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Understanding Alternative Financial Services

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by

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Abstract

In this paper, we will have a meaningful discussion on Alternative Financial Services, which will be referred to "AFS" in the context of this document. There will first be an introduction to this paper, giving an overview of what to expect. Then, we will look at what these services are and list six types of them and what services they try to provide. Next, we will take a look at who uses them. This will be done by using state, regional, and national demographics by presenting charts created from FDIC data. The charts will provide for usage percentage - the percentage of people within the demographic that use AFS - and household usage, the number of households that use AFS. This will give us a better idea of who most often uses them.

This paper will attempt to explain why people use AFS by utilizing surveys and personal interviews from branch managers of three different financial institutions. By using personal interviews, we may understand why someone would choose to use AFS, rather than a mainstream financial institution,by revealing the requirements of holding a checking account at each institution. We will also use a survey done by the Federal Reserve Board of Governors on mobile banking, which will help us personally get into the mindset of someone that uses one of these services.

We will then come up with solutions based on the surveys as well as personal experience. It will be explained how these solutions can be implemented and why these solutions will work. In finding solutions, we will mitigate the social harm done by excessive and/or inappropriate AFS use. In doing so, we can grow as a society. By increasing financial education, we will be able to have more people contribute to, and strengthen, the economy.

Introduction

A snapshot of our community here in north Alabama would not look all that different from any average small town anywhere in the United States. However, it would have an abundance of ugly blotches on it - far more so than even the already numerous amounts of fast food restaurants. These blotches are Alternative Financial Services. These services are practically everywhere – drive a few miles and one can see about a dozen of them. They prey on the impoverished across the country, but especially so in the Southeastern United States. But how do these services work? What is the reasoning behind the customers that utilize it? What are their lives like?

To answers these questions, a thorough discussion on alternative financial services is needed. This discussion must cover three basic questions: what services fall under this umbrella, who purchases these services, and why these services are so often used. This discussion will also explore possible solutions: which ones are already in place, which ones are attempting to be implemented, and which solutions can be put in place to help alleviate this problem.

The hope is that by answering every question, concrete solutions will be provided to bring consumers that are currently using AFSes some relief. These solutions should assist these consumers in gaining financially stability. They will also help readers gain a better understanding of how AFSes work and what can be done about them. Only then will it be seen what these blotches on the snapshot tell us about the town that is having its picture taken.

Chapter 1: What are Alternative Financial Services?

Before a discussion can begin on the inherent problems with AFSes, one must first define what they are. A 2012 study for *Consumer Interests Annual* showed that six products – payday loans, pawn shop loans, non-bank check cashing, non-bank money orders, refund anticipation loans, and rent-to-own stores- were identified as alternative financial services.

Payday loans are short-term loans that are "securitized with the borrower's next regular payment", whether that be a paycheck, a pension check, or Social Security payments (Gallegos, Gross, Hogarth, and Manohar 1). The debtor gives the lender a postdated check in exchange for an advance on a paycheck or another deposit. The lender then either deposits the check on a specified date or the debtor pays back the lender and receives the check. The terms on these loans are so short that these fees translate into high implicit rates. The combination of the monumentally high interest rate and the short term of the loan often causes the debtor to "roll over" the loan, either immediately or later in the pay cycle. This often leads to debt spirals which are near impossible to get out of.

Pawn shops offer securitized, short-term credit to consumers, much like payday loans. However, the loan is "securitized by a personal possession of the borrower" (Gallegos, Gross, Hogarth, and Manohar 1). The borrower has a limited time to pay back the loan; if they default on the loan, the pawn shop takes ownership of the item that is pawned. Non-bank money orders are offered for a fee by businesses such as Western Union and MoneyGram, and are also offered by the United States Postal Service. Many banks "offer this service for free", so these are more popular for those that do not have a bank account (Gallegos, Gross, Hogarth, and Manohar 1).

Refund Anticipation Loans – or RAL for short – are loans that are "securitized by a taxpayer's future tax refund" (Gallegos, Gross, Hogarth, and Manohar 2). Many regulators and academics have debated the dynamics of the relationship between tax preparers and tax filers. The argument could be made that tax preparers take advantage of their clients by guiding them to RALs instead of using direct deposit to speed up access to tax refunds.

Rent-to-Own stores, or RTOs, allow consumers to "rent furniture, electronics, or other merchandise with the option of buying it at a later date" (Gallegos, Gross, Hogarth, and Manohar 2). In many ways, the RTO transaction acts like an extension of credit from the store to the consumer; the consumer must pay off the value of the merchandise with monthly or bi-monthly payments that include interest-like fees. If the payments are not made, the RTO store can repossess the item. The effective interest rates on RTO items are often higher than the interest rates on credit cards or installment contracts; however, these stores are an option for people who wish to buy consumer products but who are credit-constrained.

Check cashers are businesses that cash checks for a fee. This service normally is provided by banks to their customers for free. any consumer may use a check cashing service, even those that do not have bank accounts. Prices for check cashing vary by state and location, and may also vary by the type of check. Access is not an issue; check cashers are often located in neighborhoods that also have bank branches. Along those lines, a study found that "93% of non-bank checking operations are located within one mile of a bank or credit union branch" (Gallegos, Gross, Hogarth, and Manohar 2). Therefore, consumers who use check cashers are making a conscious choice to use these firms instead of banks.

With these services now defined, the question becomes why transaction costs for these services are so high. Industry insiders speculated that this is because of the short-term, high-risk nature of bridge loans. Consumer advocates argue that payday lenders prey on those that are "so financially illiterate or unsophisticated that they are willing to take up such expensive loans" (Bertrand and Morse 2). This makes one wonder how these people came to depend on these services to survive.

The danger of these institutions and their growing abundance has been articulately detailed. Services like Rent-to-Own stores and Pawn Shops were labeled as predatory by the Department of Defense and consumer advocates. There were only a scarce amount in the early 1990s, but there were up to 24,000 as of 2006. In a report's sample period from 1995 to 2007, there were "more payday lending outlets in the United States than there were McDonald's and Starbucks locations combined" (Carrell and Zinman 2810).

In general, alternative financial services are abundant in nature and take many forms. Some of these have been made obvious by the general public's <u>use of them</u>. Others are seemingly underground to the same people. But they are definitely here and they are used across the country. What's more, the industry has not only survived, it has thrived. This begs the question: where is the demand for AFSes coming from? In order to understand the role of AFSes within the overall financial industry, I interviewed Dr. John Burnett of the University of Alabama in Huntsville.

When describing how the industry works, Dr. Burnett replied that it "provides people...access to credit who other wise would not have access to credit." He also described examples on why people would need AFSes. One that he specifically mentions is a very common example of needing to borrow money to fix your car. He explains that without a good enough credit to be accepted by a bank, these services are, in his view, their access to credit. Burnett cites reasons why people may use them, such as people not having good enough good credit scores or "maybe a convenience issue." I mentioned that it seemed that these people were living paycheck to paycheck and he agreed with me. Who exactly are these people are?

To gain a better insight into who uses AFSes, I interviewed Dr. Charles Hickman with the University of Alabama in Huntsville. I first asked him to compare AFSes to low-rent businesses such as Dollar General, if that were possible. He found that both AFSes and low-rent businesses "tended to be community-based", meaning that one doesn't have to travel too far to get there (Hickman). He points out some differences between the two: stores such as Dollar General or the Dollar Tree tend to be "low-cost", while AFS are "extraordinarily high-cost", but they both have a common marketing strategy: to "cater to low-income populations" (Hickman).

I spoke to the issue of providing a needed service versus exploiting customers, which is what AFSes are often accused of doing. The question that needs to be asked is: do these services fill a need by providing a needed service? Dr. Hickman advises that we should “look at the context of the environment”, as well as the “population that is being served” (Hickman). He explains that low-income residents often cannot gain access to credit cards, nor have savings accounts. If they wanted to purchase a TV or computer for example, that person would have to go to a rental center and rent it. Hickman explains how there are two opposing sides to this; the person gets the TV today, but over the period of the rental agreement that person will wind up paying “multiples of the purchase price” compared to buying it at Wal-Mart or on Amazon.

He explains that check cashing services also provide a useful service, but at similarly extraordinarily high costs. Hickman also brings up the point that the population that this service is targeting is “underserved” by mainstream financial institutions. These populations often do not have a checking account and so “it is difficult to know what to do with a big check” (Hickman). He gives a personal example to further explain the impact of having a checking account with an established financial institution. He has an account with a bank, so when he has a check, he typically deposits it to the bank at no cost to him. But if he took it to a check cashing service, it would cost “a significant fee for the privilege of being able to walk out of that retail establishment with my money” (Hickman).

What he is trying to say is people without bank accounts are disadvantaged. He argues, therefore, that while a service is legitimately provided, they are also performing a type of extortion because of the high costs associated with that service. To illustrate his point, he brings up his brother who lives in poverty and confesses that check cashing services are one of the only options that he has when he has a check. He expresses relief that, in recent times, some employers pay using prepaid debit cards which one can use anywhere, including an ATM machine. He points out that the ATM fee for accessing cash is significantly lower than walking into an AFSes and letting them handle the check.

From the two interviews, it is easy to gather why these services still exist. They are the "bank" for people that no bank will grant access to. They target people who do not have many societal advantages and are often not properly treated by legitimate financial institutions, including banks. Since there is obviously a population big enough for AFSes to thrive as well as they have, who exactly is using them?

Chapter 2: Who is Using AFS?

