These include:

- **Sparse populations distributed over a large area.** It is difficult to achieve the "critical mass" of customers necessary for traditional financial institutions to be viable. Consequently banks and credit unions are less available. Even ATMs can be difficult to find. Ajo, AZ has only one bank. The nearest national bank ATM is 50 miles away.

- **Weak technology infrastructure**. The move to on-line banking would seem to be well suited to sparsely populated rural areas. But these areas are currently underserved by broadband service.

- **Unstable employment base.** Economies based on seasonal agriculture and tourism, self-employment or "boom and bust" industries make it hard for rural residents to find a steady full-time job. This, in turn, reduces access to financial products that require a reliable source of income or a consistent employer.

- **Economically vulnerable population.** Rural communities are characterized by lower incomes, higher unemployment and lower educational attainment than metropolitan areas.

- **High concentration of alternative financial services.** The four previous factors combine to create an attractive environment for fringe financial services. Some are providing welcome services to an underserved community. Many others are predatory lenders appealing to their traditional target of the economically vulnerable.

Portrait Of Four Rural Communities

Four rural southwest communities were selected for this project. As is common in rural communities, they share issues of unemployment, poverty and lack of opportunity for young people. However, each also has distinct economic problems.

Gallup, NM is the primary commercial center for people living on the nearby Navajo reservation. As a result the population of the town can more than double on weekends when people come in to shop and perform financial transactions. Persistently high unemployment rates and chronic poverty among the Native American population create a large economically vulnerable population. Gallup is served by several national and regional banks. It also has substantial fringe lending sector. Gallup is home to a number of Trading Posts that traditionally serve the Native American population as a primary source of financial services and tax preparation as well as being a market for their craft products, pawn shop and shopping center.

Nogales, AZ sits at the border of Mexico and is an important entry port for Mexican produce. The produce industry is a major employer, offering seasonal, largely unskilled jobs. Economic recession, the collapse of American tourism in Mexico and reluctance of Mexicans to venture into Arizona for shopping and negative publicity or border communities have all contributed to a steep downturn in the economy of Nogales in the last few years. The population of Nogales is 94% Latino, half of whom were born outside the U.S. Nogales is served by several national bank branches that are managed from Tucson.

Ajo, AZ is a former mining town close to the Mexican border. The Phelps Dodge copper mine, once the largest employer in the area, closed in 1985, causing a steady long-term decline in the population and economy of Ajo. An influx of retirees and snowbirds helped stabilize the population in the 2000's. However, the economic recession has had a negative impact on this segment. Simultaneously, Ajo's income from travellers between Mexico and the US has declined drastically. Ajo is struggling to find an economic engine that will provide future growth. Efforts are underway to develop Ajo's reputation as an arts community. The population of Ajo is largely Anglo and Latino with a substantial minority of Native Americans. The Tohono-O'odham Indian Reservation is nearby. Ajo is served by only one bank.

Cortez, CO is a tourist destination for people visiting nearby Mesa Verde National Park or the Southern Ute Casino. The small town is located halfway between the larger towns of Durango and Shiprock, which overshadow Cortez as a shopping destination. Like Ajo, Cortez has seen some activity as a retirement community, but this has declined with the economy. Cortez is served by seven regional, state and community banks, which is a surprising large number for a town of its size. Cortez' proximity to oil and gas industry activity and location as the county seat of a large agricultural area explain this banking concentration.

ORGANIZATION AND SCOPE

Building financial strength in rural communities requires a two-pronged approach focusing on both financial infrastructure and individual capability. The insights gained in this exploration address both.

The first part of this report focuses on financial infrastructure. Rural communities need strong financial service providers offering safe, effective products and services to help working people manage their money and build assets. We will discuss how the rural poor use, or don't use, the services currently available to them. We will examine their unmet needs. And we will look at how the financial services sector is changing in response to the needs of the underserved.

The second part of this report focuses on behaviors and beliefs that weaken individuals' financial health. Individuals who live in these communities need knowledge, skills and tools that strengthen their ability to manage their money in a way that is most beneficial for themselves and their families. We propose a framework for providing help tailored to the needs of individuals.

