ChangeMatters

The Financial Clinic's Customer Insights

A comprehensive research series leveraging Change Machine's data from more than 40,000 customers across 42 states.

VOLUME 1: **CONSUMER DEBT**

This is the first brief in a new series from the The Financial Clinic leveraging the data gathered through our revolutionary financial coaching platform, Change Machine, alongside the voices and wisdom of Change Machine customers' lived experiences. We hope that our action-oriented analysis will influence positive social change. We believe we have a responsibility to ask the right questions, to use our data for good, and to inspire products, practice, and policy innovations that centralize the needs of working poor in building economic mobility. You can find forthcoming insights in this series on our website: thefinancialclinic.org/changematters.

Working poor families face a number of barriers to building financial security and achieving economic mobility. Perhaps no barrier on a day-to-day level represents a greater challenge than living under the constant shadow of debt. The impact that household debt has on other financial security areas—from credit to savings to assets—is extensive and often stymies a families' ability to make the best financial decisions for their long-term future. The knowledge that your wages or benefits are insufficient, that garnishments could be levied on any paycheck, and the stress of navigating the constant misinformation around your rights as a debtor are constant challenges. Debtors need more support to navigate these forces.

Change Machine Demographics

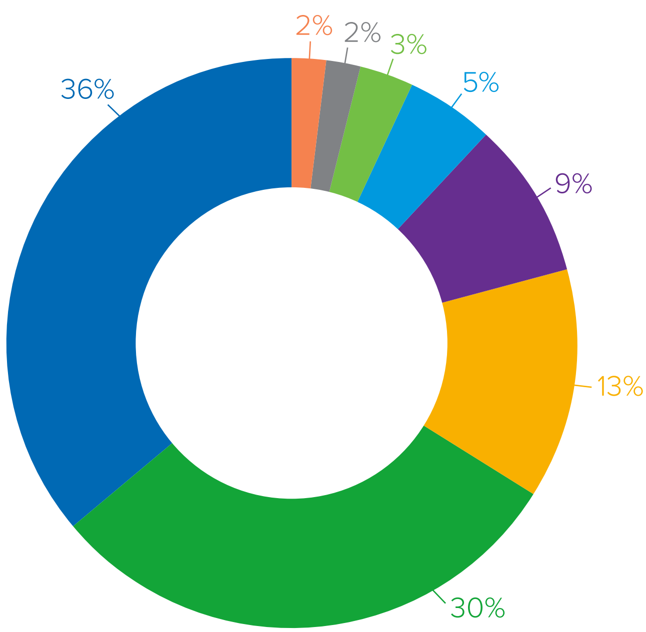
Of the 41,880 customers (as of July 2018) the average customer on Change Machine[1] has an:

- **Average Income** of $24,160
- **Average Debt** of $7,725
- **Ethnic & Racial breakdown** is 45% Non-Latino Black, 33% Latino, 12% Non-Latino White, 2% Asian, 1% American Indian or Alaska Native, 7% Other & Prefer not to answer.
- **Gender** 67% Female, 32% Male, 1% Prefer Not to answer and Transgender.
- **Median Assets** of $0
- **Average Credit Score** of 609
- **Highest Education attained** 34% High School, 29% Some College/Associate's Degree/ Vocational School, 19% Less than High School, 11% Bachelor's Degree, 3% Master Degree, 4% Prefer not to answer.
- **Age breakdown** 15% < 25 years, 30% 25 to 35 years, 23% 35 to 45 years, 18% 45 to 55 years, 15% > 55 years.

What is the Debt Profile of Customers on Change Machine?

Collections and credit card debt are the most common types of debt held by Change Machine customers, while student loans make up a significant portion as well.[2] Over one third of Change Machine customer debts are collection or a charge-off debts.[3] Even small amounts of debt in collections—like an unpaid utility bill—can have long-lasting negative consequences, lowering a individual's credit score, raising their borrowing costs, and can leave them vulnerable to abusive practices by creditors and collectors. Recent research by the Urban Institute shows that a staggering 71 million Americans have debt that has gone to collections, further underlining the pervasiveness of this source of financial insecurity.[4] Debt management is a primary driver for seeking financial coaching.

