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Reaching Out To The Unbanked

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This chapter presents a strategy for helping the "unbanked"—those who do not have deposit accounts of any type—to join the financial mainstream. The purpose is to help these individuals build savings and improve their credit-risk profiles, in order to lower their cost of payment services, eliminate a common source of stress, and gain access to lower-cost mainstream credit. The proposed strategy has five elements. First, participating banks should open special branch offices, called "outlets," that are conveniently located for lower-income households and that provide fee-based, check-cashing services in addition to traditional consumer banking services. Second, these outlets should offer "starter" bank accounts that have low minimum-balance requirements, cannot be overdrawn, and include access to low-cost money orders for making long-distance payments.[1] Third, the outlets should offer accounts, similar to traditional "Christmas Club" accounts, designed to help people accumulate savings. Fourth, the outlets should offer deposit-secured loans to individuals whose credit histories would make them ineligible for mainstream credit. Fifth, banks should form partnerships with nonprofit community-based organizations to help promote the outlets and to offer budget-management and credit-repair seminars to interested clients of the outlets.

This chapter argues that a strategic approach is likely to be most effective in assisting the unbanked and, furthermore, that it is realistic to expect many banks to implement it. The proposed initiative will appeal to banks because it can be effective for the clients, while offering banks a reasonable rate of return on their investments. In addition, banks that implement the strategy can receive credit toward the "service" component of their federal Community Reinvestment Act obligations.

The section below describes people who are unbanked, noting their demographic characteristics, why they decide to remain outside the banking system, and the problems they face as a result of their status. The next section presents my strategy for bringing the unbanked into the financial mainstream and explains the rationale for the strategy. And in the final section, I explain why it is realistic to expect banks to implement the strategy.

A BRIEF DESCRIPTION OF THE UNBANKED

Several surveys have attempted to identify the socioeconomic characteristics of households without bank accounts and to ask individuals in these households why they do not have bank accounts. Although the details of these surveys differ, they all find that the unbanked are disproportionately represented among lower-income households, among households headed by African Americans and Hispanics, among households headed by young adults, and among householders who rent their homes. Table 8.1, based on data from the 2001 *Survey of Consumer Finances,* presents data supporting such generalizations.

The second issue that the surveys attempt to answer is why people do not have deposit accounts. Again, the details differ across the surveys, but there is a broad consensus in their findings. Families most frequently report that they do not have deposit accounts because they have almost no month-to-month financial savings to keep in the accounts. In 1996, a consulting firm working for the U.S. Department of the Treasury surveyed a large sample of recipients of federal benefit checks to inquire why they did not have deposit accounts (Booz-Allen, 1997). About half of the respondents cited as the primary reason, "Don't have enough money." In the same year, 1996, I commissioned a survey of 900 lower-income households to obtain information on their use of financial services (Caskey, 1997b). Of those without accounts, as shown in table 8.2, 53 percent cited, "Don't need account because we have no savings," which made this the most frequently cited reason.[2] Unfortunately, the *Survey of Consumer Finances* does not ask people why they do not have deposit accounts. Rather, it asks households without checking accounts to give the primary reason why they do not have a checking account. As shown in table 8.3, the most common (28.6 percent) reason cited is "Do not write enough checks to make it worthwhile." "Do not have enough money" is the third most common (14 percent) response.

In the surveys, other common responses for why people do not have deposit accounts include "Bank fees are too high," "Bank minimum balance requirements are too high," "We want to keep our financial records private," and "We are not comfortable dealing with a bank." The first two of these reasons are closely related to people's low level of financial savings, as depositors able to maintain a month-to-month balance of about $500 or more rarely pay account maintenance fees and rarely write checks that "bounce," leading to nonsufficient funds fees. The desire to keep financial records private could arise because (a) a creditor might seize the savings of a delinquent debtor, (b) a former spouse might pursue the savings of an individual behind on his child-support payments, (c) welfare eligibility could be threatened by a substantial account balance or by a history of