The majority of the people we spoke with use a fairly limited set of products: debit cards, checking accounts, ATMs, check cashing services, Moneygrams, tax preparation services with their accompanying refund anticipation loans and payday loans. Credit cards, savings account, mortgages and bank loans were not common. Most of their financial activity centered on meeting basic needs and everyday transactions:

- Cashing checks—payroll, government or personal
- Safely "storing" money
- Having immediate access to money
- Paying bills
- Coping with an unexpected shortfall

Some of our respondents, particularly in Nogales, had become embroiled in mortgage restructuring, credit card debt and bankruptcy. Their stories echoed those that have been reported continuously throughout the financial crisis. But these were not issues for most of our respondents who are struggling with much more basic challenges of living paycheck to paycheck or on government assistance. So this report will focus on those experiences and their challenges.

PART ONE: STRENGTHENING INFRASTUCTURE

Setting the Context: How the rural poor deal with money

Our respondents represent a range of financial situations including retirees living frugally on a pension and small nest egg, elderly living precariously on disability payments, working people who are overextended and the chronically underemployed. However a common theme in all our conversations was the need to live paycheck to paycheck and the challenges that brings.

The uncertainty of living paycheck to paycheck

Living paycheck to paycheck is fraught with uncertainty. People are not sure how much they will earn from week to week—they may get the hours they need, or they may not. This is particularly true in today's economic climate. They are also not sure what their expenses will be—if the price of a tank of gas goes up, an early cold snap requires an expenditure for propane, a child needs school supplies or an overdraft fee is assessed, everything changes. And because they do not have a cushion to fall back on, each unexpected setback, either on the income or the expenditure side, has a ripple effect—an electric bill has to be delayed or a debt can't be paid down. And so the uncertainty extends into the next pay period. And generally things get worse

This uncertainty makes planning and budgeting seem difficult, if not impossible. Money can't be managed over a long term, so it has to be managed over the very short term. People develop strategies for getting to the next paycheck. Having access to all your money is essential. So it can't be tied up in a minimum balance bank account, even if that will save on fees. Direct deposit has the benefit of making funds available earlier than a paper check. Paying the minimum on a credit card puts off the need to deal with the balance. And when things are really bad people turn to high-interest short-term loans.

Everyone in our research would love to have savings to fall back on when the unexpected occurs. But very few are able to manage it. The realities of paycheck to paycheck living leave no room for putting extra aside—every penny is committed for now and often for the future. And in the rare times when there is extra money in the household—from an income tax refund or extra work hours or a casino win—there is always a long list of deferred needs or wants ranging from new tires to a family vacation.

Barriers To Use Of Mainstream Financial Services

We have seen that dealing with constant uncertainty is a huge challenge in the life of the rural poor. Ideally, a relationship with a bank or credit union would help reduce that uncertainty and provide a measure of stability. Unfortunately, our respondents too often have a different experience—banks are also a source of uncertainty in their financial lives. This is partly due to bank policies and partly due to the customer's own behavior and lack of knowledge. But the result is a lack of trust in banks that keeps potential customers away.

The complicated and seemingly illogical fee structure used by banks is a primary source of uncertainty for our respondents. People feel they are caught in a game of "Gotcha" with the bank. They are constantly being surprised, and in their mind, cheated, by unexpected or unfair fees. They believe that banks are looking for ways to take their money away. The fees that are most responsible for this are the overdraft fee, check cashing fee, particularly if the check is presented at the issuing bank, and fees for small services like checking a balance.

- **Overdraft fees** are the most infuriating. They occur without warning and seem disproportionately high. Most people acknowledge that there should be penalty for overdrawing their account. However they think that the current system takes a bad situation—you're out of money—and make it much worse—now you are in debt. For people living on the financial edge, this can be the difference between difficulty and disaster. And while the Federal Reserve now demands that overdraft protection only be offered on an "opt in" basis, many of our respondents had either been convinced by high-pressure campaigns to opt in, or they were unaware of the change.

- **Check cashing fees** are a second source of uncertainty. Many people do not know what to expect when they try to cash a check at a bank. Sometimes they are denied, sometimes they are surprised at the high fee, and sometimes they are surprised that there is any fee at all. The do not understand the bank's fee structure and that people with different types of accounts, or no account, get treated differently. In contrast, when they go to a check cashing service they know exactly what they are going to pay—the fees are generally posted in plain sight—and they can shop around for the best deal. Because they do not know what the bank fees are, they assume the worst--that the bank is overcharging them.

- **Fees or refusal to cash a check that is presented to the bank it is drawn on** are baffling to people. They feel it is just wrong—a dereliction of responsibility that should not be allowed. People believe that if the check has the bank's name on it, the bank should be required to cash it. After all, the bank knows the funds are available and the check-writer has an account.

