POLICY BRIEF

The Role of Markets in Creating Economic Opportunity for Black Americans

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Investing is fundamental to wealth building as every person is limited in the number of hours they have in a day.

Without having income derived from investments it becomes increasingly difficult to move up income classes, retire, or build any wealth. Increasing market access for the Black population is vital to any plan for improvement in economic standings. Technology changes have allowed more people to access the stock market, loans, and other banking services, but there are well-intended policies that can hinder this growth. These tools are part of the foundation on which upward economic mobility is deeply reliant. If future regulation and efforts are not coordinated, gains in this area could be reversed.

Key Facts

+ In 2015, nearly 1 out of 5 Black households were considered unbanked, and 40% of Black households were considered underbanked
+ Black investors are 3% more likely to deem financial services institutions untrustworthy, and over 24% less likely to use a financial advisor
+ 55% of Black Americans own stock compared to 71% of white Americans

Checking Accounts

Each year we move closer to a cashless society. According to the Diary of Consumer Payment Choice study of 2019 transaction methods, 28% of transactions are via debit card. Cash is used in only 26% of transactions, down from 30% in 2017. The trend is clear, people are engaged in more transactions and using cash for less of them. Those without a checking account face greater hurdles to participate in the economy than those with a checking account – they are subject to higher fees, less services, difficultly obtaining cash from checks, and issues around cashless purchases.

The Federal Deposit Insurance Corporation (FDIC) has three categories when defining banking status. Those are unbanked, underbanked, and fully banked.

+ **Unbanked**: No one in the household has a checking or savings account
+ **Underbanked**: The household has an account in an “Insured Institution”

and utilizes “Alternative Financial Services,” e.g., payday loans, money orders, or check-cashing services

+ **Fully Banked**: The household has an “Insured Institution” account and has not used an “Alternative Financial Service” in the last 12 months

In 2015 nearly 1 out of 5 (18%) Black households were considered unbanked, and 40% of Black families were considered underbanked. This number contrasts with the general population of 6% unbanked and 16% underbanked. These households experience the extra cost that comes with being unbanked and underbanked.

According to the “Financial Health Network, 2019 Financially Underserved Market Size” study, unbanked and underbanked individuals paid an estimated $189 billion on financial services interest and fees in 2018. This averages to $3,000 in fees per person. This cost represents the direct expense and misses the indirect cost of being unbanked. Indirect cost includes:

+ The lack of a safe location to hold funds
+ Access to interest-bearing accounts
+ Access to credit
+ Time cost

These costs ripple through the lives of unbanked and underbanked individuals. Emergencies that a fully banked person would use a savings account or credit to resolve, the unbanked are left to use title loans, payday loans, and pawn loans to address. Payday and car title loans often carry an interest rate above 400% annualized percentage rate (APR), while pawnshop loans are around 200% APR. The higher interest rates of these loans frequently create dependence on a loan to repay a loan, hence creating a cycle of dependency.

The Center for Responsible Lending’s 2005 report “Race Matters: The Concentration of Payday Lenders in African-American neighborhoods in North Carolina” concluded that, per capita, there are three times as many payday lenders in Black neighborhoods than there are in white communities. This discrepancy persists through control for age, gender, number of children, income, poverty rates, homeownership, unemployment rate, urban location, and education levels. Frequently, in communities where there are high levels of payday lenders, you do not see traditional banking services. According to the Federal Reserve 2009 paper “Determinants of the Locations of Payday Lenders, Pawnshops and Check-Cashing Outlets”, “payday lenders tend to locate in neighborhoods (Census block groups) that are poorer and have higher concentrations of Blacks than the county in which they are located as a whole, while banks tend to locate in neighborhoods that are wealthier and have lower concentrations of Blacks than countywide averages.”

Payday loans have been deemed so dangerous, due to the confiscatory level of interest rates, that they have been banned in 18 states and the District of Columbia. In the states in which they are allowed, it is common to see payday lenders transact under strict regulations on maximum fees, interest rates, and availability of loans to borrowers.

When a community’s primary lending source is payday lending it wrecks its financial health. Again, higher rates create dependence on a predatory loan but also instills a sense of distrust about financial institutions broadly, including traditional banks.

One means for addressing the needs of the unbanked and underbanked communities is public-private partnerships which focus on advancing financial services education. Banks have frequently offered low and no-cost checking accounts, and have done so for many years, but the positive results have come slowly to these at-risk populations.