Table 8.1 Percentage of Families without Deposit Accounts, 2001 *Survey of Consumer Finances*

Family Characteristic	Percentage without Deposit Account
All families	9.1
Percentile of income	
Less than 20	29.1
20–39.9	10.6
40–59.9	3.9
60–79.9	1.2
80–89.9	0.3
90–100	0.8
Age of head (years)	
Less than 35	14.0
35–44	9.3
45–54	7.8
55–64	6.4
65–74	6.2
75 or more	6.3
Race or ethnicity of respondent	
Nonwhite or Hispanic	21.8
White non-Hispanic	5.1
Current work status of head	
Working for someone else	7.6
Self-employed	4.8
Retired	11.1
Other, not working	29.5
Housing status	
Owner	3.5
Renter or other	20.7

Source: Aizcorbe, Kennickell, and Moore, 2003.

deposits from under-the-table earnings, or (d) illegal immigrants might fear that a bank record would reveal their presence to the Immigration and Naturalization Service. The formal surveys have not delved into these reasons, but one ethnographic study finds evidence of these concerns even, in some cases, when there is little legitimate basis for the concerns (Caskey, 1997a). Less common reasons given for not having a deposit account include, "Banks won't let us open an account" (presumably because the per-

Table 8.2 Reasons Given in Caskey Survey for Why Households Do Not Have Deposit Accounts

Reason/Reasons Given	Percentage Giving This Reason
Don't need account because I have no savings	53.3
Bank account fees are too high	23.1
Banks require too much money just to open an account	22.1
I want to keep my financial records private	21.6
Not comfortable dealing with banks	17.6
Banks won't let us open an account	9.5
No bank has convenient hours of location	8.5
Problem fee/fees among those citing bank fees as a barrier	
Monthly account maintenance fee	28.4
Bounced-check fees	18.5
Check-writing fees	12.9
ATM fees	11.0

Source: Caskey, 1997b.

son has a history of writing bad checks or a severely impaired credit record) and, "No bank has convenient hours or location."

Many of the unbanked encounter few problems from their status (Prescott and Tatar, 1999). They have no financial savings, so there is no hardship from not having access to a financial institution to safeguard such savings. They cash paychecks for free at an accommodating deposit insti-

Table 8.3 Primary Reasons in 2001 *Survey of Consumer Finances* for Why Households Do Not Have Checking Accounts

Reason	Percentage Giving This Reason
Do not write enough checks to make it worthwhile	28.6
Do not like dealing with banks	22.6
Do not have enough money	14.0
Service charges are too high	10.2
Minimum balance is too high	6.5
Cannot manage or balance a checking account	6.6
Do not need/want an account	5.3
Credit problems	3.6
No bank has convenient hours or location	0.4
Other	2.1

Source: Aizcorbe, Kennickell, and Moore, 2003.

tution, grocery store, or other business. They purchase money orders from the post office or convenience stores to pay bills by mail. They have no immediate need for credit or do not find that their unbanked status excludes them from the credit that they do need.

Such a sanguine outlook is not, however, true for a significant fraction of the unbanked. In urban areas, surveys indicate that somewhere between 30 and 60 percent of the unbanked pay fees to cash their paychecks, and many of these patronize commercial check-cashing outlets, called CCOs (Caskey, 2002). CCOs cash people's paychecks or government checks for a fee that is usually expressed as a percentage of the face value of the check. Except in a small number of states that impose fee ceilings below 2 percent, typical fees for cashing low-risk checks range from 2 to 4 percent. Some CCOs will cash personal checks, usually for a higher fee to reflect the higher risk that such checks might bounce. CCOs also sell money orders, handle utility bill payments, serve as agents for firms that transfer money electronically, and sell related convenience items, such as photocopying services and prepaid calling cards.