- **Fees for services that could help people stay out of trouble** are not only seen as unreasonable, they also create the belief that the bank is actively trying to make you overdraw your account. Examples are an ATM fee for checking a balance or a fee for speaking with a teller. People believe banks should encourage their customers to check their balance in order to avoid overdraft, not create fees that discourage responsible behavior.

- **Fees on savings accounts** are also a source of surprise and considered little more than legalized theft. We have been taught from childhood that if you put your money in a savings account it will grow. But too many people have had experiences where their small savings have been eroded by service and inactivity fees. As a result they can't be sure that a savings account is a safe place to put their money.

All of the fees creating this Gotcha Game can be justified as legitimate fees for services rendered. And they may well be necessary if banks are to remain profitable. However, the uncertainty produced and the loss of trust that results when people feel taken advantage of is also a cost that should be considered by the banking industry

People's feeling that they no longer know who their banker is has become a second cause of uncertainty. Because of mergers and acquisitions, banks in these small communities have changed hands many times. For example, the building that now houses the National Bank of Arizona in Ajo has held 5 different banks since 1992. People have fond memories of "the old days when your banker knew you and your family." Now they feel they don't know who the banker is because it is someone different all the time. They don't know whom they will talk to or what to expect when they enter a bank.

The bankers in these towns are making serious outreach efforts, trying to make connections with their communities. But residents who feel they have seen it all before have become cynical. And they remember every bad experience they had with the previous banks, but forget that the new management is not responsible.

Technology-based banking procedures are a third source of uncertainty. Opening and using a bank account can be very challenging for the rural poor. They often grew up in families that did not use banks, and so have no history to draw on. They are not familiar with ATM machines, passwords and pin numbers. They do not have access to computers or the internet and cannot easily master online banking. Even writing a check can be a new and intimidating experience that needs to be mastered. Many of our social security recipients were very apprehensive about the government-initiated switch from paper checks to direct deposit planned for 2013 because it would require them to use unfamiliar and intimidating services.

By creating additional uncertainty in people's lives, the banks are also creating a climate of distrust. It is certainly not always the bank's fault—customers often do a bad job of managing their bank accounts and have unrealistic expectations. But the result, no matter who is at fault, is that all of our respondents—even those who are generally satisfied with the services of their bank—feel they have an adversarial relationship with financial institutions.

In our conversations with bankers in rural communities we spoke with professionals who are deeply concerned about the welfare of their communities. They are well aware of the struggles that face their low-income population and are working hard to reach out to their community. They offer products that they know could help low-income residents manage their money such as direct deposit and low or no-fee checking with low minimum balance requirements. They are eager to provide personal service to their customers and willing to make an extra effort to help people learn how to use unfamiliar banking technology or processes.

Unfortunately, the good intentions of the local financial professionals are undermined by policies and past history that they have no control over. Often this is as frustrating to the local bankers as it is to their customers. But the effect is to create barriers that inhibit people from using their services.

Credit Unions: A special case. Only a few of our respondents have experience with credit unions, but that experience is uniformly positive. They feel that unlike banks, the credit unions are on their side. They have a low price of entry, charge reasonable fees and are easier to work with. The only thing that prevents people from using a credit union was lack of availability in their area.

The customer's own past history can also be a barrier to use of mainstream financial services. It is not uncommon for low-income people to have unresolved issues with a bank. As a result they are on the ChexSystems list for 5 years, making it impossible for them to reestablish a relationship with a bank. A typical story is one where the customer overdrew an account, triggering fees that compounded. Rather than deal with the mess, paying fees well in excess of the original overdrawn amount, the customer walked away assuming the account would be closed. They do not realize that they will be prevented from any further banking activity for quite a while, even if they repair the damage.

A banker we talked to believes that the ChexSystems five year restriction prevents her from opening accounts for people who, in her judgment, would be good customers of the bank and would benefit from having an account. They made a mistake, learned from it, and are ready to start over.

People are learning they don't need a bank for many common services. In each of the towns we visited, local businesses are offering basic financial services as a side business. People use these services as an alternative to having a checking account.

