INCREASING FINANCIAL WELL-BEING THROUGH INTEGRATION

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Meeting People Where They Are

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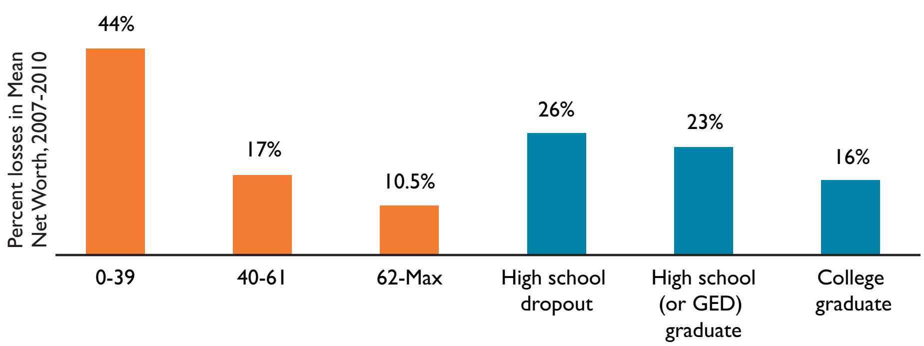
This brief is the first of a five-part series that will highlight the need and opportunity for integrating financial capability services into social service programs to improve overall outcomes that lead to financial well-being. This introductory brief covers (1) the state of households' finances, (2) the impact of financial insecurity on families, (3) the financial challenges experienced by households beyond lack of income and wealth, (4) the definition of financial capability and integration, (5) the federal government's investment in innovation and cross-agency dialogue regarding integration and financial capability and (6) the framework for future policy recommendations.

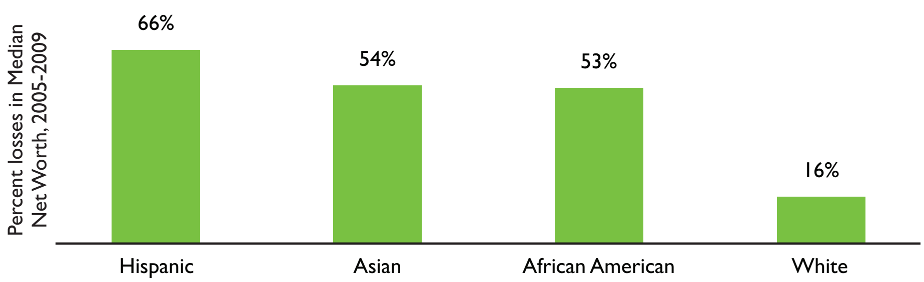
Household "Balance Sheets" are Suffering in the Wake of the Great Recession

The Great Recession devastated the net worth of millions of households. Families lost housing wealth and business equity, took on high levels of debt and tanked their credit. Between 2007 and 2010, median household wealth dropped 39%. Younger families, individuals with less than a college education and households of color suffered particularly large wealth losses.[1] The Federal Reserve Bank of St. Louis has coined this recession a "balance sheet[2]" recession due to this extreme loss of net worth (assets minus debt).

Younger households, those with less education and households of color saw the most dramatic net worth losses