The problem created by the regular use of a CCO is that CCOs are an expensive source for payment services. Over the course of a year, a family making $18,000 a year can easily spend $500 or more of this limited income obtaining basic payment services at a CCO. Nevertheless, there is little mystery as to why many individuals without financial savings go to a CCO. The CCO will cash their paychecks instantly. While standing at the service window, the customers can use some of the cash to purchase money orders for paying bills. The CCO also sells stamps and envelopes for mailing the payments. CCO customers will frequently use some of their cash to pay utility bills, cable television bills, and phone bills at the CCO. In communities with large numbers of recent immigrants, many CCO customers wire some of their funds to family members in home countries. After conducting these transactions, the customers walk out of the CCO with their remaining cash. They spend this down until the next pay period when they repeat this procedure.

Given this behavioral pattern, it is understandable why such customers do not go to a bank. Most banks in urban areas refuse to cash paychecks for people who do not have accounts at the bank or who do not have accounts with sufficient funds to cover the check. Banks typically require account holders without sufficient funds to deposit the check and wait a few days for it to clear before they gain access to the funds. Although the CCO charges fees for cashing a paycheck (a percentage of the amount), a money order (generally about $0.35 to $1), or transmitting a utility bill payment (commonly about $1), this can be less costly for someone with no month-to-month savings than relying on a bank. It is very easy for a person who runs his account balance down to nearly zero at the end of each pay period to bounce checks on the account. Each bounced check can cost the account holder $25 to $35.[3] It is also expensive and inconvenient for customers without checking accounts to make long-distance payments. Almost all banks charge at least $1 for money orders, and many charge as much as $3. Moreover, they do not sell stamps and envelopes, so the customer must go elsewhere to meet this need. Finally, banks generally do not transmit payments to utility companies, nor do they serve as agents for electronic money transfer services, such as Western Union.

Although most attention has gone to the relatively high fees that many of the unbanked incur for basic payment services, this may not be the major problem associated with their status. In 1997, in collaboration with a group of anthropologists, I conducted a series of detailed discussions with lower-income individuals, many of whom were unbanked, in two communities, San José, California, and a small town in Mississippi (Caskey, 1997a). In discussing their financial affairs, the unbanked rarely complained about the expense or inconvenience of obtaining payment services. Rather, they complained mainly about the insecurity and stress associated with living from paycheck to paycheck. This was also true of individuals with bank accounts who consistently ran down their account balances to nearly zero at the end of each pay period. In both cases, the interviewed individuals commonly spoke of feeling physically and emotionally drained from facing frequent personal financial crises and worrying about future unforeseen expenses.

Because so many of the unbanked live from paycheck to paycheck with no financial margin of safety, many have been forced by past personal financial crises to miss scheduled payment obligations, such as rental, debt service, or utility bill payments. In my 1997 survey of 900 lower-income families, for example, 42 percent of the families without deposit accounts reported that they had been two months late on some bills in the previous year (see table 8.4). Among lower-income families with deposit accounts, 28 percent reported being late paying some bills in the previous year. Similarly, 41 percent of the unbanked families and 25 percent of lower-income families with deposit accounts reported that they had been contacted by a bill collection agency in the past year.

Table 8.4 Indicators of Impaired Credit Records among Households with Incomes of $25,000 or Less

Indicator	% Families without Deposit Accounts Answering "Yes"	% Families with Deposit Accounts Answering "Yes"	Difference Is Statistically Significant?
Been more than 2 months late on some bills in the past year?	41.9	28.2	Yes
Contacted by a bill collection agency in past year?	40.9	24.8	Yes
Have a Visa, MasterCard, Discover, or Optima credit card?	13.6	58.7	Yes

Source: Survey conducted as part of Caskey, 1997b.

These data indicate that the unbanked are more likely to have impaired credit records than those in households with bank accounts. But they also indicate that problems with credit histories and debt service burdens are widespread among lower-income households generally, including those with bank accounts. As indicated in table 8.5, this impression is supported by data from the 1998 *Survey of Consumer Finances*.