Given the abundance of AFSes in the Huntsville-Madison area, it is safe to presume that an array of people utilize them. Key questions arise in determining who is using them: What are common characteristics of the people who use AFSes? Are AFSes as abundant in other regions of the United States as they are in the Southeast? The Department of Defense is “convinced” that payday lending does more harm than good (Carroll and Zinman 2806). To this end, they successfully lobbied Congress for a federal cap of 36% APR for military members and their families. Yet was that enough to deter these people from using AFSes?

In 2014, a survey was conducted estimating the effects of payday loan access on enlisted personnel. The survey focused specifically on enlisted Air Force members. Three variables were used to determine causal evidence of links between consumer financial access and workplace productivity in this population. The first is the presence of an Unfavorable Information File, or UIF, which is an indicator of “extremely poor job performance or readiness” (Carrell and Zinman 2814). The second is reenlistment eligibility, which provides a summary statistic for job performance as airmen can only re-enlist if their job performance was satisfactory. Lastly, there is the reenlistment itself, which could be affected outside of the eligibility channel if payday loan access provides different options for airmen.

The survey found that payday loan access had adversely affected job performance and readiness in the Air Force. They discovered that having payday loan access increases the likelihood that an ineligible airman will reenlist by around 3.9%. Additionally, the airmen with greater access were 5.3% “more likely” to have a UIF (Carrell and Zinman 2830). This evidence is in line with the Department of Defense’s hypothesis that payday loan borrowing creates productivity-sapping distractions, such as exacerbated financial distress or taking a second job to service the debt.

In spite of this evidence, there are still plenty of airmen that decide to borrow loans anyway. In 2005, an estimated 20 percent of military households took out a payday loan. There is also evidence suggesting that annual prevalence may actually be as high as 25 percent. This is up from 2001, when perhaps 19 percent of military households used payday loans. Some experts believe that “prevalence is substantially higher among junior enlistees”, demonstrating that the effects are strongest among the junior airmen and those in non-finance occupations (Carrell and Zinman 2810). Overall, the survey was consistent with the Department of Defense’s concerns: payday loan access and payday borrowing produces financial distress that distracts from military job performance.

Several previous studies have found some generalities with AFSes service locations. One study found that alternative financial service providers locate themselves in “areas with greater concentration of African Americans” and “people who lack high school diplomas” (Gallegos, Gross, Hogarth, and Manohar 2). Another posits that using these services often depends on the personal networks of customers. Yet another proves that AFSes providers are located in places that lack traditional banks.

There are three major categories of people to describe their financial status included here:People are either unbanked, underbanked, or fully banked. An unbanked customer is one that does not have a checking, savings, or money market account. An underbanked customer is a person that has a checking, savings, or money market account, but has used an alternative financial service in the last 12 months. Lastly, a fully banked customer is one that has a bank account and does not use alternative financial services.

In order to get the broadest picture as possible on this issue, charts were created from FDIC spreadsheets. These charts were based on 2013 FDIC surveys of a nationally representative sample of over 100,000 homes ("Create Custom Data Table"). These surveys measured AFSes usage for the nation and the state of Alabama. Demographic breakdowns focused on race, gender, education level, and income level. To begin the analysis, we will first focus on who has ever used AFSes in the nation for 2013.

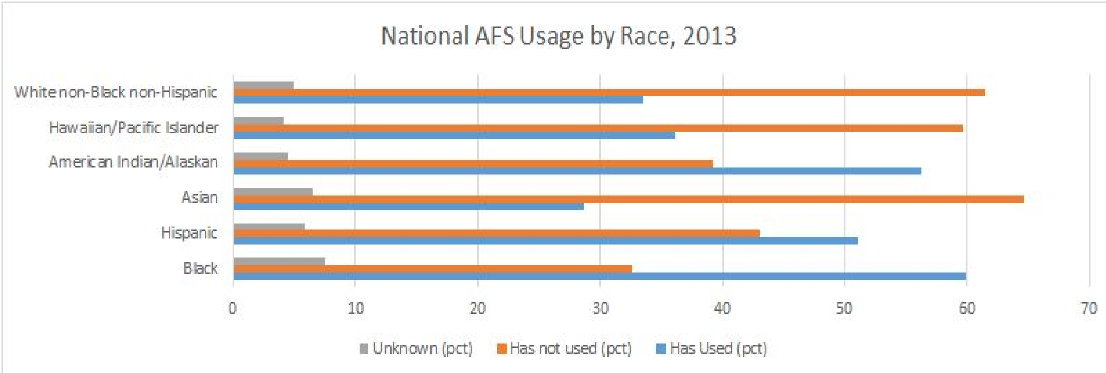


Chart 1.1

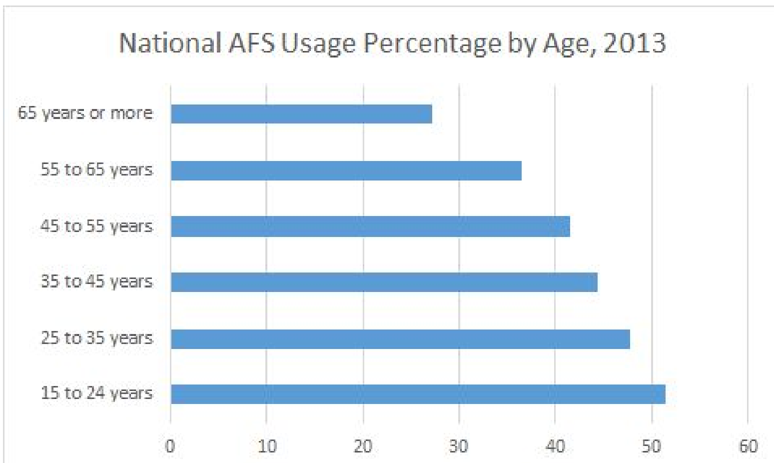


Chart 1.2

Immediately, we see two obvious, but unfortunate, discoveries. The first is that many minority groups, such as African-Americans, Hispanics, and American Indian/Alaskans, use AFSes more often than whites. In fact, Asians are the only minority that use AFSes less often than whites. It should be noted that in chart 1.1 that American Indian/Alaskans have a much smaller sample size than the other minorities - 1,464 compared to over 16,000 African-American and nearly 15,000 Hispanic respondents (“Create Custom Data Tables”). So why do so many minorities need to use AFSes? The answer to that question will involve understanding why people are unbanked or underbanked.

The second conclusion is that the younger you are, the more likely you are to use AFSes. In fact, the age group that is most likely to use these services is the 15-24 age group, judged by percentages. This is likely because that particular age group may include college students that may not have qualified for loans, or whose loans have outstanding student debt with monthly payments. It may also includes young adults that went straight into the workforce and must now find the money to pay for monthly living expenses. Perhaps their job does not pay enough for them to cover these expenses and let them have a social life at the same time.

It is also likely that they lack the financial experience that older people have. Ergo, they just do not know any better. Really, when you see an ad that says that you could have cash instantly, you think that your problems are solved. Also, by virtue of being young, they have not had much time to save up money for the future. Therefore, places like check cashers, payday loans, and the like can be seen as instant relief for any expenses that these young people may owe.

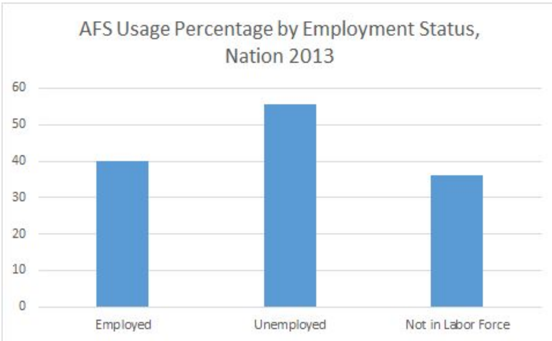


Chart 1.3

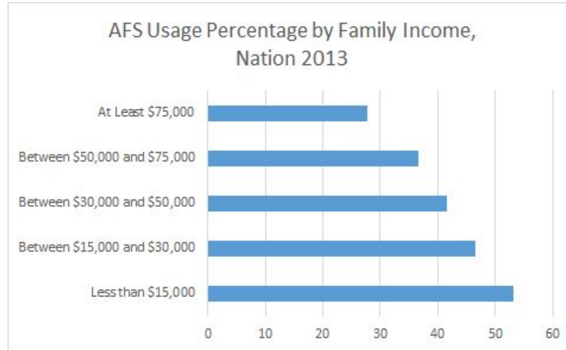


Chart 1.4

Chart 1.3 reveals that, on a national scale, those that are unemployed are more likely to use AFS than those that are employed. But what is interesting is that those unemployed are more likely to use it than those that are not in the labor force. Unemployed people are still seeking jobs; those not in the labor force are often not seeking employment at all. A possible hypothesis is because there are people not in the labor force who are either too young to work or are retired. Also, if they are unemployed, they may be more optimistic about their ability to repay the loan once they find work and may also be more used to a certain lifestyle that is more difficult to sustain on unemployment alone. Ergo, there is no logical reason for them to use AFSes.

Chart 1.4 was made from an FDIC table which had upwards of 120,000 total respondents. It reveals that the less wealthy a person is, the more likely they are to use AFSes. Those with low incomes must use these services to help pay off expenses. Surprisingly, 41.5 percent of FDIC respondents that used AFSes had an income between $30,000 and $50,000 ("Create Custom Data Tables"). It would seem that an income of around $40,000 would be enough to pay living expenses. However, consider that many respondents may be in between jobs or currently live in a house and cannot make their monthly payments. Consider also that these respondents may be young or part of a minority.

For purposes related to this paper, a breakdown of the south and a comparison with the state of Alabama to the overall Southeast region is provided below. These charts show a more detailed look at AFSes usage within the state of Alabama. First, let's look at AFSes usage in the Southeast by percentage and household numbers, based on ethnic group.