Source: St. Louis Federal Reserve, 2013

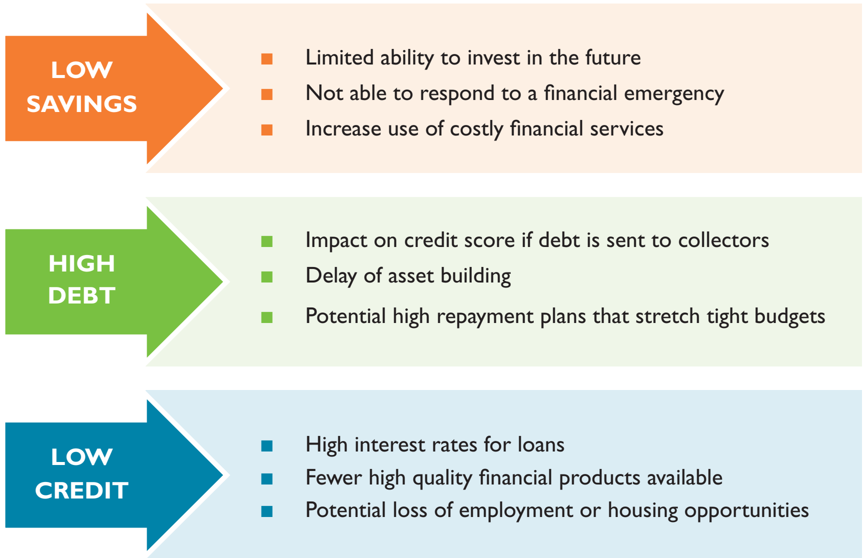


Source: Pew Research Center, 2011

Years into the economic recovery, families continue to be in a state of persistent financial insecurity. Nearly half (44%) of households in the United States are "liquid asset poor," meaning they have less than three months' worth of liquid savings—conservatively measured as $5,887 for a family of four, or three times a family's monthly income at the poverty level— to weather a financial storm, such as a job loss or medical emergency, or to invest in the future.[3]

Unstable Household "Balance Sheets" Affect a Multitude of Economic Well-Being Outcomes

Unstable balance sheets generate a multitude of financial ripple effects. Households without savings and high debt are less able to invest in long-term assets like a house or an education in order to move themselves up the economic ladder. These households are also at particular risk of suffering economic hardship when they experience an unexpected income drop or a large expense. Families with no "slack" in their budget for unforeseen expenses, such as a car repair or medical bills, could be financially devastated or forced to take on more debt. Research has shown that low- and moderate-income households experience significant fluctuations in income from month to month in both amount and timing. These inconsistencies can generally be attributed to having multiple jobs, seasonal work or having jobs that provide irregular income.[4] The mismatch between income and expenses for families creates challenges when planning for long-term goals or when paying for essential expenses.



Sources: CFED, 2014; Urban Institute, 2009; CFED, April 2014; Federal Reserve Bank of St. Louis, 2012; CFED, October 2014.

The health of household balance sheets significantly impacts a multitude of outcomes related to overall financial well-being:

- **College attendance and completion increase significantly with savings.** Low- and moderate-income children with $500 or less in savings are three times more likely to enroll in college and four times more likely to graduate than children with no savings.[5]
- **Low or no credit can lead to an increased cost of financial products.** In 2006, more than four million low-income consumers paid higher auto loan and mortgage interest rates due to their thin credit files.[6]
- **Families with savings are more likely to move out of poverty.** Among adults in the bottom income quartile, 34% of those with low initial savings left the bottom approximately 15 years later, but 55% of those with high initial savings left the bottom during the same period.[7]
- **Savings helps households' weather financial emergencies.** Households that were liquid asset poor were two to three times more likely than those with liquid assets to experience material hardship in the form of skipped utility bills, forgone medical visits or failure to cover other basic needs.[8]

Financially Insecure Americans are Generally Overwhelmed and Stressed by Their Finances

Financial insecurity creates challenging circumstances for households. Research has shown that low-income households are often so overwhelmed and exhausted by their financial situations that they lack the "mental bandwidth" to think about the long term or handle financial emergencies effectively.[9] Behavioral economists have coined this term to refer to the reduced cognitive capacity for low-income Americans, whose mind is almost constantly preoccupied with financial trade-offs, such as paying rent or visiting the doctor. This puts financially insecure households into a tunnel where long-term financial goals seem hopeless and overwhelming.

Little savings and low mental bandwidth create a precarious situation where households have little room for economic missteps.[10] Worse yet, the strain placed on families in this situation often lead households to make suboptimal financial decisions. One study found that 14% of workers have borrowed money from their retirement account in the past year, dipping into already thin retirement savings.[11] This is one example on how many households are forced to make suboptimal financial decisions based on immediate need, which inevitably hurts their long-term financial security.