Problems with credit histories and debt-service burdens leave a large share of the unbanked, as well as a significant share of lower-income households generally, cut off from mainstream credit.[4] When these households need short-term loans to meet emergencies, they find informal sources of credit or turn to high-cost, formal-sector lenders, such as pawnshops, car title lenders, payday lenders, and small-loan companies. Interest rates from these lenders are generally over 100 percent average percentage rate (APR) and often as high as 300 percent (Caskey, 1997b).

PROPOSED OUTREACH STRATEGY

This section sets out a strategy for bringing the unbanked into the financial mainstream. As noted earlier, the strategy has five elements, the details of which will be presented below. First, however, it should be emphasized that while the overall proposal is new, it embeds several other initiatives with similar goals that are already under way. For example, the proposed strategy includes efforts to design accessible, low-cost deposit accounts, to create institutional mechanisms that facilitate people's efforts to accumulate savings, and to increase financial literacy within lower-income communities.

Open Specialized Bank Branches That Provide CCO Services

The first step in the proposed strategy is for banks to open specialized branches that offer a full range of CCO services, as well as standard con-

Table 8.5 Indicators of Debt Burdens and Debt Payment Difficulties

Family Characteristic	% with Ratio of Debt Payments to Family Income above 40 Percent	% with a Debt Payment Late 60 Days or More in Previous Year
All families	12.7	8.1
Income (1998 dollars)		
Less than 10,000	32.0	15.1
10,000–24,999	19.9	12.3
25,000–49,999	13.8	9.2
50,000–99,999	5.7	4.5
100,000 or more	2.1	1.5

Source: Kennickell, Starr-McCluer, and Surette, 2000.

sumer banking services. To distinguish them from other bank branches, I call these specialized bank branches "outlets." An alternative approach would be for banks to form partnerships with existing check-cashing outlets and to offer basic consumer banking services through these outlets. For simplicity, the discussion below assumes that banks are opening their own outlets, but it could easily be adapted to fit a model based on a bank/CCO joint venture.

For an appropriate fee, the new bank outlets should cash low-risk local paychecks and government checks without placing a hold on the checks, even for individuals who lack deposits to cover the checks.[5] As people without checking accounts who cash their paychecks will need a means to pay bills, these outlets should sell money orders, stamps, and envelopes, and they should serve as an in-person payment point for utility bills, cable TV bills, and so on. They should also offer a service for transferring funds by wire, especially when the outlets are located in areas with large numbers of recent immigrants. Additionally, when unbanked people cash paychecks and pay bills, they frequently need to obtain convenience items and services such as photocopies, fax transmissions, prepaid telephone calling cards, and, in some regions, transit tokens. The outlets should provide such supporting products and services—in fact, the outlets would perform all CCO-type services but charge somewhat lower fees for all products and services than charged by the CCOs.

If the outlets are to be successful, banks must locate them at points likely to be convenient for large numbers of low- and moderate-income households. The outlets will need to maintain hours similar to those of check-cashing outlets, meaning that they should be open early evenings and on Saturdays. Banks should also post prominent signage indicating that the outlets offer check-cashing services. In many cases, giving the outlets a CCO-type name, such as "Cash Express Center of Bank X," will serve this purpose. It also distinguishes the outlets from a bank's regular branches that do not offer check-cashing services to those without deposit accounts.

Opening such outlets serves three purposes. First, by offering CCO services in a bank branch, the bank establishes direct contact with CCO customers. Over time, banks can develop relationships with unbanked individuals that they can use to encourage them to take steps to build savings and address credit record problems. Simply put, banks cannot help the unbanked if they do not get them in the door. Second, the establishment of such outlets recognizes that many CCO customers are likely to be slow to open deposit accounts. As noted earlier, many simply do not have month-to-month savings and see little advantage to a deposit account. Others do not want deposit accounts for fear that their savings might be seized by creditors or might make them ineligible for welfare. By offering check-cashing services, banks can provide high-quality, relatively low-cost payment services to individuals who remain outside the deposit system. Third, banks with branches in lower-income areas often report that it is difficult to cover the costs of these branches with traditional services because deposit mobilization is low, transaction levels are high, and loan opportunities are limited (Caskey and Humphrey, 1999). If these branches were able to find new sources of revenue, such as check-cashing fees, this could contribute toward making these branches profitable and encourage banks to open branches likely to attract large percentages of lower-income households.