MOST COMMON DEBTS HELD BY CHANGE MACHINE CUSTOMERS



COLLECTIONS AND CHARGE-OFFS Overdue debt that is reflected on credit report

CREDIT CARDS Unsecured consumer debt, accessed through credit cards

STUDENT LOANS Loan designed for post-secondary education

SECURED LOANS Loan guaranteed by collateral such as mortgages and car loans

URGENT Debts with payments due immediately such as past due rent, utilities and parking tickets

GOVERNMENT Debt owed to public agencies such as taxes and child support

UNKNOWN Debts not tagged with a category

JUDGMENTS Court's decision that an individual owes a sum of money

[2] These statistics reflect data collected about 36,452 debts from 9,981 customers on Change Machine who baselined debt.

Thirty percent of Change Machine customer debts are **credit card**-related. The frequency of credit card debt reflects national trends that show American households rely on credit cards both to smooth out unpredictable income or to supplement low wages that have barely grown in previous decades.[5]

The impact of the 2008 financial crisis continues to loom large for many working families, as an overwhelming majority of jobs created since the downturn have been low-wage or part-time positions. These dynamics increase the importance of short term financial products like credit cards for families struggling to make ends meet, creating issues if the household's income doesn't increase fast enough to resolve these new debts.

Everyday, the Clinic's financial coaches witness the impact of rising debt on customers like Joan. After going through a tough time financially, Joan had close to $1,500 in credit card debt that had fallen into collections. While her income has yet to fully recover, she chose to set up automatic deposits to a savings account so she would not have to rely on credit to deal with a future emergency. She told the coach, "it's not much, but it is something, and that is important to me." These small contributions have added up to over $1,000, making it much less likely she would need to rely on expensive credit in the future. By building this savings, Joan now has a solid base to begin tackling the debt in collections with the help of her financial coach.

Thirteen percent of Change Machine debts are paying off **student loans**. While these loans help build a foundation for a more financially secure future for many people, recent research shows that rising pressure from growing student loan balances is leading to an alarming decrease in lifetime wealth for low- and moderate income students that earn college degrees. This same research shows that for minority students in particular, the wealth gains for achieving a college degree have almost completely disappeared, largely because student loans are such a drag on household finances.[6]

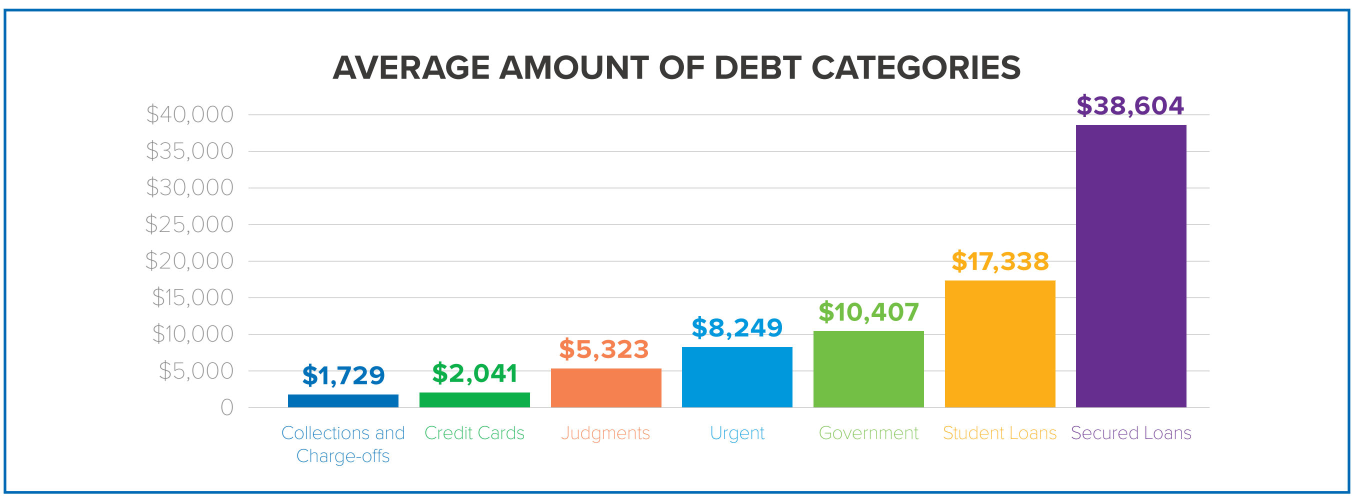
How do Change Machine Customers Reduce Their Debt?