Specifically, an opportunity for a public-private partnership exists in encouraging the opening of a bank account with a private institution for depositing financial government assistance. This along with the private institutions working on a state-sponsored education programs focused on ease and cost-saving benefits that come with a bank account at an insured institution has the potential to directly impact a group in need of economic assistance. Encouraging more partnerships and education should help improve the unbanked numbers.

Pairing receipt of a monthly child tax credit payment with an initiative to have recipients receive compensation in an insured institution account can significantly reduce the number of unbanked and under-banked populations. This concept also applies to other direct payments from the federal government, such as social security and welfare benefits. This is currently an option for the people receiving these benefits, but having the federal government push for more recipients to receive benefits in this manner would reduce the number of unbanked and under banked people. Attaching the child tax payments to an insured institution account has the potential for far-reaching results.

Moreover, with the prevalence of online access to traditional bank accounts, anyone with a smartphone – 85% of Americans according to Pew Research – has the opportunity to open an account, deposit funds, and maintain a bank account. Some banks work exclusively online. Banks like Sofi and Ally have no physical presence and work through their phone app and website.

Stock Market

One of the most consistent and effective ways to build wealth has been through the stock market. Gallup reports that before the 2008 recession, 62% of Americans owned stock. As of 2021, the number has reduced to 56%, with a large discrepancy between Black and white Americans. According to the 2020 Ariel-Schwab Black Investor Survey, 55% of Black Americans own stock compared to 71% of white Americans. There is hope for improvement in this number overall, with 63% of both Black and white Americans under 40 investing in stocks.

While the number of investors is similar, the amount invested is not. Black Americans invest $393 a month, while white investors typically contribute $693 per month. A comparable gap is consistent across income levels showing that a Black investor, typically invests smaller amounts.

The 2020 Ariel-Schwab Black Investor Survey found trust and respect to be two of the most significant contributing factors to the lack of consistency among Black and white investors. Black investors are 3% more likely to deem financial services institutions untrustworthy and are over 24% less likely to use a financial advisor. Only 35% of Black investors say they feel respected by financial institutions. This can be the result of a lack of trust in "the system", potential poor treatment by bank employees to Black patrons, or a misunderstanding of services on behalf of Black customers.

In the same report, Ariel Investments, a global asset management firm, discussed solutions they are attempting. Ariel started a group of trained employees to present financial education focused on underrepresented teens and low-income students. These employees prioritize mentorship opportunities to support minority career development, the importance of which cannot be overstated as it encourages longevity in minority careers and promotes Black employee recruitment. Blacks, by a margin of 63%, say ethnic diversity is essential to them in a financial institution.

Modern technology has also improved access to the market. Because of market pressures and resources like payments for order flow (which allows for cheaper trades), financial institutions have offered low to no fees for trading in brokerage and retirement accounts. Clients can also use one institution to house multiple accounts, including checking, savings, brokerage, futures, Roth, and Traditional IRAs.

Some apps make investing effortless, like Acorns and Stash. Both of these apps will create a personal brokerage account, which they link to someone's checking account. They then monitor transactions and round up each transaction to the nearest dollar, and use the change to invest. Some companies focus specifically on new and low-volume traders. Webull and Robinhood allow anyone with a smartphone to buy any amount of stock, including fractional shares, that numerous larger firms do not. These tools and a public-private partnership providing financial education can improve Black access to the market.

Congress could also improve access to the stock market by not increasing regulation on broker-dealers. Recently there has been a movement to remove the ability to use the payment for order flow. Without trade commissions, many, but not all, broker-dealers use the payment for order flow for revenue. Payment for order flow is when a market maker—which is the entity which connects people who want to buys stocks with people who want to sell stocks—pays a broker-dealer for routing trades to them over another market maker. The money from payment for order flow replaces the revenue a broker dealer would make over trade commissions.

Payment for order flow creates an incentive for a broker-dealer to send their trades to the highest bidder. Payment for order flow can also result in the trader making the transaction not receiving the best price when placing a trade. Typically, the gap is between a fraction of a cent ($0.001) to a $0.10 difference. The cost difference is a massive problem for high-volume trades and frequent traders.