Banks opening such outlets may be able to set fees for check-cashing services that are somewhat lower than those of most commercial check-cashing outlets and yet sufficiently high to be profitable for the banks. This is true for two reasons. First, bank outlets, which will offer traditional consumer banking services as well as check-cashing services, should benefit from economies of scope. Earnings from both services can cover many of the same fixed overhead expenses. Second, banks, unlike commercial check-cashing outlets, have direct access to check-clearing systems and have a relatively low cost of financial capital. This will eliminate some of the costs that check-cashers incur from the need to clear checks through the banking system and obtain working capital.

Offer "Starter" Bank Accounts That Have Low Minimum-Balance Requirements, Cannot Be Overdrawn, and Include Access to Low-Cost Money Orders for Making Long-Distance Payments

In addition to offering traditional, fee-based check-cashing services, these specialized outlets should provide the full range of consumer banking services offered at banks' traditional branches. This recognizes that even in very low-income communities, there will be significant numbers of people who desire traditional deposit and credit services and can qualify for them. To the extent that outlets can attract such customers, they will make banking services more convenient for some community members and help to cover the costs of operating the outlets. In addition, because the outlets are intended to help the unbanked become traditional bank customers, it will be helpful to have banking services offered in locations where unbanked individuals are already comfortable.

Beyond their traditional deposit accounts, the outlets should offer a low-cost, low-minimum-balance savings account, and account holders should be able to purchase at least ten money orders per month for no more than $0.75 each, as well as stamped envelopes for mailing the money orders. For qualifying households, the account should include automated teller machine (ATM) and debit-card access. If banks are able to block individuals' abilities to overdraw their accounts, then banks should be able to provide ATM access even to householders with severely impaired credit histories. Finally, the accounts should accept electronic deposits of wage payments and government transfers.

The proposed features of this type of account differ from those of two other prominent accounts that have been advocated as mechanisms to help the unbanked join the banking system. A number of advocates for the unbanked have sought to enact laws, called "basic" or "lifeline" banking laws, that would require banks to offer a low-cost checking account with a low minimum-balance requirement. A small number of states have enacted such laws, but the federal government has not. Although bank trade associations fought against such proposed laws, especially at the federal level, they called on banks to offer such accounts voluntarily. A majority of banks claim that they do (Krieger, 2000). In a second initiative, beginning in 1999, the U.S. Department of the Treasury asked banks to offer "electronic transaction accounts" (ETAs). The federal government wants banks to offer these accounts in order to encourage the use of direct deposit by unbanked recipients of federal transfer payments. Currently, the government must mail paper checks to individuals who do not have deposit accounts. In designing the ETA, the government had two concerns. First, it wanted to ensure that the account was inexpensive for account owners, even for individuals unable to maintain a month-to-month minimum balance. This was to provide the unbanked an incentive to open an ETA, making them eligible for direct deposit. Second, the government wanted the account to be at least moderately profitable for banks so that they would be willing offer the ETA. To meet these two goals, the government offers to pay banks $12.60 for each ETA they open. It permits the banks to charge account owners up to $3 a month and requires that the accounts accept electronic payments from the federal government, have no minimum balance requirement, and permit account owners to make up to four withdrawals per month from the account. The withdrawals can be from a proprietary ATM machine or through a teller. The accounts need not include the ability to draw checks on them or the ability to initiate electronic payments.[6]

There are good reasons to think that basic checking accounts and ETAs are unlikely to bring many of the unbanked into the banking system. A checking account can be very costly for someone who lives from paycheck to paycheck. Individuals who consistently run down their account balances to zero or nearly zero by the end of each pay period are likely to bounce checks frequently unless they are especially scrupulous account managers. Writing a check that bounces commonly results in fees of $25 to $35, so people who bounce a few checks every other month or so will quickly spend more for their bank accounts than they would for using a check-cashing outlet. In addition, because banks fear that people who bounce checks might not pay the fees that banks charge to cover the banks' costs of handling the checks, they generally do not permit people with histories of bouncing checks to open or maintain checking accounts.

