



Individual Development Accounts

Engaging the Financial Services Industry in Asset Building

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Anywhere between 10 million and 22 million U.S. families—most of them earning less than \$25,000 per year—are unbanked, meaning that they lack a basic checking or savings account.¹ Instead, these families rely on alternative financial services—check-cashing outlets, pawn shops, rent-to-own firms, and payday lenders—for most of their day-to-day financial needs.

In addition to the high fees and interest rates charged to consumers (which in some cases can translate into a 300% APR), one of the most significant consequences of this two-tier financial services system is that large numbers of low-income families lack the tools they need to save, build assets, and become part of the “ownership society.”² Check cashers and payday lenders do not offer asset building services, nor do they offer products that help people build a positive credit history. On the other hand, research shows that families with bank accounts are more likely to save and own other assets, and that access to a bank account makes it easier for low-income families to save.^{3,4}

Financial institutions therefore play an important role in asset building initiatives, from offering that first saving account to providing affordable home or business loans, financial education, and more recently, IDAs. Since IDAs can serve as an important tool for “banking the unbanked,” which benefits both consumers and financial institutions, it is important to analyze how IDAs fit into a financial institution’s business model. Are they sustainable? How can financial institutions expand the IDA programs that they currently offer? And what will it take for more financial institutions to offer IDAs? No matter how strong the grassroots support for IDAs may be, if they don’t work for financial institutions, they’ll “wither on the vine.”⁵

Two recent surveys of financial institutions, one conducted by the Federal Reserve Bank of Chicago⁶ and the other by the Center for Community Capitalism,⁷ shed light on these questions.

The major finding from these surveys is that most financial institutions participate in IDAs for community development reasons, and that the IDA partnership is the continuation of an ongoing relationship with a local community organization (Figure 2.1). As Brian Stewart of Washington Mutual in Oregon notes, “In many cases, we participate in an IDA program to develop and strengthen our overall relationship with the sponsoring organization.” Financial institutions rely on nonprofit partners to provide key aspects of program delivery—including financial education, program marketing, and client prescreening—and many (71 percent) of the financial institutions offering large programs would not continue to offer IDAs without the nonprofit partner’s involvement.

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Financial institutions also participate in IDAs to meet their Community Reinvestment Act (CRA) obligations. Partnership in an IDA program can potentially meet portions of all three CRA tests—lending, investment, and service. For example, financial institutions could receive credit under the service test for holding the client accounts or providing financial education; under the lending test if loans are made to accountholders after they have reached savings goals; and under the investment test if the financial institution supports service provider operations or provides match funds. As a result, financial institutions are an important source

Figure 2.1 IDA programs typically develop out of long-standing relationships between financial institutions and nonprofits



Source: Center for Community Capitalism Financial Institution Survey of Individual Development Account Programs (2002)

of funding for IDA programs. More than half of all IDA programs and 70 percent of all large programs receive direct financial support from their financial institution partner. Research based on the Center for Community Capitalism survey suggests, however, that more could be done to raise awareness of how IDAs can meet CRA obligations and to clarify how IDA programs will be treated under CRA examinations.⁸

The surveys also reveal that most IDA programs are not profitable (Figure 2.2). Nearly all IDA programs waive monthly account fees, offer interest-bearing accounts, and do not assess transaction fees. Combined with low balances and frequent transactions, the lack of fees translates into a loss of revenue for the bank. The start-up and administrative costs of running an IDA program can also be high. In addition to holding accounts, financial institutions are often involved with submitting the paperwork for match funds and monitoring accounts for unauthorized withdrawals.

Consistent with the community development reasons cited above, the expectation of profit isn't what motivates the decision to participate in an IDA program, and a large number do not subject these programs to financial scrutiny. As one banking official said, "I think we looked at [IDAs] as something we have to do because of the merits of the program itself and the benefits to the individuals participating. We didn't look at it as a cost-benefit analysis."⁹

Some financial institutions, however, believe that the benefit of IDAs for the bottom line may be in the business they generate in the future. Many use IDAs as an inroad into the "unbanked" market, and view these accounts as forming the basis for a long-term relationship with accountholders. For example, the assets in IDA accounts can generate