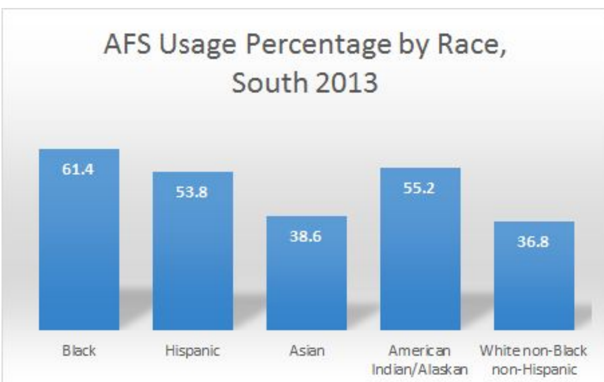


Chart 2.1

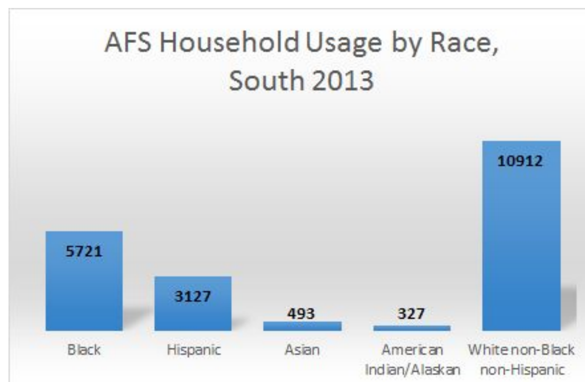


Chart 2.2

In the south, white respondents far outnumber the other ethnic groups' households put together in terms of AFSes usage. This was because the vast majority of the respondents were white. Of the 46,738 overall respondents, 29,651 of them were white. However, if looking at just percentages in chart 2.2, black respondents compose the greatest amount of AFSes users in the south. In fact, the percentage of white respondents is the lowest of the five ethnic groups. If we were to extrapolate the 61.4% of black respondents using AFSes over the 29,651 overall white respondents, we would have

18,206 black respondents using AFSes. This would far exceed the actual 10,912 white respondents who used AFSes at any point in their lives as of 2013 (“Create Custom Data Table”). Accordingly, this reflects the reality that those who belong to an economically disadvantaged ethnic group are more likely to utilize AFSes than other ethnic groups.

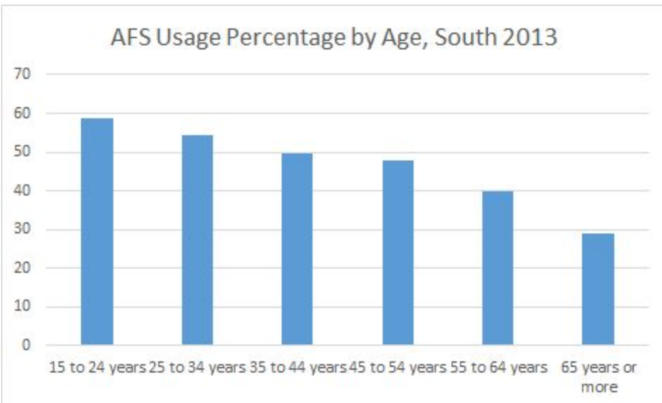


Chart 2.3

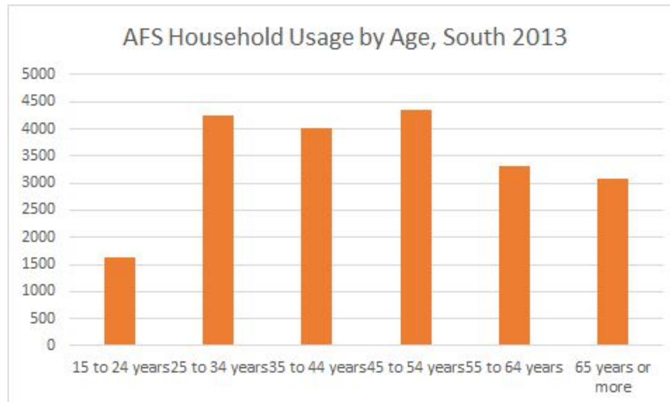
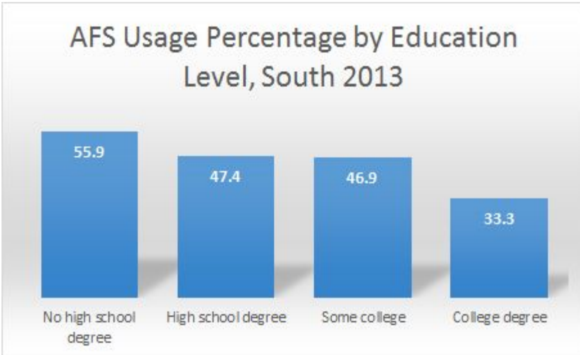


Chart 2.4

When looking at the statistics based on age breakdowns, some unusual things are discovered. While chart 2.3 slants toward the young, chart 2.4 shows that households aged 45 to 54 years old that most often used AFSes. Households with respondents aged 15 to 24 had the least amount of AFSes users in the graph. It should be noted that the sample size for 45 to 54 year olds - 9,115 - is significantly larger than the 2,784 respondent sample size of 15 to 24 year olds (“Create Custom Data Table”). Additionally, the usage graph demonstrates a decrease in AFSes usage as age increases, meaning that as you grow older, you are less likely to use AFSes.



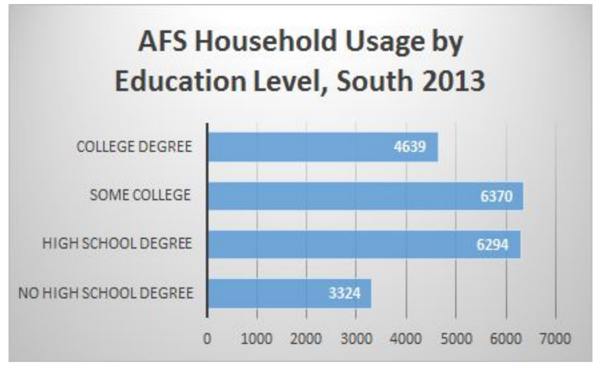


Chart 2.5 *Chart 2.6*

The same story told for ethnicity groups and age groups is seemingly being told in terms of education, as well. Chart 2.5 again shows that those with the least demographic advantage - in this case, not having a high school degree - represent the highest percentage of AFSes users. Households without a high school degree represent the smallest amount of AFSes users in the household usage chart. The largest representative in chart 2.6 are those that at least went to some college.

This seems plausible; college students are often poor and find difficulty in paying for their educational expenses including books and tuition. But the sample size for those with some college education - 13,582 - is vastly larger than those without a high school degree - 5946 (“Create Custom Data Table”). Ergo, it would not be difficult to say that those without a high school degree are the most likely to use AFSes.

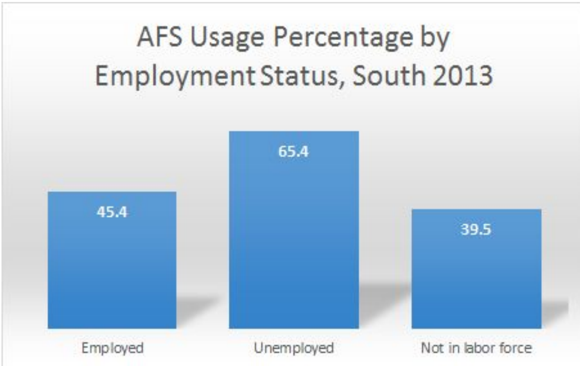


Chart 2.7

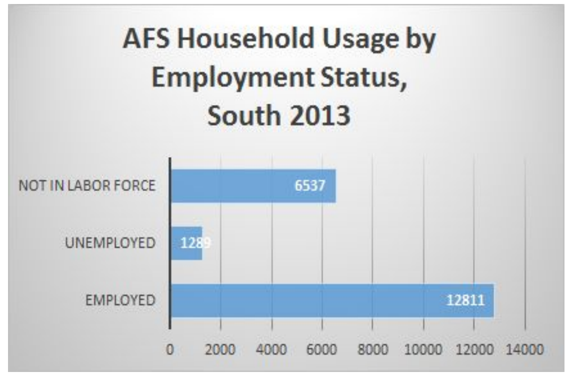


Chart 2.8

When looking at employment status, the usual conclusions could be put forth. Chart 2.7 demonstrates those unemployed make up the greatest percentage of AFSes users. However, those employed make up the greatest amount of households that use AFSes. This difference between the two categories in chart 2.8 could be explained by the difference in sample sizes between the two categories. There were 1,971 unemployed respondents compared with 28,218 employed respondents ("Create Custom Data Table"). If we were to extrapolate the employed respondent number to the unemployed percentage - 28,218 times 0.654 - it would equal 18,455 - a far greater number than both the employed and unemployed households that used AFSes. Given this knowledge, it would be easy to assume that those that are unemployed are more likely to use AFSes than those that are employed. This is especially true given their need to pay for expenses without a steady income.