Low-cost deposit accounts on which individuals cannot write checks, such as the ETA, have a different problem. These accounts do not include any means for account holders to make long-distance payments. Since most banks charge comparatively high fees for money orders, do not sell stamps and envelopes, and do not handle utility bill payments, account holders have to go elsewhere to obtain these services, a feature that makes the ETA unattractive.

Unfortunately, there are no data indicating whether or not basic checking accounts have drawn significant numbers of the unbanked into the banking system (Doyle, Lopez, and Saidenberg, 1999). Anecdotal information suggests that they have not. Complicating the analysis, however, several surveys of banks in states requiring basic checking accounts have found that banks do not publicize these accounts and frequently steer customers to more costly alternative accounts (Pristin, 1999). Such behavior is not surprising, as banks claim that the accounts are unprofitable. The ETA has also failed to have a significant impact. As the U.S. General Accounting Office (2002, 25) reported, "Despite Treasury's efforts to market the ETA program, since the program was initiated in July 1999, about 36,000, or fewer than 1 percent, of unbanked federal beneficiaries had opened ETAs by June 2002."

The account that I propose has two advantages over the basic checking account and the ETA. For one, banks can offer it to people who have a history of bouncing checks, and people who fear the expense associated with bounced checks will not be deterred from opening the account. In addition, unlike the ETA, it provides account holders with a convenient, low-cost means to make long-distance payments: inexpensive money orders with stamped envelopes. If they desire, banks can design the proposed account to qualify as an "electronic transfer account" in order to receive the $12.60 that the Treasury Department pays for each ETA that banks open.

Offer Accounts Specifically Designed to Help People Build Savings

In addition to the savings account described above, the outlets should offer a "savings-building" account. Although there can be many variations in the details of savings-building accounts, research on consumers' savings behavior indicates that these accounts should have several key features. First, in opening such an account, an individual should pledge to make regular, fixed-value contributions to the account over a specified time period, usually one year. The timing of these contributions should closely coincide with the individual's receipts of income. Second, the bank should permit the required periodic contributions to be small, perhaps as little as $20 per month. Third, if possible, contributions to the account should be automatic. The contributions, for example, could be linked to a member's direct deposit of his or her salary, or a check-cashing customer might agree to deposit $10 each time he cashes his biweekly paychecks. Fourth, a savings-building account should be separate from other accounts that the individual might own. This helps separate the funds psychologically from savings for short-term transaction purposes. Finally, there should be some financial penalty if the account owner closes the account early or fails to keep the commitment to make specified deposits at regular intervals. In imposing this penalty, such as loss of accumulated interest, the bank should probably show some flexibility. It might, for example, permit one or two missed deposits before the penalty takes effect.

The psychological basis of these rules is obvious. People have a hard time saving on a discretionary basis, so they save most effectively when the act of saving is relatively unconscious and the savings are viewed as "locked away" (Thaler, 1992).

This proposed savings-building account is similar in several of its features to the individual development accounts (IDAs) that some banks and credit unions have begun to offer in partnership with philanthropic foundations, community-based organizations, or government agencies. There are, however, two main differences. The IDAs offer matching funds to lower-income individuals who accumulate and maintain savings over a designated period of time. In addition, holders of IDAs, if they are to receive the matching funds, must use their IDA savings for an approved set of purposes, such as education or the down payment on a home.

When matching funds are available and administrative costs are not a problem, the outlets might consider offering IDAs in addition to the savings-building account advocated above. The IDA should not, however, replace the savings-building account. For one, the savings-building account is administratively simpler and has lower costs, making it more likely that banks will offer it. A bank can offer it to anyone and need not verify that an account holder has a sufficiently low income to qualify. The savings-building account also does not require the bank to find a source to provide matching deposits. More important, IDAs are intended to help people build medium- or long-term savings for a particular set of approved purposes. People living from paycheck to paycheck would benefit from such savings, but they also need short-term savings to dip into to handle periodic fluctuations in income and expenditures. Such short-term savings are a form of self-insurance, a financial margin of safety or "buffer" intended to prevent periodic personal financial crises.