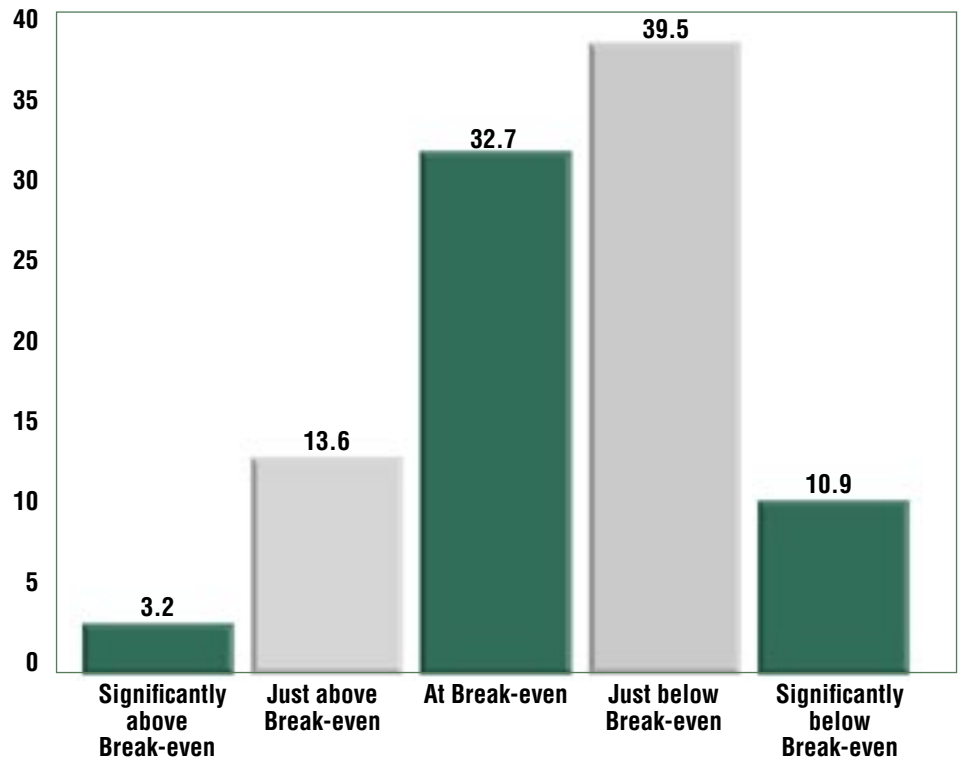
cross-selling opportunities for other bank products such as mortgages, small-business loans, student loans, and car loans.¹⁰ U.S. Bank, an IDA partner with Lincoln Action Program (LAP) in Nebraska, reported that IDA clients typically opened four other accounts with the bank. The bank estimates that every dollar it invests in the program has the potential to generate \$12 in assets.¹¹

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Whether or not IDAs live up to their promise for profit in the future remains to be seen. And although profit may not be the primary motivation for participating in IDA programs in the present, IDAs are more likely to succeed over the long term if efforts are made to decrease the costs in delivering them. One CRA officer in the Center for Community Capitalism survey suggested that IDA programs need to develop their own revenue base as a longer term objective. "Community development has to be sustainable. It needs to have some type of business profit-developing mechanism. I don't mean big—just something not in the red. You can't sustain the program without it."¹²

Figure 2.2 *Financial viability of IDA programs: Can financial institutions break even?*

Source: Center for Community Capitalism Financial Institution Survey of Individual Development Account Programs (2002)



Innovations in IDA Practice

What will make this possible? Some promising ideas include:

Standardizing products and developing technological innovations. Already, large financial institutions that sponsor more than one program take steps to standardize the IDA saving products and procedures in order to reduce costs. Washington Mutual now collaborates in over 30 IDA programs and holds more than 1,500 accounts nationwide. To be able to reach this level of operations, Stewart says that they “modified an existing savings account vehicle rather than creating a new product. We also developed standardized policies and procedures for account opening and created document templates easing program implementation in multiple markets.” U.S. Bank has developed the technology to produce streamlined monthly statements with two columns showing the total savings and the earned match, and to transmit balances electronically to specialized IDA software housed at nonprofits.¹³

Building the capacity of nonprofit partners. The Center for Community Capitalism survey reveals that one factor limiting the expansion of IDA programs within financial institutions is the capacity of their nonprofit partners. Given the relatively high fixed costs of embarking on an IDA program, more accounts would make it more attractive for financial institutions to participate. While the limiting factor for nonprofits is often a lack of matching funds, there is the opportunity for banks to work with their nonprofit partners to improve their capacity to recruit participants,

open accounts (e.g. prescreening and paperwork assistance), and educate accountholders about the differences in loan products (e.g. adjustable versus fixed rate mortgages).