Small scale experiments have shown how thinking about a financial emergency can dramatically lower general cognitive ability. For example, researchers asked shoppers at a New Jersey mall to handle one of two following decisions: Your broken-down car needs $150 worth of repairs, or your broken-down car needs $1,500 worth of repairs. While the participants considered their options, they were given simple cognitive tasks. Low-income participants who were contemplating the $1,500 expense had worse overall cognitive performance (a decrease of about 13-14 IQ points), which is similar to people who have missed a night's sleep. However, this group's cognitive performance was indistinguishable from that of higher-income participants when contemplating the more moderate $150 repair, suggesting that taxed bandwidth can equate to impaired decision-making ability.[12] Thus, solutions to alleviate unstable balance sheets cannot just address the mechanics and technicalities of financial management, but must also consider the full range of challenges facing low- and moderate-income households.

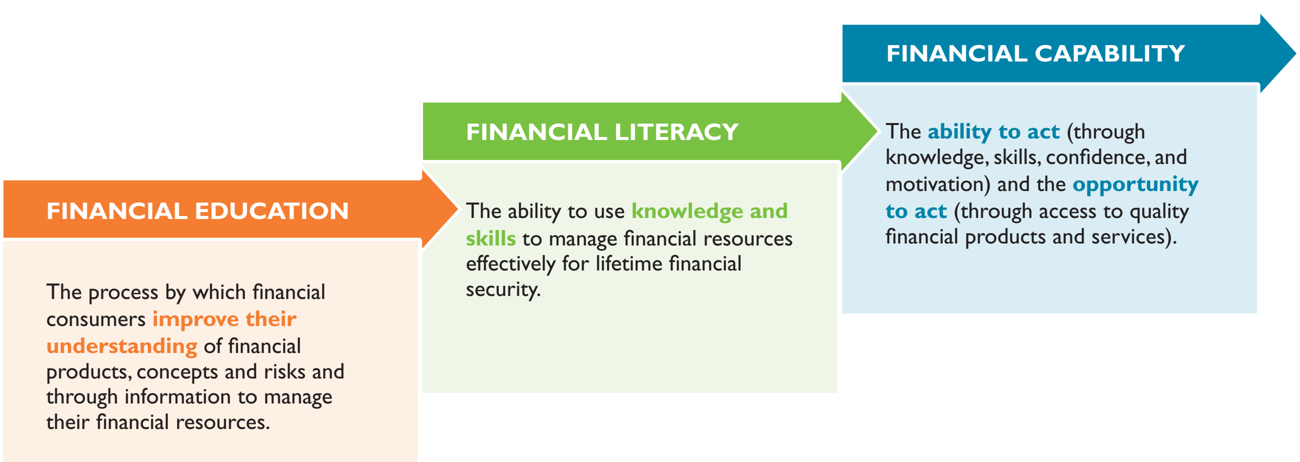
Financial Challenges that Impact "Balance Sheets" Go Beyond Lack of Income or Wealth

As households struggle with damaged balance sheets, many challenges go beyond merely having adequate income or wealth. Financial products are often costly and complicate the financial lives of households. Sixty-eight million individuals are currently underserved by the financial services industry and rely on costly alternative financial services.[13] Low-quality, high-cost alternative financial products, like payday loans, impact a family's financial security over a long period of time, as these families have less time and money to spend on other necessities or on building savings. The average household that uses alternative financial services has an annual income of about $25,000 and spends about $2,412 on fees and interest—nearly 10% their income.[14] This is an avoidable expense and can be curbed with education and access to quality financial products.

To make prudent long-term investments, households need savings, credit and the knowledge to use them properly. However, financial knowledge is notoriously low for all Americans, across all income levels.[15] One key difference is that wealthier households can often afford to hire a financial planner, whereas low- and moderate-income people tend to turn to friends and family for financial advice because they cannot access private market financial advising services. Additionally, wealthier households have more of a buffer to overcome financial mistakes.

Individuals are also increasingly responsible for their own long-term financial stability. For example, in the past, employers provided Defined Benefit (DB) retirement plans which ensured a lifelong stream of income for a retired worker. However, Americans today are largely responsible for ensuring that they have adequate retirement savings. Unfortunately, evidence shows it is increasingly difficult for Americans to manage their long-term financial futures. Among those households with any retirement savings at all, the median savings is only $40,000, still far less than many workers need to maintain their standard of living in retirement.[16]

The complex challenges facing household balance sheets demand policy solutions that address more than just income and wealth. Policy solutions must also address the ability to manage finances, access products and effectively use tools that lead to financial well-being.