The most common is check cashing services Gas stations, grocery stores, trading posts and Walmart will cash checks either for a set fee or a percentage. People are drawn to them for several reasons:

1. **Certainty.** The fees are posted above the counter. Everyone knows exactly what they will pay. And, surprisingly, the fees don't seem excessive—people generally think they are fair. An exception is when a higher fee is charged for government checks. That seems inexplicable to people.
2. **Flexibility.** The informal check cashers will sometimes accept checks that the bank will not.
3. **Comfort**: People are often on a first name basis with the proprietor who lives in the community and has an established business selling gas or food.
4. **Convenience.** People can do other errands at the same time. They don't need to make a special trip to an ATM

Money Orders and Moneygrams are used for paying bills. They are easy to buy and the fees do not seem too high to the purchasers (particularly when compared to bank pricing.) Because they are offered at various outlets, the customer has the opportunity to shop for the best price. And in a small town, everyone knows who charges what.

Some respondents have started using a prepaid debit card. They like that it gives them the convenience of a debit card without the possibility of overdrafts. It also is seen as a safe way to store money—no need to carry cash.

Predatory lenders offer a quick fix at a high cost. When people are most vulnerable there is always somebody ready to make things worse. This is particularly true for our Gallup respondents where payday loans, car title loans and tax refund loans are readily available. Most of our respondents in this town have experience with predatory loan products and none of the experiences are positive. They always end up in worse financial shape after taking out the loan.

These lenders are not directly competing with banks, since they offer a service that most banks do not provide. However they prevent people from achieving a level of financial stability that would make it possible for them to effectively manage their money through a bank.

We heard much less about predatory lenders in Arizona, where the practice is illegal. However it was disturbing to hear a young single mother in Ajo talk about how easy Wells Fargo makes it to borrow repeatedly against her soon-to-be-directly-deposited child support check. She frequently takes out these loans because it is so easy—just a click on the website. This short-term, high-cost loan with extremely low risk to Wells Fargo would seem to meet the characteristics of the outlawed Payday Loan.

What Customers Need In Their Banking Relationship

Most of our respondents realize that they could benefit from a relationship with a mainstream financial institution. But for that relationship to be successful, the bank or credit union will have to understand what the rural poor expect and need. In our conversations we heard customers asking for control, simplicity, fairness and help.

Control. The rural poor have very little room to maneuver in their financial lives. So they need a bank that helps them be in control of their money. They need to know exactly what to expect. Any surprises are bad. Unexpected fees (no matter how justified) undermine any sense of control.

Simplicity. People need financial products that are easy to understand and easy to use. Many of our respondents have little experience with bank accounts. They are looking for simple accounts with clear rules and fees—not extra features that just add confusion and the possibility of error.

Fairness. People accept that fees are necessary. But they expect the fees to be fair and logical. There should be some apparent connection between the fee and the service. Charging the same fee for an overdraft of $10 and $500 does not seem fair. Charging more to perform a transaction in person than over the phone does not seem logical.

Help. Most people know they are not doing a good job at managing their money. They need people who will help them find ways to do a better job. Bankers could be part of the solution. They need someone to take the time to explain clearly, and in their language, how a debit card and pin number works. They need someone to point out that consolidating a checking account and CDs would result in lower fees. They need to clearly understand the possible fees and the situations that trigger them. They need continuous, free communication letting them know the status of their account. They need a mortgage restructuring process that works. Banks are by no means the only place where people should be able to get help. But they could play a role.

Products That Work

In the course of our discussions we identified several financial products that genuinely help people manage their money more effectively. All of them put control in the hands of the customer. These were:

- **Direct deposit** because it gives people quick and, ideally, free access to their money.
- **Telephone banking** because it allows the customer to check a balance or find out what checks have cleared any time and without fees. And cellphones access is far more common among our rural respondents than internet access.
- **Debit card without overdraft protection** because it makes it impossible to incur an overdraft fee. As one respondent said “It saves me from myself.”
- **Pre-paid debit card** because it provides a convenient way to store money and make purchases without the risks of a credit card.
- **Second chance or provisional bank account** because it allows people with a poor history to work their way back into the good graces of the financial system while they learn how to more effectively manage their money.
- **Mortgage restructuring** because it protects their only asset.

We did not hear about any formal products that help people with savings. However we did learn about an informal system— a *tanda*—in which a group of co-workers create what is, in essence, a group saving account that each member can use in succession. Each member of the group contributes a set amount to the tanda every week. Each participant is given the weekly total in turn. In the case of our respondent, 7 women each contribute $10 at week for a “kitty” of $70. Most interesting about this method was the fact that no one in the group had ever failed to make a payment. This demonstrates to potential effectiveness of peer pressure as an incentive for positive financial behavior.