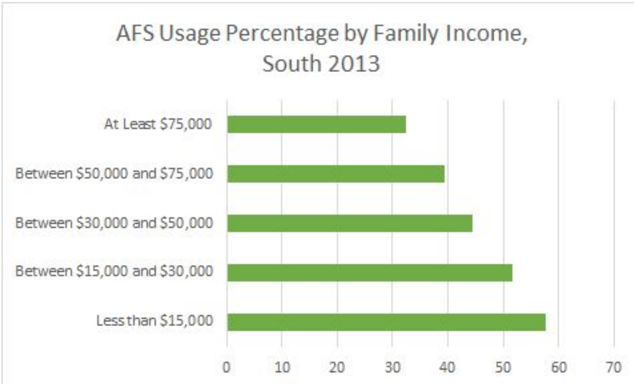


Chart 2.9

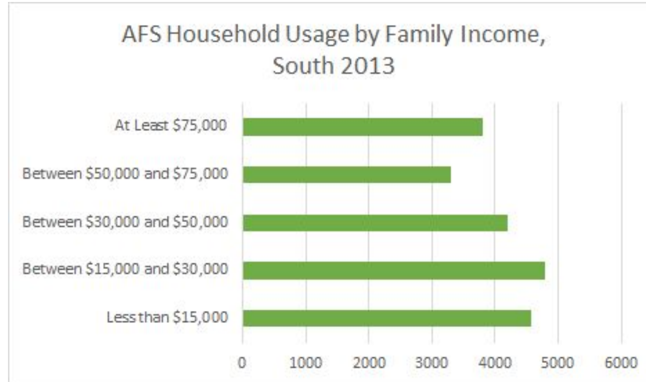


Chart 2.10

Lastly, in Chart 2.9, respondents with less than $15,000 in income represented the greatest percentage of AFSes users in the south. But what is telling is that these respondents make up the second-greatest amount of household respondents in chart 2.10. This is especially surprising given that the 7,906 sample size of the that group is smaller than the sample sizes of all but one of the other levels of family income (“Create Custom Data Table”). This demonstrates that having low income is likely the biggest factor in using AFS. The greater the income, the less likely people are to use AFSes.

The story being told in the south is that those in less than ideal situations are likely to use AFSes. Whether it is a lack of education, low salary, lack of employment, or a combination of any of the three, these respondents use AFSes to alleviate the financial situations that they are in. Sometimes, the AFSes prey on these unfortunates by providing them with easy solutions to their economic problems. This is the case for the other regions in the country as well. But what specifically does Alabama look like?

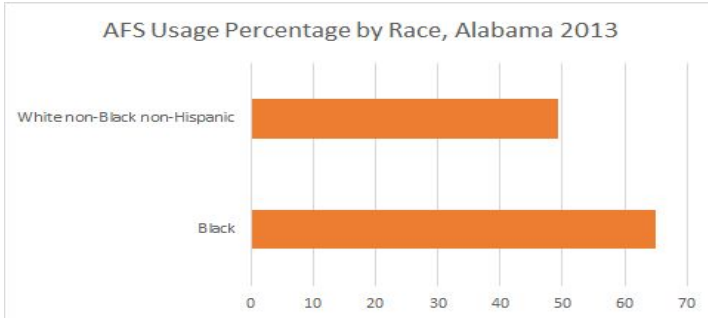


Chart 3.1

In the Alabama survey, only two ethnic demographics were provided: black respondents and white non-black non-hispanic respondents. For the purposes of this comparison, we will only take a look at those two and compare it to usage percentages in the rest of the south. AFSes usage for black respondents in Alabama is a little higher than in the South overall. It appears as though Alabama is more poor than much of the rest of the south, as least in terms of ethnicity. Can the same hold true for age?

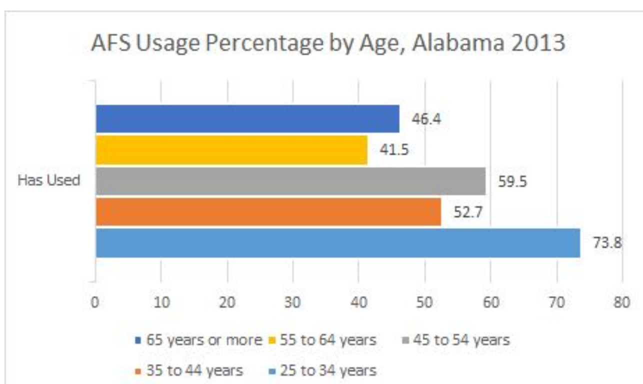


Chart 3.2

The 15 to 24 age group is not listed here, indicating that either the sample size was too small or that many people aged 15 to 24 do not have proper experience with dealing money. Either way, usage percentages in Alabama are either equal to, or much higher than, the same usage percentage figures in the South across the board. Keep in mind that these percentages are the amount of people in a given sample size that said that they had used AFSes before. In looking at this and the ethnicity chart, the implication that Alabama is one of the most AFS-heavy states looms large.

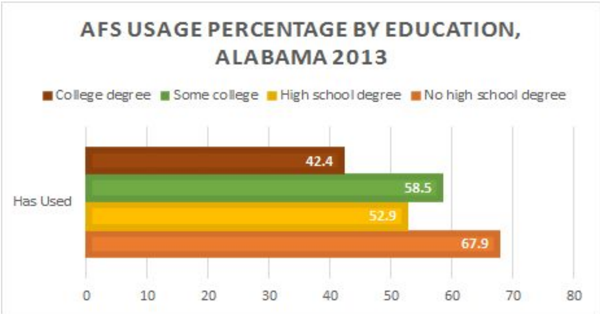


Chart 3.3

What we see indicated in Chart 3.3 based on education is alarming. Around two-thirds of every respondent without a high school diploma has used AFSes at some point in their lives. Compare this to the 55.9 percent figure for all of the south and it looks even grimmer. Even if you have completed some college or have a college degree, you are very likely to use AFSes in Alabama. There may not be enough opportunities for those with degrees in the state. It may also be that the jobs that people are seeking are not available in the state of Alabama. Either way, it is clear that education is not being rewarded.

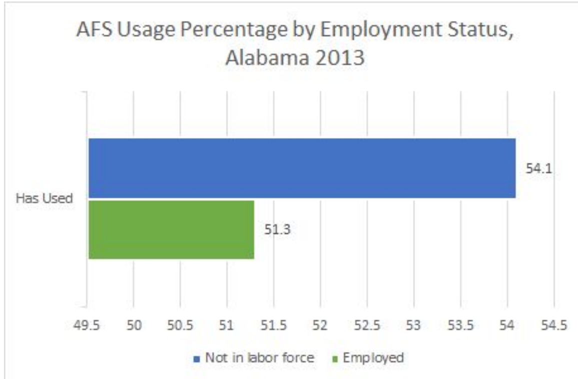


Chart 3.4

Chart 3.4 is fairly simple given that there were only two types of employment surveyed here: employed or not in the labor force. Due to the absence of the unemployed from the Alabama surveys, these figures are considerably inflated. In spite of this, it appears as that the narrative for employment and AFSes usage is as consistent in Alabama as it is in the south and across the nation. Those that are not in the labor force or unemployed are more likely to use AFSes than those that are employed. Of course, it should not come as a surprise to anyone that not having a job makes it easier to use AFSes. However, these statistics illustrate the point.

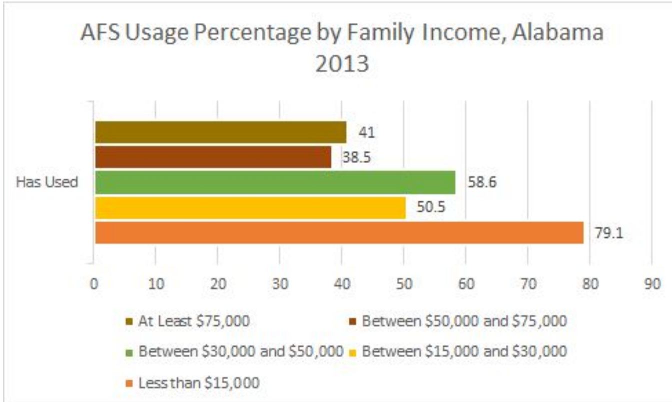


Chart 3.5

Finally, the family income chart shows Alabama has a much larger wealth gap than what is usually seen in the south. What do I mean by this? At the two extremes - less than $15,000 and at least $75,000 - the AFSes usage percentages are far greater in Alabama than in the south overall. But for other income levels - such as those between $50,000 and $75,000 for instance - the levels are about even. This suggests two surprising things: First is that those with at least $75,000 of annual income, while not likely to use AFSes, will still use them far more often that the average southerner, possibly because the standard of living in Alabama is low. Secondly, those with less than $15,000 in annual income - essentially, those without a job - are all but guaranteed to use AFSes. There is a chance that many of the people with an annual income below $15,000 do not have a high school degree.

We have found that, across the nation, AFSes users are more often than not disadvantaged in one way or another. These people may be racially disadvantaged, unemployed, or lacking either experience, income, or education. This is especially true in the south and even more true in Alabama. These charts show that Alabama is as likely to use AFS as anyone in the nation. In fact, Alabama has created conditions where, on a low enough income, you may be forced to use AFSes. This clearly is not the most effective, nor the most efficient, solution toward helping the disadvantaged in Alabama. Although a statistical picture for the city of Madison could not be made, these charts can provide a good idea at the impact AFSes usage has on the city.

The true picture of AFSes in Alabama cannot be provided by these charts alone. It is with a combination of previous studies that paints an unflattering picture for the state. Remember that alternative financial service providers locate themselves in “areas with greater concentration of African Americans” (Gallegos, Gross, Hogarth, and Manohar 2). The high African American population in the south and its reputation for being an uneducated area of the country make the south a prime target for AFSes providers. It is no wonder, then, that they are so abundant in this region, especially in Alabama.