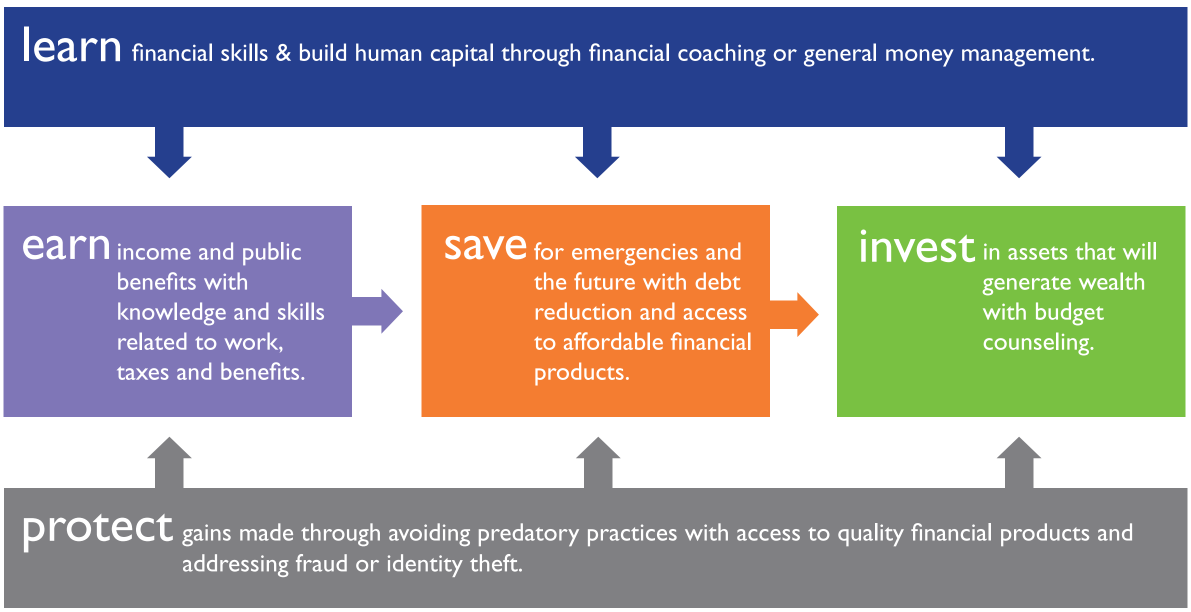


Sources: OECD 2014; Center for Social Development, 2010.

Financial Capability Combines Knowledge & Skills with Access to Financial Resources

Financial capability is "the capability, based on knowledge, skills and access to mange financial resources effectively."[17] Financial capability goes beyond financial literacy and education, both of which are more focused on knowledge and less on access and hands-on skills. Examples of financial capability services include helping clients understand how to establish and build credit, how to budget or how to decrease debt. These services are combined with support in accessing safe and affordable financial products. The habit of savings, sticking to a budget and managing debt, combined with the right tools, can help households stabilize for years after services are provided. The return on investments in building these skills for adults is high as financial habits are often passed down to children.[18]

Household Financial Security Framework



CFED's Household Financial Security Framework[19] (above) describes what families need to move along the path from financial insecurity to financial well-being. The framework includes *learning* financial skills, *earning* income through work or other sources, *saving* for the unexpected and the future, *investing* in assets that will generate wealth and *protecting* assets by avoiding predatory practices.[20] This model recognizes the key role financial capability plays in moving a family out of economic insecurity and into financial stability.

Integrating Financial Capability into Other Services Can Improve Outcomes

Integrating financial capability services into an existing agency or program during a key life moment can substantially boost overall programmatic outcomes.