An Industry in Transition

Our discussions in rural communities have provided an interesting perspective on how the financial services industry is evolving. Professionals generally view the industry as a two-tiered market. In this view traditional providers—banks and credit unions—are the top tier with a checking and savings account being the essential tool for sound money management. Alternative or “fringe” services are the bottom tier and are seen as far less desirable, charging excessive fees and preying on the vulnerable. Based on this view of the market to be “banked” is a positive situation and to be “unbanked” is problematic.

However, the combination of changes in the banking business model, the financial strain many families are experiencing and technological innovation is giving rise to a third segment in the market that is fulfilling the low income customer's need for financial products relevant to their situation. Retailers as large as Walmart and as small as the local gas station are applying retail principles to financial products. This retail financial segment makes it possible to cash a check, load a debit card and pay a bill in a simple transaction. Pricing is generally transparent and can be reasonable.[1] Perhaps most importantly, the customer has greater ability to control the process, reducing the uncertainty that has damaged their relationship with banks.

As this segment develops it will be critical for regulators and consumer protection advocates to monitor the direction of its growth. A key component of this emerging segment is the prepaid debit card. Prepaid cards are a growing business with many players getting into the game. As a result there is a wide range of cost, quality and service associated with different brands. Consumer protection lags behind traditional credit and debit cards. [2] Tax preparation and the associated high-cost refund anticipation products are also moving into this retail segment.

This informal retail segment helps address the basic transactional needs of rural communities: cashing checks, storing money, accessing cash and paying bills. But the last need—coping with unexpected cash flow shortfalls—is still largely being met by predatory lenders. We found no examples of innovative lending practices in our locations in the Southwest. However, innovation is happening elsewhere, though on a small scale. The North Carolina State Employees Credit Union has successfully offered a salary advance loan that also contains a savings component. NCSECU has been able to generate revenue with this product while providing a needed service to its borrowers. In 2008 the FDIC launched a pilot program with 31 banks to offer small dollar loans on reasonable terms with promising results. Participating banks reported that the program helped their business by bringing in new customers and creating positive relationships.[3] This could be one small way that banks can begin to repair their trust problem with their communities and strengthen their customer base.

---

[1]A study by *The Center for Financial Services Innovation* found that the common assumption that the alternative services used by the unbanked to conduct essential financial services are more expensive than a checking account is not necessarily true. The study found that in the context of real-life cash flow situations, alternative services can be more cost effective than a checking account. They concluded that "there is no one financial strategy—whether based on using a traditional checking account, check cashing services or a prepaid card—that is right for all people. Each of these services can be used relatively cost effectively, if the individual has access to low cost providers." *One Size Does Not Fit All: A Comparison of Monthly Financial Services Spending*, Center for Financial Services Innovation, 2009

[2]*Prepaid Cards: Second-Tier Bank Account Substitutes*, Consumer Union, 2010

[3]*Creating Fair and Affordable Alternatives: How traditional lending institutions can help rural communities break the predatory-lending cycle*, MCD, 2011

Harnessing Innovation To Serve Rural Communities

The innovations in products, services and distribution channels that are fueling the growth of the emerging third tier are happening everywhere, not just in rural communities.[4] But they could be particularly beneficial to rural communities that have always struggled to obtain safe, affordable services that are also profitable for providers. Channeling this innovation energy into products and services that serve the needs of the rural poor rather than exploit their vulnerabilities should be a priority for community leaders.

- **Consumer advocates** need to monitor new products and services, challenging those that are deceptive, confusing or exploitive and encouraging those that are genuinely helpful.
- **Regulators and legislators** need to extend consumer protection standards to emerging products, services and providers.
- **Social service providers** should be prepared to educate clients about new products so they will be used effectively.
- **Community development advocates** can explore social enterprise opportunities in the financial sector that could create a revenue stream while providing needed services.
- **Financial services providers** should develop products that are simple, fair and, most importantly, are profitable for the provider when the customer manages their money successfully rather than when they fail.

Ultimately it is in everyone's interest to improve the financial infrastructure serving our rural communities. Channeling the energy that too often goes into extracting wealth from these communities into preserving the little wealth people have and, eventually, building wealth will benefit the low income populations, as well as the community at large.