The legality of payday loans varies across states. As of 2016, twelve do not have any specific payday lending statutory provisions. If we consider the southeast to cover the area from Texas to North Carolina, then only three of those states - Georgia, North Carolina, and Arkansas - have outright prohibited payday loans. Thirty-eight states - including every other state in the southeast - allow them. Alabama, Florida, Mississippi, South Carolina, and Tennessee allows payday loans up to $500, while Louisiana allows loans up to $350 (Morton). Mississippi and Kentucky only allow check cashers to give out loans. Each of these states has an APR of at least 300% (“Legal”).

Let’s consider the west to be every state from California to Colorado. In this region, only Arizona outright prohibits payday lenders. Every other state allows payday loans to some degree. It should be noted that Montana placed a cap on APR percentage at 36% (effectively banning payday lending), while Colorado and Oregon both ban high cost payday lending. For the states that allow payday lending, Utah, Nevada, and Idaho have no limit on APR; every other one of these states has at least a 390% APR ("Legal").

Here, the northeast is considered to be every state from West Virginia up to Maine. In this region, every state except for New Hampshire, Rhode Island, and Virginia prohibits payday lending in some way, shape, or form. It seems that the northeast is the least accepting of the regions when it comes to payday lending. One possible hypothesis to explain this is the region's proximity to, and inclusion of, Washington DC. The political environment there is reflected throughout the entire region. In this case, DC would seem to be strongly against payday lending, a notion that is reflected throughout the northeast. Here, there is a major regional difference in the treatment of AFSes ("Legal").

For the purposes of this paper, the midwest will be considered to be North Dakota to Ohio. In this midwest, every state allows for payday lending and only one - Ohio - has put a cap on APR at 28 percent, essentially banning it. All but two of the other states allow a maximum of $350 to $600 to be used for payday loans. In Illinois, the "lesser of $1,000 or 35% of a customer's gross monthly income" is the maximum amount allowed for a loan. In Wisconsin, that amount goes up to $1,500 ("Legal").

So it appears that the south, statistically, is not the worst region for payday loans. However, it is also clear that payday lending, and AFSes usage in general, is a widespread problem across the southeast, and for most of the nation. Even if payday lending were to be banned across the nation, other forms of AFSes could still persist. Georgia, for example, could find that pawn stores and rent-to-own stores are perfectly legal. So payday lending is only part of the story.

Mobile phones have become much smarter and more important to our daily lives than we could have ever anticipated. Today, they are capable of helping us with financial transactions through apps for the local banks. The Board of Governors of the Federal Reserve System took note of this and proposed that mobile phones could impact how people managed their finances. Additionally, they also believed that innovative financial service technologies could help foster financial access to unbanked and underbanked people. To that end, a survey was conducted in December 2011 and January 2012 by the Board's Division of Community and Consumer Affairs. This survey was done in order to better understand consumers' use of and opinions about mobile financial services.

There were several key findings that were discovered in the survey. The survey found that "11 percent of U.S. consumers were unbanked and 22 percent were underbanked" (Gross, Hogarth, and Schmeiser). Unbanked and underbanked consumers had a better chance than fully banked consumers to have lower incomes and be younger, minority, female, unmarried, and unemployed than fully banked customers. They were also less willing to pursue financial risks and more likely to use AFSes. In terms of mobile phones ownership, "63 percent of unbanked consumers and 91 percent of underbanked consumers have a mobile phone" (Gross, Hogarth, and Schmeiser).

Of the people that responded, the most frequent banking activity reported was checking account balances. The most frequent mobile payment activity was paying a bill.

28 percent of underbanked consumers have used mobile banking and 17 percent have use mobile banking in the past 12 months. For comparison, “21 percent of fully banked consumers have used mobile banking and 12 percent have used mobile banking in the past 12 months” (Gross, Hogarth, and Schmeiser). This suggests that underbanked consumers and fully banked consumers have an equal chance at having a mobile phone used for financial purposes. However, this was not quite proven to be the case.

Of those that responded to the report, 87 percent stated that they had a mobile phone. Only “63 percent of unbanked households owned a mobile phone, compared to 91 percent of the underbanked and 90 percent of the fully banked” (Gross, Hogarth, and Schmeiser). Of those that owned mobile phones, two-fifths of them had smartphones. Underbanked households are more likely than the unbanked, and even the fully banked, to have a smartphone. 57 percent of those households owned a smartphone, while 26 percent of unbanked and 44 percent of fully banked households could say the same.

The median age of an unbanked household is 39. Of those households, 36 percent are ages 18 to 29; over 8 percent of those same households are in excess of 60 years old. 74 percent of unbanked households do not have an education beyond high school. The unbanked are also unlikely to be homeowners; only 42 percent claim to be as much. For comparison, “60 percent of the underbanked and 76 percent of the fully banked are homeowners” (Gross, Hogarth, and Schmeiser). Individuals who are currently experiencing unemployment, but still in the labor force, are more likely to be unbanked. 32.5 percent of respondents - virtually one out of three - report that they are temporarily laid off or are looking for work.

In terms of using alternative financial services, the results of the survey were sadly predictable. The survey found that the unbanked and underbanked were more likely to use alternative financial services. These services include check cashers; payday, title, and pawn lenders; or rent-to-own services, even though AFSes were available in the same neighborhoods as financial institutions. Two-fifths of underbanked households responded that they had used a payday loan before; two-thirds of those households had used one within the past twelve months. In comparison, “about one out of six unbanked households had ever used a payday loan and about one in twenty fully banked households had used one” (Gross, Hogarth, and Schmeiser).

Furthermore, the board tested the financial capability of these respondents by asking the questions pictured above. Less than half of the unbanked respondents correctly answered a question about inflation, while two-thirds of the underbanked respondents and three-fourths of the fully banked respondents answered that same question correctly. On a question about “relative rates of return on savings accounts, government bonds, and stocks”, three out of ten unbanked households, half of the underbanked, and three-fifths of the fully banked provided a correct response (Gross, Hogarth, and Schmeiser). Finally, when asked about the risks associated with investing in stock mutual funds, half of the unbanked households correctly answered. In comparison, two-thirds of the underbanked and four-fifths of the fully banked households correctly answered this question.

Bertrand and Morse contend that those that use AFSes are aware of the risks involved. However, as part of their report, they conducted surveys with 187 people on the financial literacy of payday borrowers. Many questions were asked although three main questions were asked. They set up this survey as follows: payday lending is widely believed to be a fairly transparent transaction. However, they do not trust that some people fully understand the implication of the fee structure, such as how the fees add up over periods of refinancing.

First they asked, to the best of their respondents' knowledge, what "the APR on a typical payday loan in their area" was (Bertrand and Morse 17). Next, they asked their respondents, to the best of their knowledge, how much it costs in fees to borrow $300 for three months from a typical payday lender in their area. Finally, they asked their respondents what their best guess of how long it took, in weeks, the average person to pay back in full a $300 payday loan.

For question 1, the answers varied by the individual. It was found that "there is a bulk of people (about 30%) who know that the APR is too high" (Bertrand and Morse 18). However, other respondents claimed that it is close to the dollar cost per hundred that they borrow. Nevertheless, they were taken aback at how little APR knowledge many of the respondents possessed. It cannot be denied that those that are unbanked are not as financially literate and capable as those with a bank account. Even those with a bank account that still occasionally use AFSes are less financially capable than those that are fully banked. This does imply a statistical correlation between using financial literacy and using AFSes, but the empirical evidence suggests it does.

Chapter 3: Why? Motivations for using AFS

Now that the users of AFSes have been identified, the next question that must be answered is why they use them over banks and the stock market. Why do these people choose to use these services when there are far superior options available? The answer to this question is threefold. First, credit status has a dramatic effect on people's usage of AFSes. Second, many people may face barriers to having accounts at banks and credit unions. Third, the psychology of these people plays a role, namely their confirmation biases.

In 2007, Americans paid an "estimated $8 billion in financial charges to borrow more than $50 billion from payday lenders" (Bertrand and Morse 1). This is an astounding amount of money that could have been circulated into the economy and helped to create prosperity for these same Americans. There is a belief that people who are financially illiterate to the point that they need these services are preyed upon.

In March 2009, Bertrand and Morse wrote a paper together titled *Information Disclosure, Cognitive Biases, and Payday Borrowing*. They suggested that the mere act of individuals taking out payday loans "does not prove that these individuals are being fooled or preyed upon" (Bertrand and Morse 2). Rather, they are completely knowledgeable of the fees associated with these services. A possible hypothesis is that they may not have realized when these services advertise on television and radio, they do so to anyone that is willing to watch or listen. Their ads are broadcasted to any audience that is interested in their offer, whether they are in a financial bind or not. These services are indiscriminate in their advertised efforts.

The study also contends that there are people who may experience some self-control problems that should be factored in. There may also be customers that have “overly optimistic expectations about repaying their loans” (Bertrand and Morse 2). The duo also suggest that there are people that use these services and possess neither of these problems; they simply face a pressing need for cash at a time when they lack access to other cheaper forms of financing.

There is also the event when the cost of a single decision is not considered in an additive way over time. This is often called the *peanuts* effect. This is when people do not consider the consequence of a small dollar transaction because small amounts of money are “peanuts” (Bertrand and Morse 6). Payday borrowers may view each loan fee as peanuts and fail to add up the cost over time.

Financial education and having financial literacy reaps benefits that last a lifetime. One of those benefits is greater lifetime household accumulation - being more financially educated will lead to earning more money over the lifetime of the household. But can this be statistically proven? This is what professors Jere R. Behrman, Olivia S. Mitchell, Cindy K. Soo, and David Bravo attempted to show. They sought to show that people who find it difficult to understand their financial environment are also less likely to accumulate wealth.