- **WHERE TO INTEGRATE?** Social service agencies and community action agencies have an infrastructure to deliver financial capability services that can boost overall outcomes and improve the long-term financial stability of their clients. They have trained staff who directly interact with low- and moderate-income families, and many of these agencies already have an established training system. Furthermore, these organizations and agencies already have programmatic goals—such as increasing housing or employment levels among clients—which can be reached faster by integrating financial capability services.[21] For example, workforce programs have seen their clients reach financial milestones significantly faster when the primary employment service is integrated with financial capability services.[22] Additionally, integration helps programs address the multiple financial challenges of unstable balance sheets, such as low levels of savings, high levels of debt and low credit scores.

- **WHEN TO INTEGRATE?** Integration capitalizes on times when people are already interacting with a social service agency, community action organization or another formalized system, such as an employer. For example, during a financial crisis, people often seek services related to loss of a job or housing, or to address a family financial emergency—they are likely to benefit from services that boost financial capability to address the other financial challenges they may be facing. Positive moments such as the achievement of a financial milestone like receiving a pay-check, enrolling in college or other post-secondary training, buying a home, saving for retirement or receiving a tax refund, are also opportune times to integrate financial capability services. Research finds that these are ideal moments to support sound financial decision-making because the participants find financial management most salient. They are also more likely to put what they have learned into action immediately because they have a context in which to practice what they learn.[23]
- **WHY SHOULD PROGRAMS INTEGRATE?** Clients often enter a program with more than one financial challenge. In order to assist participants more holistically many programs started integrating multiple services into their core service delivery streams, such as helping clients open a bank account or assisting them to file their tax returns. Research shows that clients who receive multiple services are three or four times more likely to achieve a major positive economic outcome— such as getting out of debt, purchasing a car, getting a job or completing a training or education program— than those whose services are siloed.[24]

Financial Capability Services

- Establishing and building credit
- Financial education
- Accessing credit reports
- Evaluating and accessing quality credit products (for mortgages, credit cards, or student loans)
- Accessing quality savings and checking products
- Budgeting and general money management
- Developing long-term savings strategies to prepare for emergency expenses and major purchases
- Reducing debt
- Saving at tax-time
- Tax filing assistance for eligible tax credits
- Addressing fraud or identity theft
- Accessing state and federal benefits

Key Components for Successful Integration of Financial Capability Services

A scan of the financial capability field revealed five key programmatic components vital to successful integration. In 2013 the ASSET Initiative Partnership (AIP)[25], an initiative within the U.S. Department of Health and Human Services implemented by CFED, conducted a field scan to identify trends and opportunities in the integration field. The field scan identified five key components for programs to integrate successfully and have the greatest impact on economically vulnerable families.[26] For optimal impact, policymakers and practitioners considering integration should:

1. Be able to articulate how integrating financial capability services **boosts outcomes and builds on already established program goals.**
2. Demonstrate the **ability to scale integrated services** for a large number of families.
3. Identify **champions or the ability to cultivate champions for integrating financial capability** who can help ensure pilots or initiatives move forward in a substantial way.
4. **Capitalize on a "leverage point,"** in time or location, where there is a feasible strategy for integrating one or more financial capability services.
5. **Interact with households to identify their financial challenges,** meeting them where they are and engaging with them in a meaningful way.

The Federal Government Has Fostered Dialogue and Innovation to Increase Integration

The chart below briefly chronicles the federal government's efforts to foster cross-agency dialogue and innovation to increase integration and Americans' financial capability.

2003 Financial Literacy and Education Commission (FLEC)

Mandated to improve the financial literacy and education of Americans, and to coordinate financial education efforts within the federal government through development of a national strategy to promote financial literacy and education. The commission is comprised of 21 federal agencies and the White House Domestic Policy Council. **MyMoney.gov** is one resource established by the Commission.

2009 ASSET Initiative Partnership (AIP)

A collaborative effort within the Administration for Children and Families that brings together federal offices and their partner agencies and organizations to extend the benefits of financial education and other asset-building services to more individuals and families across the nation.

2010 Consumer Financial Protection Bureau (CFPB)

Established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, CFPB's mission is to make markets for consumer financial products and services work for Americans. CFPB has been developing financial capability tools and metrics related to what financial well-being looks like in an effort to evaluate social service programs engaged in this work. The CFPB developed ***Your Money, Your Goals***, a financial management tool that multiple government agencies are able to use to help clients set goals, choose financial products and build skills in managing money, credit and debt.