While collections and credit cards are the debts held most frequently by Change Machine customers, they respectively represent the lowest average balances customers carry. Secured debts, of which the overwhelming majority are mortgages, make up the largest average balances, with student loans coming in second.

Among Change Machine customers, only a few debt categories show substantive differences by race. African-American customers are slightly more likely to have debt in collections than white and Latino customers, but much more likely to have debt as a result of judgements against them. However, the amount of these judgement debts are about 10% lower on average than those of white and Latino customers.

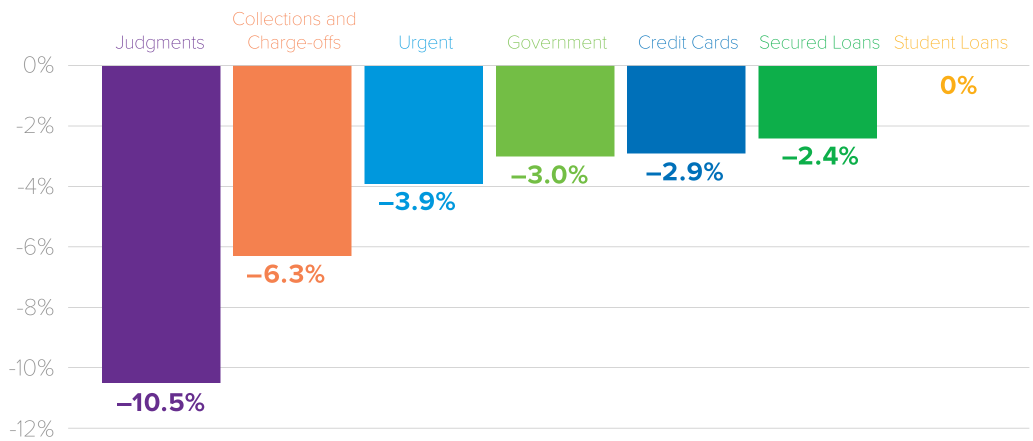
A key insight we gain by analyzing the debts of customers on Change Machine is that looking at the average balance size of various debts does not on its own though tells us much about what types of debt can present the biggest barrier to a customer's financial security. **The power of each creditor to collect a debt varies,** and sometimes the impact of getting behind even on a small balance can be devastating.

Non-loan debt in particular is presenting a growing problem for many Americans. A customer with unpaid child support, tax payments, or municipal fees can find their wages garnished, that they're unable to access other benefits, or may have difficulty finding a job.[7]



The trends in debt reduction among Change Machine customers highlighted by the graph below demonstrate that customers are forced to give these non-loan debts a higher priority, making less progress on reducing credit card, secured, and student loan balances. As such, **it's not the amount that drives which balances are reduced the most.** It's also important to remember that a customer that reduces balances of these debts may not actually experience increased financial security compared to one that reduces another type of debt, such as a credit card, by a smaller amounts.

AVERAGE CHANGE IN DEBT CATEGORIES



A Clinic coach recently reported that one of their customers had his driver's license suspended as a result of unpaid child support, making it nearly impossible to get to work and putting his job in jeopardy. Government creditors are the best example of what financial coaches at the Clinic call a **"super creditor,"** meaning that debts owed are harder to discharge and the creditor has more power to pursue the individual to collect what their owed.

Fortunately, debts owed to super-creditors can be some of the easiest to renegotiate, and the government in particular is more likely to take unemployment or ability to pay into account. However, the process and paperwork required to manage these debts can be prohibitive for many customers. Additionally, unpaid government debt like back taxes or outstanding fines can never be discharged in bankruptcy, meaning customers will carry these debts with them for life.

Every day, working poor Americans face tough choices when thinking about making the best use of scarce resources. The difficulty customers have re-prioritizing their debts can put them in a position where what started off as small balances become unmanageable. Debt resulting from municipal fines and fees, unpaid parking tickets, or legal judgements puts a unique kind of pressure on a household balance sheet that is difficult to capture in aggregate statistics, especially if we are trying to identify the actions that are most suggestive of financial security.