In order to successfully gauge this hypothesis, the team took three measures. First they created a “more complete set” of financial literacy questions to ask (Behrman, Bravo, Mitchell and Soo 300). Next, they use a unique dataset called the Chilean Social Protection Survey, the objective of which is to “evaluate the effects of financial literacy for a richer range of ages and schooling than heretofore available" (Behrman, Bravo, Mitchell, and Soo 300). Finally, the team uses a set of "plausibly exogenous instrumental variables" that demonstrate that financial literacy is "positively, significantly, and substantially associated with wealth outcomes even after controlling for schooling" (Behrman, Bravo, Mitchell, and Soo 301).

The financial literacy set consisted of 12 questions. Of those, three vital questions were developed and implemented in the United States Health and Retirement Study. Next, there is a set of three, more "sophisticated" questions that are meant to measure more "complex" concepts like compound interest, inflation, and risk diversification (Behrman, Bravo, Mitchell, and Soo 301). The remaining six questions focus on key aspects of the Chilean Retirement System. These aspects include the mandatory contribution rate, minimum male and female retirement ages, how pension benefits are computed, whether people know about the welfare program for the elderly, and whether people know they can contribute to a Voluntary Pensions system.

In the United States, the CSPS revealed that many respondents "do not possess much understanding of basic economic concepts" and have "little knowledge of the pension system." (Behrman, Bravo, Mitchell, and Soo 301) Only half of the respondents could answer the core questions, and even less than that could answer the sophisticated questions. Regarding knowledge of the pension system, the majority of the respondents knew the legal retirement ages, but only about one-third knew contribution rates and only ten percent could explain how benefits were computed. About half of the sample knew about both the guaranteed minimum benefit and the Voluntary Savings plan.

The responses were aggregated by using an approach that they call PRIDIT. The approach is done in two steps. First, each question is weighted by difficulty, applying a greater penalty for not answering correctly a question that more of the population answers correctly, but greater credit for answering correctly questions that more respondents answer incorrectly. Second, principal components analysis is applied in order to take into account correlations across questions. The PRIDIT scores indicate "how financially literate an individual is in relation to the average population and to specific questions asked" (Behrman, Bravo, Mitchell, and Soo 301).

The collection of professors were interested in the outcomes of *total net wealth* and its components: pension wealth, net housing wealth, and other wealth. In their study, *pension wealth* measured 54 percent of total net wealth, which was around $38,600. It is their belief that pension wealth is reported relatively accurately because "respondents receive annual government statements outlining their pension system accruals" (Behrman, Bravo, Mitchell, and Soo 302). Net housing wealth is based on self-reported data on market values minus estimated mortgage debt. Lastly, *other net wealth* includes items such as self-reported business wealth, as well as agricultural and other real estate assets.

Their primary explanatory variable, in addition to financial literacy, is schooling attainment. In their survey, they measured three different levels of school. There was primary school, referring to grades 1 - 8; secondary school, referring to grades 9 - 13; and postsecondary school, which refers to grades beyond secondary, but up to a maximum of

20. The results showed that "the average schooling attainment in our samples is 10.4, with a standard deviation of 3.9 grades" (Behrman, Bravo, Mitchell and Soo 302).

For their empirical findings, the professors used ordinary least squares (OLS) to determine if there was a relationship between financial literacy and wealth accumulation. It was consistent with previous studies that demonstrated that financial literacy was "positively and significantly" associated with total net wealth and its components and that "controlling for the effect of schooling reduces the magnitude of the effect of financial literacy by almost half" (Behrman, Bravo, Mitchell, and Soo 302). This effectively means that financial literacy has an impact on schooling.

The empirical analysis provides estimated impacts of financial literacy and schooling using the above independent variable (IV) strategy. When just PRIDIT is used, the coefficient estimates are positive, significant, substantial, and two to three times larger than the comparable OLS estimates. With just schooling, the coefficient estimates are positive, significant, substantial, and "16 - 84 percent larger than the comparable OLS estimates" (Behrman, Bravo, Mitchell, and Soo 302). Either way, it demonstrates that OLS estimates greatly understate the effect of financial literacy of wealth accumulation.

The IV estimates imply that a 0.2 standard deviation increase in the PRIDIT financial literacy score would correlate with an increase of net wealth by an average of $13,800. Of that money, "$5,200 of that was gained in pension wealth, $1,600 in net wealth, and $6,900 in other wealth" (Behrman, Bravo, Mitchell, and Soo 303). That same increase would also boost the density of pension contributions by an average of three percent and the probability of calculating retirement monetary needs by an average of 0.5 percent.

When schooling is added to their financial literacy model, they find that the interaction term is positive for all wealth components. It is also substantially more precisely estimated than the linear financial literacy and schooling terms. These finding suggests a specification that includes only the interaction between financial literacy and schooling terms. Ultimately, the professors found that “in all cases, the estimated effects for financial literacy-schooling interactions are positive and substantial for wealth” (Behrman, Bravo, Mitchell, and Soo 303).

What this ultimately shows is that greater financial literacy scientifically correlates to an increase in lifetime earnings. Thus, there is proof that education brings benefits to those that are willing to learn. However, the AFSes continue to prosper, in part, because the opportunity to be educated is not always available. High schools may not offer these classes in their curriculum. If they do, students may decide not to take them in order to get their diploma. Even if colleges offered financial literacy courses, it is doubtful that those that need them the most can even afford to attend college.

Is there a psychological motivation for these customers to trust these services over banks? Lisa Servon is a professor and former dean of Milano School of International Affairs, Management, and Urban Policy in New York City. As part of her research, she spent four months in 2013 working as a teller at RiteCheck, a check cashing business in the South Bronx. In the winter of 2014, she sat down with the Federal Reserve Bank of Philadelphia and was asked what she learned from working at a check cashing business.

She explains that “Most of the customers that I worked with and interviewed at RiteCheck made informed choices about how and where they got their financial needs met” (Servon). She also found that banks were not the best choice for most check casher customers. She claimed that at check cashiers, “fees are more transparent than they are at banks, the hours and locations are convenient, the services provided are what customers need, and customer service is excellent” (Servon). She also provides some insight into how these check cashiers supposedly treated customers better than banks.

In her experiences with customers, she found that those who use RiteCheck would rather pay predictable flat fees that they understand rather than incur unexpected changes and overdraft fees. Customers found overdraft fees “particularly hard to manage” (Servon). She also went into great detail on interactions between employees of RiteCheck and typical customers and what RiteCheck offered customers that a bank could not. In her experiences, the words “service”, “trust”, and “respect” came up repeatedly, signifying that the check casher attempted to use pathos in gaining new customers by treating them as individuals and doing everything in their power to help them (Servon).

She concluded her interview by saying that “There’s a large gap between the rhetoric of policymakers and the lived reality of the low-income people using check cashers. If we really want to help low-income people have better access to financial services, we have to listen to what they need instead of assuming that what we do is best for them” (Servon). This statement, as well as most of what she said during her interview, helped gain some insight into the basic motivations for the users of these services. One hypothesis for these motivations is that people desire trust and recent world events have played a role in the creation of that trust.

For many people, their trust in banks and the stock market was eroded in the wake of the 2008 Global Financial Crisis. Malignant behavior and abuse of money by these legitimate financial institutions in dealing with the housing markets heavily damaged the financial holdings of many Americans. For some Americans, the crisis effectively wiped out their retirement savings. This sudden transformation in wealth status from being middle-class to being considered low-income shocked and angered these customers and caused them to take their monetary needs elsewhere. Even without this crisis, there is the process of dealing with banks in handling income.

Servon mentioned that banks would “often spur overdraft fees and unexpected charges on customers without warning” (Servon). In essence, they created sudden changes and unnecessary complexity in their financial dealings. In recent years, people have learned to value simplicity and straightforwardness in their endeavors. Any sudden changes like overdraft fees can cause confusion and anger in people if they are not fully explained or not specified as a feature of holding a checking account from the beginning. These customers put trust in the banks that they would deal with just a flat fee in order to maintain their checking accounts. They see these fees and charges as a betrayal of that trust and an unnecessary way for the banks to get more of their money, especially after the banks wiped out their money in 2008.

AFSes provide straightforwardness, offering just a flat fee for customers, without any overdraft fees or surprise charges. To most people, it is a quick way to get some cash and pay off their bills. Yet these borrowings do build over time and capture people in a vicious debt cycle. However, these customers are not concerned about the long run. Instead they are worried about how to keep their lights on or how to feed their children and keep them healthy. They are constantly fretting about how to pay the monthly rent or mortgage payment to keep a roof over their heads. They may also be trying to keep their kids happy by getting them the newest Nikes or the latest smartphone. Many of these customers live paycheck to paycheck and sometimes that paycheck is not sufficient enough to help them maintain a decent standard of living. AFS providers sympathize with their plights and treat them like ordinary people, making things as easy and straightforward as possible.

In their study of mobile phone usage by the unbanked and underbanked, the Board of Governors of the Federal Reserve conducted a survey in order to understand why some customers were unbanked. In that survey and the Board's 2010 Survey of Consumer Finances, three common reasons for being unbanked were discovered: consumers often found they don't like dealing with banks, they didn't think they wrote enough checks to make it worthwhile, and they thought the fees and services were too high. Additionally, 10% of respondents that said that "no bank would give them an account" (Gross, Hogarth, and Schmeiser).

The board also conducted a survey asking what types of risk each type of customer would take. The options were taking substantial risk for substantial gain, above-average risk for above-average gain, taking average risk for average gain, or taking no risk at all. Three-fourths of the unbanked respondents refused to take any financial risk at all. In comparison, “half of the unbanked respondents and just over one-third of the fully banked respondents” indicated that they would take at least some form of risk (Gross, Hogarth, and Schmeiser).