[4] For an excellent analysis of the forces shaping the future structure of the financial services industry and the implications for low and moderate income individuals, see *The Future Of Financial Services: Recommendations for Asset Building*, Center for Financial Services Innovation, 2011.

PART TWO: STRENGTHENING INDIVIDUALS

America's financial crisis has shined a light on our shockingly low level of financial literacy. In rural areas, where all forms of education lag, financial education is no exception. In our conversations with bankers they consistently pinpointed raising the level of financial knowledge as the critical first step toward achieving stability. Similarly, our respondents also believe that education is essential, and they regret that they are not more knowledgeable.

In response, many dedicated and creative people are designing and implementing financial education efforts. Additionally, social service providers are dealing with a tsunami of clients who are suffering financially. Their limited resources make it essential that they have tools that will help them direct their efforts most efficiently and effectively. Our Community Dialogues have provided us with insights that can guide innovators in the financial education arena.

Focusing On Root Causes

All of our respondents have experience with financial trouble. A few have overcome their problems and achieved a measure of financial stability. But most are continuously coping with problems. For some, these are new problems resulting from a job loss, divorce or other setbacks. For others the situation is chronic—they have never known financial security.

In our discussions we found that there are four inter-related beliefs and behaviors contribute to financial problems:

- **Not knowing how money is being spent**. We frequently heard the phrase "I just don't know where my money goes—it seems to disappear." It didn't matter if the person is using cash, checks, credit cards or debit cards. For many people keeping track of expenditures simply doesn't happen. The demands of work and family leave little time for analysis of household expenditures. Most of the people we interviewed have little or no experience with budgeting, and were often not sure how to do it or where they would go to learn.

- **Inability to deal with the unexpected**. Our respondents are no better at predicting future financial setbacks than the Wall Street analysts that didn't notice a crash coming. But because low-income people often live paycheck to paycheck, they have very little capacity for coping with unexpected needs.

A truck that breaks down, or getting one's hours cut back at work creates an immediate hardship. The family rarely has an emergency fund to tap into.

- **Using credit, pawn or high-interest short term loans to get out of trouble.** Our respondents find that there always seems to be someone ready to get them out of an immediate financial bind. Credit card offers arrive in the mail, payday or car-title loans are easy to arrange, and pawnshops are plentiful. These options are always approached with the idea that they are strictly a temporary measure. However, that rarely proves to be the reality. And their use results in deepening financial stress.

- **Not knowing how to get help.** Rural residents have few resources to turn to for help with financial problems. People seeking mortgage modification from their lender find themselves in a nightmare of conflicting information, lost paperwork and lack of response. People who want advice on how to handle their financial situation are not aware of organizations that can help them. And because these are sparsely populated areas very few resources exist. Friends and relatives are often no better off and can't be helpful.

None of these beliefs and behaviors is confined to low income, rural communities—they occur everywhere at all levels of income. But they are particularly harmful in these communities because meager financial resources are more difficult to manage effectively, social services that can offer financial counseling are sparse and mainstream financial services are less available and underused when they are available.

A Framework For Designing Programs to Build Financial Strength

As our discussions progressed it became very clear that most people would welcome help dealing with their money. But it was also clear that people are in different situations—both financially and psychologically—that require different approaches. To successfully help, we need to understand not only the person's financial issues, but also the mindset they bring to the situation. This will allow us to tailor appropriate solutions to situations and increase the chances that the effort will be successful.

During our discussions people talked about themselves and their situation in five distinct ways.

1. **Adrift**: People in this situation take a passive approach to money management. They often tell us "I just don't know where my money goes." For some, it is a puzzling situation—they are surprised at the end of the month when an overdraft occurs. For others it is simply a statement of fact—a sense that money is beyond one's control so there is no point in trying.
2. **Overwhelmed**: People in this situation have reached a crisis point and don't know what to do. They know they need help, but don't know where to get it.
3. **Goal Oriented**: In this situation the person has taken steps to get their financial life under control. They are developing ways of managing their money, either on their own or with help.
4. **In Control:** This group feels confident that they can manage their money. They have systems for monitoring expenses and use a range of financial products and tools.
5. **Off the grid**: Several of our respondents have largely opted out of the financial infrastructure. They don't trust banks, want to remain anonymous and believe that cash is best.

These segments have different needs that must be addressed if they are to achieve a stronger degree of financial control. So it will be important to use a targeted approach to designing programs and products and messages.