A relationship with a **financial coach** who is willing to support a customer through the process of negotiating a sustainable payment plan with a variety of creditors can empower customers to manage their debt burdens. Financial coaches also help customers develop a holistic plan that puts debt reduction in the context of their other financial goals and put them in the best position to succeed in the long term. Change Machine data shows that customers reduce the balance of judgements, charge-offs, and urgent debts by the greatest percentage over the course of a coaching relationship, and on average it takes about three meetings with a coach for a customer to reduce baseline debt balances.

Unconventional Experts: *Uncovering Resourcefulness*

Financial coaching honors and elevates the nontraditional methods customers use to achieve their financial goals. Each Change Matters brief will feature one example of a customer finding creative solutions to the presenting issue they are discussing with their coaches related to the topic of the Change Matters issue brief. At the Clinic we believe customers are experts in finding creative solutions to meet their financial security needs.

A few months ago, Elizabeth came to the Clinic for financial coaching because she knew she needed a better strategy to pull herself out of $17,000 in credit card and loan debt. She recently secured part-time work, while also receiving Social Security disability support. But before that, her essential expenses—food, rent, medicine—quickly mounted because she was stuck between her unemployment and waiting for her application with the Social Security Administration to be approved. In her second meeting, Elizabeth and her coach worked through calculations to determine how many additional hours she could work every week, without going over the "benefits cliff," a term used to describe when wages increase to such an extent that one is no longer eligible for different public supports. People who fall off this cliff often find themselves in greater financial insecurity because their earnings don't typically compensate for the entire value of the public support.

Elizabeth and her financial coach "did the math": They figured out that while she could pick up more hours and increase her earnings a little, her existing budget inclusive of her Social Security disability support, gave her the best chance of consistently keeping up with her debt repayment plan. If and when she could take advantage of full-time hours, they will "do the math" again. Elizabeth's approach could be considered by many to be "unconventional"—who doesn't want greater earnings?—but her own understanding of her financial security makes her the expert.

In contrast to financial counseling or financial literacy, coaching places an individual, their personal goals, and the complexities of their lives and communities at the center of their journey to financial security. Financial coaching does not presuppose which financial commitments should be prioritized, but instead supports how customers balance debt reduction with other needs and those of their families. Debt is personal, and how an individual or a household deals with it is too.

Because debts owed to super creditors can exert much more pressure on a household balance sheet, creating a goal driven plan with a financial coach can help place debt reduction strategically among a range of other important goals.[8] For example, supporting family and friends, creating a savings plan, strengthening credit, and planning for tax season are all equally important outcomes for building financial security. Getting the full picture of the rich context that makes up an individual's life is essential if we want to understand what barriers they face to being financially secure.

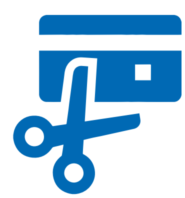
Characteristics of Customers Most Likely To Reduce Debt

We focused our analysis on identifying the commonalities between Change Machine customers that reduced their overall debt burden during the time they worked with a financial coach.[9] Our belief is that identifying these types of trends and shared experiences between Change Machine customers can help bring additional clarity and context to the role that debt plays in their everyday lives and what conditions tend to be most closely associated with debt reduction. Our analysis demonstrated the following insights:

A person's stage of life matters a lot for debt reduction. In fact our analysis suggests that when other factors are controlled for, each additional year increase in a customer's age increases the odds that a customer will reduce debt by 1 percent. The Clinic's financial coaches report that older customers more often say they feel burdened by their debt and in general are much more anxious to pay it off. They are also more likely than younger customers to use moral language to describe debt, and more frequently say they feel it reflects personal shortcomings. Current economic trends will likely complicate this life-cycle dynamic. Today's prime-age working adults are experiencing lingering financial insecurity, including a higher debt overhang, as a result of the Great Recession, so we anticipate that this generation will carry even more debt later into life.