The board of governors claims that this risk aversion can be explained by numerous factors. It may be related to inexperience with financial products and services. They claim that “this may explain, in part, why the unbanked scored low relative to other respondents on the financial capability questions” (Gross, Hogarth, and Schmeiser). The greater risk aversion among the unbanked may also reflect the fact that low-income individuals have little, if any, margin for error or loss in their finances.

Another hypothesis that may explain risk aversion is, again, the fallout of the 2008 crisis. A host of these unbanked customers are weary of dealing with major financial institutions. They hold the banks and stock market responsible for their financial desolation. They believe themselves to have been wronged and in that, their trust in services were broken. Yet these people need money to keep themselves afloat on a week to week basis so, rather than put their faith in something that they know they cannot trust with their finances, they go to AFSes in the hopes that they will not be fooled again.

In spite of this, mobile financial services offer an opportunity for some economically unfortunate customers. They could possibly gain a sense of financial literacy and break the cycle of debt a payday loan yields. With the unbanked and underbanked, there is a vast potential for companies to not only improve their financial standing, but to also improve their community. 28 percent of underbanked customers and 10 percent of unbanked customers make use of mobile phones. Of these consumers, “close to 100 percent” of the unbanked and three-fifths of underbanked customers said that they were satisfied in some way (Gross, Hogarth, and Schmeiser).

In choosing mobile banking over other, less legitimate channels, these customers end up satisfied with themselves and their financial position. So what’s stopping more people from using them? As it turns out, it is for more reasons than seems likely. A survey conducted by the board revealed that for customers that have a mobile phone but do not use mobile banking, the two common reasons that fully banked and underbanked customers did not use mobile banking services were that “their banking services were already being met with existing services” or “that they have concerns about the security” (Gross, Hogarth, and Schmeiser). For the unbanked, common reasons were that they did not have a bank account, security concerns, and a lack of trust in the technology.

For the fully banked and underbanked who do not use mobile payments, the top three reasons were “concerns about security, not seeing any benefits to using mobile payments, and that it was easier for them to pay another way, such as through credit card or cash” (Gross, Hogarth, and Schmeiser). Across all banking statuses, security was the top concern, and why would it not be? In the current economy, most want to make sure that their lives go as smoothly as possible. Additionally, the underbanked were the least likely of the three groups to admit that their phones were lacking the necessary feature to perform. This is consistent with the underbanked having the highest rate of smartphone ownership among the three groups.

But for the unbanked, a deeper story is being told. In addition to security concerns, they indicated they were most worried about a “significant lack of trust” in the technology (Gross, Hogarth, and Schmeiser). This implies that the only mobile phones that the unbanked could afford are phones that are either outdated or lacking the technological power to perform these services. In addition to this, the unbanked were the least likely to indicate that they did not see any benefit from using mobile payments. This may indicate that the unbanked are open to using mobile technology as a means of performing financial transactions, provided that their concerns about the security of the technology are addressed.

In order to better understand why people cannot be accepted into banks and credit unions, I went to interview branch managers for Regions Bank, Redstone Federal Credit Union, and Alabama Credit Union. At each financial institution, I asked the branch manager three questions: What is required to hold a checking account? What type of people held checking accounts at their financial institution? And how often they had to turn a person away from their institution and deny them a checking account?

I first interviewed Donna Duke, the branch manager for the Alabama Credit Union branch at the University of Alabama in Huntsville. Unlike a bank, a credit union member had to have an account. Mrs. Donna Duke (Alabama Credit Union branch manager) stated in order to open a savings account, one must have "$5 stay open in the account at all times while he or she was a member", while another $1 constitutes a one-time membership fee. After that, he or she would be able to open a checking account, with a $50 deposit. She noted that if you did not have $50 to open, the credit union would take a smaller deposit.

Since the branch that I interviewed with was on the UAH campus, many account holders at that branch are students and faculty of the university. However, the branch is willing to service anyone in Madison county and in any of the counties that the credit union serves in. They have not had to turn away many customers because they had many different guilds of membership. However, if a prospective member was just 18, he or she would need a parent or a guardian on their account.

After her interview, I spoke with Yasmin Baria, a branch manager for Regions Bank. She prohibited the interview from being recorded, so her answers were written down. She said that in order to hold an account at Regions, a member must be over 19 years of age (if they do not want anyone else on the account), provide a state-ID, and deposit $50. Baria could not describe what type of people held accounts at that Regions branch, but stated that “they only turn down potential members if they have defaulted at any U.S. banks”, resulting in the accounts being charged off.

Finally, I attempted to interview Tammy Crayton, the branch manager of the Redstone Federal Credit Union branch on Highway 72. However, she elected to let one of her assistants answer all of the questions. Mrs. Crayton’s assistant explained that in order to hold a Redstone account, “you must have a basic savings account before he or she does anything else.” The savings account must be opened with $5. At that point, one can open any checking account that they desire. Redstone has three different checking accounts: the Easy checking account, which requires no money to open, the Extra Checking account, which requires an initial deposit of $100, and the relationship checking account, which requires $500 to open.

In terms of the type of customer that goes to that Redstone branch, they have customers whose age range spans from 13 on up. They also have working people - people who have jobs - as members. These people often have direct deposit so their checks go directly to their Redstone checking accounts and frequently use Redstone to pay their bills. They do not turn customers away often; this is because Redstone has a type of account called a Gateway Checking account. It works like this: if one has had a bad history with banks, or even with Redstone, and they owe money, the Gateway Checking account allows them to reestablish their relationship with the credit union. So it is considerably difficult to be turned away, unless one had a large amount of money owed to Redstone and they had not received the money.

Unfortunately, those most likely to use AFSes are the unbanked and underbanked, who are often times young. So, they do not have the experience necessary to get a job that will allow them to have the money necessary to open an account.. Even if they were able to hold a job, it may not pay all that much. If they are living on their own, then living costs - rent, utilities, internet, insurance - all adds up and they're left with enough to maybe eat out one night. So it is entirely plausible that you could get a job and still be unable to open a checking account.

Chapter 4: Solutions

With all of these problems discussed, the big question now is this: what solutions are there to solve these problems? In order to answer this question, three types of solutions can be looked at. First, what types of solutions have already been implemented? Second, what solutions are in the process of being implemented in this country? Lastly, what types of solutions can be implemented and how can they involve the local community?

The concerns of critics of AFSes have not fallen on deaf ears in Washington. Already, solutions are being implemented to help curtail the debt spirals instigated by these services. As of 2009, 13 states and the District of Columbia have disallowed the use of these services. Several other states have placed a cap on the APR. The 2007 Defense Authorization Act "limits the implicit interest rate on payday loans to military personnel" to 36 percent (Gallegos, Gross, Hogarth, and Hughes 1). However, the market continues to flourish in at least 30 states (Cowley).

A study found that rate caps are an effective way to limit pawn shop use, but "do not have a significant effect on payday loans" (Gallegos, Gross, Hogarth, and Hughes 2). While one form of AFSes may be curtailed and bring money into the economy, another could take its place and gain the customers lost by the pawn shop ban. So the problem of AFSes is allowed to persist.

In their thesis, Bertrand and Morse suggest education to enhance financial sophistication. They believe that greater financial education will help make people more comfortable with mainstream financial institutions such as banks and the stock market. It is their belief that this education will also help people budget better and enable them to understand an increasingly large and complicated menu of debt and investment products.

While they try to show that a relationship exists between financial literacy and indicators of superior financial decisions, they are unable to determine whether the relationship is “causal” (Bertrand and Morse 3). They contend that access to, or exposure to, financial education might be correlated with unobservable individual or household characteristics. They believe that this can lead to making better financial decisions. Also, because people cannot be forced to learn, it is “unclear whether financial education can truly effectively reach those that might benefit the most from it” (Bertrand and Morse 3).

The pair also suggest a third solution: for lawmakers to better understand how users of various financial products can better understand the costs and benefits of these products. They contest that improved disclosure can help reduce mistakes for on-the-spot uses of a financial products like mortgages or payday loans. By this, they mean that “it is easier to ensure that the at-risk population is being exposed, and that they are being exposed to the site-relevant information” (Bertrand and Morse 4). Another reason that this measure might work is that the content and form of the disclosure should be both a conveyance of information, and a tool to “de-bias” individuals at the point of decision (Bertrand and Morse 4).

They suggest providing an example to help their argument that this idea works in real life. People might not be aware of how high the APR is on payday loans. They say that “ APR disclosure is mandated by state and federal law” (Bertrand and Morse 4). Despite this, payday loan stores often provide a large pricing menu for their services expressing how expensive their fees are. Therefore, they believe the only cost information that the borrower internalizes is this dollar fee of the loan. Their conclusion is that “people might confuse the fee structure they face when taking out a payday loan for the APR” (Bertrand and Morse). By making disclosure requirements stronger for APR, borrowers could better understand how costly using a payday loan truly is.

The idea of improved disclosure, like almost all ideas, has its strengths and weaknesses. While the strengths have been discussed, there are limitations to this. For example, because of bad credit reports or limitations that prevented them from having accounts at banks or credit unions in the first place, customers may still be forced to use AFSes. Bertrand and Morse also suggest that people may understand what an APR is, but fail to understand its importance. They may also ignore rates and “put them as being of secondary importance to just managing the current-month budget” (Bertrand and Morse 4). In either case, strengthening APR disclosure would not increase actual understanding the costs of payday borrowing.