However, the U.S. Securities and Exchange Commission (SEC) requires all broker-dealers to disclose if they use payment of order flow and give annual updates on any changes to this status. Because some broker-dealers do not use payment of order flow, there are current options for traders who do not want their trade routed this way. Removing payment for order flow increases the bar for entry for new broker-dealers and increases the direct cost for the consumer. Payment for order flow does not yield the best possible price for the consumer, but when someone is looking to enter the market, this practice allows for easier entry.

Debt Instruments

Debt instruments, such as credit cards, lines of credit, and loans, are an essential part of access to markets. In America, banks use credit scores to determine creditworthiness. There are five factors to calculate a credit score:

+ Payment history
+ Amount of debt (credit utilization ratio)
+ Age of credit accounts
+ A mix of credit accounts
+ New credit inquiries

In 1956 Fair, Isaac, and Company (FICO) created the current system that relies on a credit-scoring algorithm. The current system removes human error and bias in previous lending practices. Though a vast improvement upon older systems, some issues need to be addressed in the current system.

When an error occurs in this system, the credit score owner faces great difficulty to correct it. Moreover, the algorithm does not capture the creditworthiness of someone who currently does not have credit. This flaw forces people to take out credit at higher interest rates until they create a consistent credit history. People without credit then face a huge challenge, to build their credit, especially later in life.

Debt instruments are the lifeblood of wealth creation. Rarely is the average Americans' most valuable asset, their home, acquired without a home loan. Those without a credit record will pay higher interest rates and will be required to make a higher down payment. Across both 30-year and 15-year loans, even a slight increase in interest makes payments, and the total amount paid, significantly higher.

The same applies to small business loans. Starting a business is one of the most effective avenues of wealth creation. Without a strong credit usage history, someone taking the risk to start a business faces higher interest rates on a small business loan, thus incurring a higher cost for the company to function. This higher cost reduces profits and makes it difficult for small businesses to succeed.

A lack of credit history is less challenging when the borrower can collateralize the loan, that is, where a loan is backed by assets so that the owner has a prominent equity position in the investment. Due to the nature of a line of credit it frequently relies on previous real estate or business as collateral. Also, because there is collateral in these loans, they come with significantly lower interest rates. People use these lower rates to expand their real estate portfolios, improve properties, grow businesses, or create new services.

One way to improve access to debt instruments is to adjust the formula used to calculate an individual's credit score. Only on-time payments of the holders' current credit lines are now included. Payment history determines 35% of a credit score. Payment history comprises traditional credit cards, retail credit accounts, loans where someone makes regular installments, and mortgage payments. It also includes bankruptcies, lawsuits, wage garnishment, and missed or late payments.

Due to the current make up payments which are included in calculating the types, payments not connected to a type of loan or credit does not help in an individual's credit score. Allowing a credit score to reflect installation payments not connected to a loan would help people outside the system have more accessible entry into the system. This change would include on-time utility payments (water and power), on-time rent payments, and other on-time monthly charges (Phone and internet). Not only would this give a more complete view of how someone manages their funds for repayment purposes, but it would also allow people to build creditworthiness before they enter the credit system.

CONCLUSION

Market access is a crucial aspect of economic growth and wealth building.

However, in the Black community, some barriers must be addressed, such as the lack of access to checking accounts, the use of payday loans, and the low trust in financial institutions. The cost associated with being unbanked or underbanked takes a toll on individuals and creates indirect costs that affects lives. Public-private partnerships and businesses promoting financial education, which can provide a path for the upward mobility of Black Americans, is the answer. If the policies are not coordinated, past gains achieved will be reversed, so it is imperative to continue the work to remove these barriers and improve access to markets for all.

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George Ferris III, MBA is a Fellow for Economic Empowerment with the Joseph Rainey Center for Public Policy. For the last decade, he has been a rising star in campaign strategy and policy throughout the state of Utah. He has worked with Senator Mike Lee, former Congresswoman Mia Love, and many other political leaders at every level of Utah's government. Moreover, George was an integral part of the campaign which successfully elected America's First African American Republican woman in Congress. This success launched him to be the co-founder of Election Season, a campaign consulting firm in Salt Lake City.

Growing up in Modesto, California, in a single mother home, George learned about the struggles of living on government assistance. During this time he also gained a love of public policy and good governance.

He holds a BA in Political Science from Utah State University and a Master's in Business Administration from Western Governors University. Currently, George resides in Salt Lake City Utah. In 2014 George married his wife Anna and in 2021 they welcome their first child Bevan to the world.

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