A strong social safety net supports debt reduction, while unemployment is a significant barrier. Our analysis shows that customers on Medicare or Medicaid, or that are receiving food, utilities, and housing assistance are significantly more likely to reduce their debt. Clinic coaches regularly speak of the stabilizing effect government benefits have for the working poor, giving them the consistent support they need to build their financial security. In particular, we found that a customer receiving all of these benefits is significantly more likely to reduce their overall debt burden. Customers that are unemployed are much less likely to reduce their overall debt burden, even when taking all of these benefits, including cash assistance programs like TANF and SSI, into account. This finding points to the unique destabilizing effect of a job loss or an inability to work, and clearly demonstrates that current cash assistance programs are not providing enough support necessary for financially insecure families. In a time when the usefulness of public assistance programs is being questioned, our analysis strongly validates the calls to not only defend—but expand—these programs as they provide a critical foundation that builds financial security.

A higher debt-to-income ratio makes it harder to reduce debt by any amount. This could reflect the overall negative impact a high debt burden has on a customer's life, and might suggest that at a certain point debt feels insurmountable. Our financial coaches see customers experience this first-hand and often recount the feelings of hopelessness that can accompany large debt burdens. According to one Clinic coach, this is especially true for those that took out debt as a means to invest in themselves, in this case student loans, and feel they have yet to see the payoff. This suggests that families dealing with high debt-to-income burdens are in need of more support that increases the impact of the debt management strategies they're already implementing. Some examples are expanding loan forgiveness programs, increasing positive income shocks like the EITC, or funding state and local block grant programs that support debt consolidation.



Completing measurable actions with a financial coach can help reduce debt. There was a strong relationship between the amount of actions completed by a customer with a financial coach—and captured in Change Machine—and their likelihood of reducing their overall debt burden. An action denotes a variety of tasks that can be completed such as "identify financial goals," "open a savings account," and "track expenses." Each additional action completed is associated with a 5 percent increase in the likelihood of the customer reducing their overall debt burden, with the tipping point of around 21 completed actions. This is an exciting observation and suggests possible causal pathways: It could reflect the importance of having a more engaged financial coach, suggesting that a clear roadmap that includes a lot of actionable steps to achieve a customer's goals supports debt reduction. At the same time, it could also suggest a more engaged customer, one with a more robust set of personal financial goals and a wider set of actions they want to complete, is the driving force behind this outcome.

What needs to be done?

- **Dive deeper into the impact of cash assistance programs on financial security:** Our analysis of Change Machine customers shows that a strong social safety net supports debt reduction, but also that unemployed customers are not receiving the help they need. Expanding cash assistance programs for low-income families, and addressing the benefits cliff, would not only give them more control over their finances, it would support a higher wage floor. The Clinic advocates for their expansion, and support more extensive research into the household-level impact of these supports as a critical tool for building financial security.

- **Give families more support to organize and prioritize their debts:** When a debt becomes detrimental for a household depends on the type of creditor they owe, and many Americans need better options to help them prioritize repayment on a variety of complex debts. We know that financial coaching is a critical support, and more working families need the opportunity to access a coach. But a product that helps individuals track the delinquency status and payment needs of their debts—especially one that helps place these demands within the context of a goal-oriented financial action plan—could significantly help working poor Americans meaningfully navigate their debt and prioritize more effectively. While research shows that many low- and moderate-income families are open to using more fintech apps and products to help navigate financial challenges, many also report that the features and the information provided are often not well-suited to their actual needs.[10] Compiling all critical information to resolve unpaid or incorrectly assigned debts can be a significant burden and represents an area where more innovation is needed.

- **Expand opportunities for individuals to resolve non-loan debt balances:** Critical reforms are needed in the assessment and collection of municipal fines and fees, and low-income Americans need expanded protection from the far reaching consequences of non-loan debt.

  – Cities like San Francisco and St. Louis are leading the nation in reforming assessments of municipal fines and fees and these bold steps need to be replicated across the country. Eliminating fees for individuals exiting the criminal justice system, capping court fines and fees, and assessing ability to pay fines and tickets prior to judgements are all essential steps to addressing these "hidden taxes" on low-income people.

  – Unresolved child support arrears can present particular barriers to low- and moderate-income individuals in ways that needlessly prevent them from building long-term financial security. Too many states adopt default child support orders that do not provide good-faith arrangements that keep non-custodial parents from being caught in a debt trap. These orders can also prevent them from accessing necessary services or hinders them finding employment, or worse, impedes healthy relationships with their children. States need to embrace a model that takes into account a parent's ability to pay when mandating their support orders, and to re-evaluate the effectiveness of sanctions that block them from building the financial security needed to meet their obligations.