In their paper, the stop smoking method is explained. Essentially, this is getting a smoker to think about “not just the next cigarette”, which would only have marginal effect on health, but on “the next year of cigarette smoking” (Bertrand and Morse 6). Applying this to using payday loans, there should be an education initiative that compels low-income residents to think about more than just the first fee. They should consider the adding up of fees over time. There should be a demonstration on how fees add up over time and send consumers into a debt spiral. That way, consumers can be effectively informed about payday loans before they decide to take a loan to pay for their troubles.

The ultimate experiment of their paper was to “mandate disclosure of information in a form that enables people to overcome limitations of biases at the point of the decision” (Bertrand and Morse 1). To that end, they found that people who receive the dollar adding-up treatment are “5.5 percentage points less likely to borrow from the payday lender in the pay cycles that follow the intervention” (Bertrand and Morse 8). What does this mean exactly? It shows that customers receiving greater information about payday loans are less likely to purchase them.

Bertrand and Morse’s research provides an invaluable insight into the psyche of potential payday loan users. It demonstrates that they will make better decisions if they are given information that will help them broaden their minds about payday loans. With these revelations come a grand opportunity for educational institutions to provide this information. They could start at a young age, with high school economics classes including payday loans into their curriculum. Universities could include payday loan classes in order to help prospective students learn more about them. There is no limit as to how valuable information can be.

A discussion of how financial literacy affects household wealth accumulation came to some interesting conclusions. IV estimates show that financial literacy is a better measure than schooling in explaining variation in household wealth and pension contributions. More importantly, their “improved estimates of financial literacy were large enough to imply that investments in financial literacy could well have high payoffs” (Behrman Bravo, Mitchell, and Soo 303)..

Their ultimate conclusion was that households that can “build up more wealth, particularly via the pension system, may be better able to smooth consumption in retirement and thus enhance risk sharing and well-being in old age” (Behrman, Bravo, Mitchell, and Soo 303). They found that financial literacy could give people a better chance of contributing to their pension, which could be a valuable pathway by which improved financial literacy could build net wealth.

What this is all saying is that there is statistical proof that financial education benefits the person. In this case, it can benefit persons for the rest of their lives. I believe that by helping those less fortunate become educated now, they will be wise enough to make smart financial decisions in their old age. In becoming educated, people will learn to trust mainstream financial institutions over Alternative Financial Services. An increase in financial literacy will also benefit the country as a whole; as more educated people enter the workforce, companies will further prosper and the economy will grow. In short, the benefits of financial education are real and they are very much attainable.

As of this writing, plans are already being implemented for these debt spirals to be mitigated further. In June 2016, a New York Times Report revealed that federal regulators were working in conjunction with the Consumer Financial Protection Bureau to create new rules that would curtail payday loans. Under this new legislation, “lenders will be required in many cases to verify their customers’ income and to confirm that they can afford to repay the money they borrow” (Cowley). The legislation also hopes to limit number of times that people could roll over their loans.

In her interview with the Federal Reserve Bank of Philadelphia, Lisa Servon mentioned an initiative called “Bank On”. In this initiative, local governments cooperate with financial institutions to eliminate barriers to financial success. These efforts are based on several assumptions. First is the concept that banks are superior choices to AFS. Second, people exclusively use financial criteria to select which institutions they will use to bank. Finally, “low-income people must lack basic financial literacy skills if they choose AFS providers over banks” (Servon).

The Federal Reserve Board of Governors believes that adapting mobile financial services to underserved populations can bring untold amounts of benefits. They use the experiences of Kenya and India to back up this claim. Kenya is a global leader in implementing and adapting mobile payments into their countries. 3 out of every 5 Kenyan adults aged 15 or older use mobile payments to send money. 2 out of every 3 of those same adults use mobile payments to receive money. In 2011, “nearly $10 billion - about 30 percent of Kenya’s GDP - was transferred through mobile payments” (Gross, Hogarth, and Schmeiser).

In India, mobile financial services are used to help provide financial services to the country’s massive unbanked population. To reach out to this gaggle of people in poverty, which measures at 43 percent, telecom companies and banks collaborate to offer services that include mobile savings accounts and remittance payments. Their success, as well as that of Kenya, has demonstrated that with appropriate products and services, “even those individuals in extreme poverty can be bankable” (Gross, Hogarth, and Schmeiser).

But the success stories of developing countries like Kenya and India are made possible because of physical banking or payments infrastructure existed in the first place like it is in many developed nations. This presents a challenge for banking in remote areas. In these countries, mobile financial services are filling a void. In the United States on the other hand, “the presence of a longstanding banking and payments infrastructure may mean different challenges in the diffusion of mobile financial services” (Gross, Hogarth, and Schmeiser).

Ninety-two percent of the top 25 financial institutions, 17 percent of credit unions, and 15 percent of community banks provide mobile banking services. The ultimate objective is to get the unbanked and underbanked more comfortable with using mobile financial services. As customers become more comfortable with these services, the hope is that “the use of new and innovative ways to reach these marginalized populations creates opportunities for new relationships with financial institutions” (Gross, Hogarth, and Schmeiser).

Mobile phones can provide consumers with “just-in-time” information on account balances and credit limits, which will greatly assist the consumer with their financial management and making sound financial decisions (Gross, Hogarth, and Schmeiser). This information can lead to customers not overdrawing their accounts or exceeding their credit limits and triggering fees. Smartphones especially can be used to purchase products and services, which leads to consumers saving money by finding lower prices or products more suited for their needs.

Their report contends that “the widespread ownership of mobile phones by underbanked and unbanked consumers suggests that providing a full suite of mobile financial services may be a means to facilitate their access to, and inclusion in, the mainstream financial system” (Gross, Hogarth, and Schmeiser). Data provided by the board of governors’ various surveys on the usage of mobile financial services shows that unbanked and underbanked often have lower levels of income; are younger, minority, female, not married, and unemployed; and unwilling to assume financial risks. However, consumers with characteristics that typify the unbanked and underbanked more often than not have mobile phones and are willing to utilize this channel for financial services.

For example, 3 out of every 5 unbanked respondents with incomes under $25,000 possess a mobile phone. Additionally, two out of every 3 unbanked respondents aged 18 and 29 report having a mobile phone. Half of unbanked hispanic respondents and two out of every three unbanked African-American respondents, and 72 percent of female respondents all have mobile phones. Lastly, “three-fifths of unmarried unbanked respondents and three-fourths of unbanked unemployed respondents have mobile phones” (Gross, Hogarth, and Schmeiser). So it appears that access to the technology does not seem to be a barrier.

One of the most commonly cited reasons that consumers give for not having a bank account is an unwillingness to deal with banks. The board of governors believes that mobile banking may separate itself from dealing with banks that consumers would be willing to use a bank account. Another common reason for not having an account is that consumers “don’t write enough checks to make it worthwhile” (Gross, Hogarth, and

Schmeiser). Mobile banking and mobile payments allow for transferring funds or paying bills without writing checks.

Another common reason for not having an account is extraordinarily high fees and service charges. Some financial institutions look at whether emerging technologies like mobile banking could reduce costs. The board of governors further point out that “the financial interaction that mobile banking would provide may be partially beneficial to budget-conscious customers” (Gross, Hogarth, and Schmeiser). To illustrate, the use of text alerts can assist consumers in managing their finances by providing reminders about due dates for bills and warnings for low balances that could lead to overdrafts. Using a mobile device to track balances on general-purpose reloadable cards, maybe by text message, could prove useful to unbanked customers dependent on the cards.

For those unbanked customers who were worried about the security of mobile banking and payments and who do not trust the technology, the board of governors suggests that financial service providers “may want to consider developing a simple customer security toolkit” showing customers how making passwords for login and access can provide security for their mobile devices and payments data (Gross, Hogarth, and Schmeiser). The software kit must also use antivirus software to confirm that any downloaded applications are free from viruses and malware and be able to load software that can wipe the phone clean, lock it, or deactivate it in the event that another person steals it.

But what about solutions that get the local community involved? An idea for that is present in a program that is already in place. From January to April, Impact Alabama has a program called SaveFirst. It is a volunteer opportunity that is available to all business students of the University of Alabama in Huntsville. The program asks for volunteers to prepare free tax returns for impoverished individuals and families. In doing so, they save these individuals hundreds of dollars that they would normally use on skeevy tax return services that would charge large amounts of money for tax returns that were often inaccurate.

A similar service can be implemented in universities across the country. General financial counseling could be used for students on campus, especially since they have either entered the real world already or are preparing to enter it. Additionally, they could also give back to their community and add some much needed volunteer experience to their resumes. This will in turn help them have a greater chance at landing better, jobs, helping them in both the short-run and long-run.

Conclusion

In this paper, Alternative Financial Services and how they operate were defined. We have also looked at who uses them and why in order to fully understand why these services are so successful. In finding who use these services, we broke down state, regional, and national data in order to understand Alabama's standing when it comes to AFS usage. All three levels of charts found the same conclusion: AFS users are often minorities, the young, the unemployed, lacking education, or possessing a low income. They often use them because they lack trust in the banks and in mobile technologies. They also may not meet the requirements to have a bank account.

The hope is that by thoroughly understanding these services, we are able to find solutions toward helping people not use them as often. The money spent on interest alone could potentially help the community do great things. We could improve infrastructure, education, and land development for starters. Improvements in education especially would improve the local and state economy. Now that we understand the problems of AFS and why people use it so often, we can start to begin curbing their practices and perhaps even banning them outright.

Steps are already being taken to phase out AFS on a national level. But in order for society to improve, we must provide more opportunities for the economically disadvantaged. Whether it is by allowing greater access to education of banking services, the more who legitimately contribute to the economy, the greater the economy will be. If we can succeed at this, perhaps the next picture taken of our community will not be as bad as it once was. Hopefully, it will look much more satisfactory.

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