Creating collaboratives that leverage resources. In Nevada, the CRA officers from several financial institutions joined together to create a bank collaborative that would be able to pool funds from a large number of banks statewide (Box 2.1: The Nevada Individual Development Account Collaborative).

In the long run, however, the sustainability of IDAs will depend on federal and state policies that provide or leverage funds for matching grants for IDA savers. The Savings for Working Families Act, for example, would help to expand the funding for IDAs by allocating \$450 million in the form of tax credits for financial institutions that contribute IDA match funds.

IDAs are neither a silver bullet nor a simple venture for institutions looking to engage in them, but they are an important component of the toolkit that increases a low-income household’s ability to build and protect assets. Almost all (98 percent) of the financial institutions that participate in IDA programs signaled their intent to remain involved with the programs over the long term. With increased innovation, partnership-building, and regulatory support, more financial institutions should be better able to realize the double bottom line of social and financial returns through asset building initiatives such as IDA programs. ■

The Nevada Individual Development Account Collaborative

Box 2.1

The motivation was simple. In 2002, the Corporation for Enterprise Development (CFED) completed a study that ranked states on “asset outcomes” and “asset policies.” Nevada was ranked third highest in the country in terms of the percentage of households with zero net worth, indicating a critical need to help boost savings for the low- and moderate-income community in the state. According to Joselyn Cousins, Senior Vice President and Community Development Manager at BankWest of Nevada, the CFED ranking was a “call to action. We needed to do something. The question was how could banks participate in a way that would maximize impact?”

Beginning in late 2002, the Federal Reserve Bank of San Francisco sponsored a series of forums in Nevada to help educate local banks and nonprofits about IDAs, to provide technical assistance, and to brainstorm about ways to involve more banks in IDA programs. The outcome of the third forum, held in September 2003 in Las Vegas, was the creation of the Nevada Individual Development Account (IDA) Collaborative.

Nevada’s IDA Collaborative is unique in that it was initiated by a group of community development officers from several of Nevada’s financial institutions. From the banks’ perspective, organizing as a collaborative provided benefits that they could not achieve on their own. For example,

- *By being part of the collaborative, small banks in Nevada can contribute modest amounts of money to IDAs, yet still be involved in a program that has impact. The collaborative also provides an investment vehicle for the limited purpose banks that would not otherwise be involved in managing the accounts.*
- *The collaborative serves as an efficient mechanism to handle the multiple requests from nonprofits looking for IDA program support. Cousins notes, “Rather than having every nonprofit squeezing out nickel and dime grants from every bank, we thought it would be better to develop a centralized system to distribute IDA dollars.”*
- *The collaborative achieves economies of scale in administering the funds, can coordinate fundraising efforts, and serves as a centralized source of expertise on IDAs.*

Banks participating in the Collaborative all donate funds to a central pool, which is managed by The Nevada Community Foundation (NCF). Nonprofit organizations apply for funds to operate their IDA program and for matching dollars through NCF. A selection committee comprised of representatives from the participating financial institutions evaluates and awards the grants. In January 2005, the Collaborative granted \$63,000 to four nonprofit organizations to help support their IDA programs across the state.

Participating financial institutions in 2004 included: Bank of America; BankWest of Nevada; Citibank (Nevada), N.A.; Citibank (West); FSB; Charles Schwab Bank, N.A.; Colonial Bank, N.A.; Community Bank of Nevada; First National Bank of Marin; Household Bank; Imperial Capital Bank; Irwin Union Bank; Nevada State Bank; Silver State Bank; Sun West Bank; USAA Savings Bank; U.S. Bank and Wells Fargo Bank. Several of these banks also participate directly in IDA programs by holding and managing accounts in their branches.

Cousins hopes that next year the Collaborative will be able to raise at least \$100,000 from participating banks, and the Collaborative has plans to work with the nonprofit partners to apply for federal funding for IDAs. “The Nevada IDA Collaborative program is an excellent example of banks setting aside competition for the betterment of the community.”

The Community Affairs Department of the Federal Reserve Bank of San Francisco has worked with banks and nonprofits to help build IDA collaboratives, share best practices across the states in the 12th District, and expand IDA programs in tribal communities.

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Endnotes

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- ²⁷ For the most recent updates on federal asset building legislation, visit the Policy link at www.assetbuilding.org.
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