- **Embed debt reduction in a broader action plan:** Developing an action plan that includes measurable and attainable milestones can facilitate debt reduction. A relationship with a financial coach can help develop passionately-held, asset-driven and forward-thinking financial goals that place debt reduction among a holistic set of outcomes that support financial security. Expanding opportunities for low- and moderate-income Americans to receive financial coaching by embedding it into a wide set of existing social services like workforce development, domestic violence survivor support, or re-entry services, can build the financial security of those who need it most.

Coming Next:

Join us for a deep dive through Change Machine's asset-oriented data, as we wrestle with issues that have consumed our staff meetings and debated on Change Machine's Share platform: Whether customers with limited earnings should prioritize savings for inevitable emergencies or paying down interest-bearing debt? Are financial goals as important to achieving outcomes as it is to engaging our customers? Does consistent savings—at any amount—lead to greater balances than one-off deposits? We hope you'll join us in these upcoming discussions!

Acknowledgements

The Change Matters series is made possible by generous support from The Prudential Foundation, MetLife Foundation, TD Charitable Foundation, JPMorgan Chase & Co., and Booth Ferris Foundation. The views and opinions expressed in Change Matters represent only those of The Financial Clinic and do not necessarily reflect those of our funders or their affiliates.

We also want to thank the many colleagues and partners that offered their insights and comments on multiple earlier drafts, including Frederick Wherry, Pamela Chan, Justin King, Denise Belser, and Ray Boshara. Lastly, we want to thank the financial coaches at The Financial Clinic, who lent their knowledge and experience working directly with customers to help us understand the complex dynamics of consumer debt. While we are grateful for the support of our reviewers, any errors are ours alone.

Endnotes

1 Not all 41,880 customers baselined all metrics such as Income, Debt, Assets, Race etc. As such some of the statistics are based on a smaller pool of customers that baselined these metrics.

2 These statistics reflect data collected about 36,452 debts from 9,981 customers on Change Machine who baselined debt.

3 Unpaid bills and debts are often sold to collectors after 180 days of delinquency. A charge off denotes when a creditor notifies credit bureaus that the creditor has given up on trying to collect an unpaid debt, and results in a negative mark on an individual's credit.

4 Hannah Hassani and Signe-Mary McKernan "71 Million US Adults Have Debt in Collections" https://www.urban.org/urban-wire/71-million-us-adults-have-debt-collections, July 18, 2018.

5 "Tipping Points: Mapping and understanding the impact of debt on household financial well-being" Center for Household Financial Stability, Federal Reserve Bank of St. Louis, 9 June, 2016. https://www.stlouisfed.org/household-financial-stability/tipping-points/impact-of-debt-on-household-financial-well-being-and-economic-growth

6 Bill Emmons, Anna Hernandez Kent, and Lowell Ricketts "Is College still worth it?: The new calculus of falling returns" research presented at Federal Reserve Bank of St. Louis, May 24 2018. https://www.stlouisfed.org/~/media/Files/PDFs/HFS/Is-College-Worth-it/Emmons_Symposium.pdf?la=en

7 Aspen Institute EPIC, Consumer Debt: A Primer. 2016. http://www.aspenepic.org/epic-issues/consumer-debt/consumer-debt-primer/

8 For more information on The Financial Clinic's empirically tested coaching model, see the results of the financial security field's first randomized controlled trial investigating the impact of financial coaching: https://thefinancialclinic.org/wp-content/uploads/2016/12/Clinic_and_Branches_Practitioner_Summary-2.pdf

9 Customers that reduced their debt in our analysis include all customers with over two meetings who, as of their final coaching session, have reduced the overall debt burden they reported at their first meeting by any amount.

10 Lucy Gorham and Jess Dorance. Catylizing Inclusion: Financial Technology and the Underserved. Center for Community Capital, Univ North Carolina - Chapel Hill. August, 2017. https://communitycapital.unc.edu/files/2017/10/CCC-FinTech-Report-2017-1.pdf