Situation	Need	Desired Outcome
Adrift	Intervention	Awareness of a better way
Overwhelmed	A plan	Confidence
Goal-Oriented	Coaching	Continuous progress
In Control	Updating	Aware of new products, changes
Off the Grid	Left alone	Autonomy, anonymity

People who are financially *adrift* are usually not actively seeking help or information. They don't have the time or skill to find a better way so they don't think about it. They won't be reached by overtly educational efforts. But they might be open to small, easy ideas delivered through local media and that they can put in practice right away. What one of our respondents called "quick tips." This would feel less like financial help and more like household advice.

People who are *overwhelmed* are often open to the idea of getting serious help. But the kind of help they need--intensive counseling, help navigating a brutal system and emotional support--is rarely available in rural communities. Several of our respondents described crisis situations that made them realize they could not get out of trouble alone. They were lucky to find counselors who could spend the time needed to not only get them out of trouble, but also teach them the budgeting and management skills that would let them move forward. Unfortunately we also spoke to people who need this type of help but don't have access to it.

Our *goal-oriented* respondents have a clear objective (get out of debt, move out of the family home, build a business) and a system that works for them. But they could also use intermittent coaching as they encounter new challenges requiring new tools. Technology can play a big role here, with computer budgeting programs, online advisors and online forums where people can exchange ideas

People who are *in control* of their finances are not looking for help. But they are looking for information that will keep them from missing out on useful services or tools—especially in a time when banking regulations and products are constantly changing. Clear, timely communication from their bank would be most helpful here.

Off the grid people want to be left alone. They are determined to find their own way.

Using The Framework

This framework can be used to target educational and service efforts more efficiently. Educators can design programs that are tailored to a particular segments. A person who is adrift needs to be communicated with in a way that is very different from someone who is overwhelmed. Both the style and the content will be different.

Similarly, social service agencies can use the framework to help diagnose problems, direct appropriate solutions, set goals and measure success. As an outcome of this research, we plan to develop a tool that will help social service providers quickly identify which segment a client belongs to so that delivering services can be streamlined.

CONCLUSIONS AND RECOMMENDATIONS

Rural communities present a challenge for anyone trying to deliver financial services or provide financial counseling. Our conversations in rural communities have generated insights that that can help financial service providers, regulators and social service providers more effectively reach people living in these areas. We believe there are many opportunities, large and small, to improve the financial life of low-income rural residents. We encourage the industry, regulators and social service providers to consider the following recommendations:

- Reduce uncertainty in the lives of the financially challenged by offering products and services that are simple, transparent and fair.

- Channel the innovation that is happening both within and outside the banking system and is fueling the growth of the emerging third tier in the market, into the development of products and services that can be successfully implemented in rural communities

- Control predatory wealth-destroying tactics that will inevitably arise during a period of innovation that weaken our already struggling rural communities.

- Challenge orthodoxies that are losing relevance as the financial services landscape evolves.

- Move away from an industry-centric view of customers to one that begins with an appreciation of the customer’s situation in order to better match solutions to needs.

About the Southwest Center for Economic Integrity

The Southwest Center for Economic Integrity engages in research, education and advocacy to strengthen local economies by mobilizing and protecting marginalized people, holding corporations and industries accountable to communities and cultivating support for good business practices. The center has been instrumental in the movement to control predatory lending in Arizona and in reforming day labor practices. The Center focuses its work regionally in the southwestern United States and receives support from the Charles Stewart Mott Foundation, The Marguerite Casey Foundation, The Wallace Foundation and over one hundred individual contributors.

The Center is located in Tucson, Arizona.
For further information contact Kelly Griffith, 520-82-2164, Kelly@economicintegrity.org

About the Southwest Rural Policy Network

The Southwest Rural Policy Network is a diverse, multicultural group of organizations coordinating efforts to affect policy that respects and improves the quality and opportunity of rural life. Together, the Network fosters personal and professional connections, shares best practices and designs new strategies for change. The Network is a member of the Rural People, Rural Policy family of networks, an initiative of the W.K. Kellogg Foundation.

Thanks

This project could not have happened without the generous support of our network partners in Nogales, Ajo, Gallup and Cortez. We are grateful to the people who gave so freely of their time, talent and hospitality: Many thanks to our friends at:

- Nogales Community Development Corporation, Nogales
- International Sonoran Desert Alliance, Ajo
- McKinley Community Health Alliance, Gallup
- Southwest Colorado Prevention Policy Network, Cortez