2010 President's Advisory Council on Financial Capability

Created by Executive Order to advise the President and the Secretary of the Treasury on ways to empower Americans to better understand and address financial matters in order to improve their financial well-being.

2013 President's Advisory Council on Financial Capability for Young Americans

Mandated to advise the President and the Secretary of the Treasury on how to promote and enhance financial capability among young Americans at early stages in schools, families, communities and the workplace, including through the use of technology.

2013 U.S. Department of the Treasury's Financial Empowerment Innovation Fund

Awarded $6.2 million to 11 research projects focused on developing, testing and evaluating new ways to empower Americans with their finances and help them access safe and affordable financial products and services. The Innovation Fund projects focus on several areas, including promoting more informed decision making in higher education, incubating innovations in payments and savings, and bringing dynamic financial education to more classrooms.

Government Agencies Should Do More to Encourage the Integration of Financial Capability Services

Financial capability helps clients achieve long-term financial stability by empowering them to use financial products and services effectively, as well as build the skills and resources to protect themselves against future financial shocks and downturns.

These federal initiatives are moving the needle forward on integrating financial capability services to improve Americans' financial stability and well-being. However, there is still work to be done to expand and integrate these vital services for low- and moderate-income households. To improve all components of a household's balance sheet, policymakers should concentrate on five types of policies:

1. Expand financial knowledge and access to financial products.
2. Leverage existing platforms, such as the workplace, community health centers and schools, to boost outcomes.
3. Adapt programmatic frameworks to encourage the integration of financial capability and consider the impact of reduced mental bandwidth when interacting with program participants.
4. Block financial products that strip wealth from low- and moderate- income households.
5. Create more accessible on-ramps for people to build a solid financial foundation.

Increasingly, programs are being required to meet tough performance standards, and the research shows that inclusion of financial capability services increase the likelihood that programs will meet their goals. This series will discuss the value of integrating financial capability services in order to boost the following programmatic outcomes:

- Finding and retaining employment
- Gaining housing stability
- Reaching and succeeding in higher education
- Improving health

As families struggle with various financial challenges, policymakers and practitioners need to provide new, impactful solutions. Expanding financial capability services improves on what programs are currently doing but creates more long-term solutions so households don't find themselves cycling in and out of financial insecurity. Rather families receive the financial knowledge and access to financial products needed to alleviate a range of financial challenges and relieve limited mental bandwidth. With these goals in mind we can start *meeting people where they are*.

Endnotes

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19 *A New Framework for Achieving Household Financial Security*, (Washington, DC: CFED, 2010).

20 Ibid.

21 *A Successful Strategy for Promoting Financial Stability*, (Working Families Success Network, 2013).

22 The Office of Financial Empowerment New York City studied a group of adults receiving employment assistance and gave some of the group financial counseling on top of employment services. The group who received financial counseling group achieved 82% more employment milestones at 90 days of employment than the comparison group. The most commonly achieved milestones included: reviewed a credit report, established a realistic budget and opened a checking or savings account. Source: *Building Financial Counseling into Social Service Delivery*, (New York, NY: Office of Financial Empowerment, 2014).

23 Ray Boshara, *Savings and Assets Over the Life Course*, (Washington, DC: New America Foundation, 2010).; *Building Financial Capability in Youth Employment Programs*, (Washington, DC: CFPB, 2014).

24 *A Successful Strategy for Promoting Financial Stability*, (Working Families Success Network, 2013).

25 The AIP has three goals: 1) to help stakeholders at the local, state, regional and federal levels to answer critical questions about financial security; 2) investigate and highlight proven and promising practices that not only embed asset-building strategies in a range of programs, but also enhance the ability of those programs to achieve their objectives; and 3) expand asset-building opportunities for low- and moderate-income families through pilots, partnerships, and other initiatives that leverage human service delivery channels (Source: *Family Strengthening through Integration and Scaling of Asset-Building Strategies*, (Washington, DC: Prepared for the Office of Community Services by CFED, 2013).

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