Offer Deposit-Secured Emergency Loans to Individuals Whose Credit Histories Make Them Ineligible for Traditional Mainstream Credit

Although bank outlets can compete with commercial check-cashers, in most cases they will not be able to provide traditional loans to people currently borrowing from deeply subprime lenders, such as pawnshops, payday lenders, and small loan companies. These people generally have far higher risk profiles than would be prudent for depository institutions to underwrite. The deeply subprime lenders can provide credit to this population group by adopting labor-intensive risk-control procedures, such as prompt and persistent in-person debt collection. The outlets could try to follow a similar path, but pawnbroking and collecting unsecured subprime debt are specialized skills that bank outlet employees are unlikely to possess or would not choose to develop. In many cases, it is doubtful that a bank outlet would be providing a beneficial service if it were to make short-term, high-cost loans to financially hard-pressed individuals. This could simply worsen the borrowers' financial distress and the costs of the resulting consequences.

In some cases, however, bank outlets should be able to use creative means to meet customers' legitimate credit needs. Banks with branches in lower-income communities frequently report that many of their customers with good credit records occasionally seek unsecured, nonrevolving loans of under $1,000. Commonly, banks do not offer such loans because the processing and monitoring costs are high relative to the size of the loan. But with credit-scoring and other cost-saving technologies, the outlets may be able to make fast-disbursing, small-value loans with fees that are attractive to both the customers and the banks.

Customers with impaired credit histories will also have legitimate needs for credit. To help meet this need, the outlets should offer deposit-secured loans to customers unable to pass standard credit-risk assessments. An outlet could, for example, issue a deposit-secured credit card to a customer. Or it could make a loan against the balance that a member has accumulated in a savings-building account. When the customer repays the loan, his or her savings are still in place. Moreover, if outlets offer such loans, customers may be more likely to agree to lock away their savings in savings-building accounts (Caskey and Humphrey, 1999).

Seek Community-Based Partners and Offer Financial Literacy Programs

As the previous example makes clear, banks can benefit by forming partnerships with not-for-profit community-based organizations (CBOs) when launching outlets to serve the unbanked. Of course, in doing so, banks must tread carefully. Just because an organization is not-for-profit or declares itself to be "community-based" does not mean that it will be a good partner. Some CBOs operate primarily to promote the personal political or economic ambitions of their executives, some are well-meaning but incompetent, and others have severe shortages of human and financial resources. In most large urban areas, however, there are numerous well-managed CBOs dedicated to helping lower-income individuals and communities.

A partnership with an appropriate CBO can bring a number of benefits to a bank that is beginning to open outlets to serve the unbanked and to the CBO. Significantly, if the CBO is well respected and well connected in the community, it can help overcome any distrust that the community might have of the bank's motives. This role is especially important if a bank's managers and board of directors are separated from the target community by racial or ethnic barriers. In many cases, the CBO can help the bank find qualified community residents to staff the outlet, further tying the outlet to the community. The CBO also benefits from the partnership because it enables the CBO to bring sophisticated financial services to the targeted neighborhood in a short time period. Some CBOs have tried, as an alternative strategy, to start their own credit unions. Most of these credit unions, however, remain very small with limited management capacity and can offer only a very restricted range of consumer financial products.

In addition to forming a partnership with a CBO to launch outlets to serve the unbanked, banks should use the outlets as bases to promote appropriate financial literacy initiatives. Although there are no random assignment studies demonstrating the effectiveness of financial literacy programs, anecdotal information and some quasi-experimental studies suggest that financial management counseling can help individuals accumulate savings and improve their credit-risk profiles (Braunstein and Welch, 2002). Typically, the educational programs are one of two types. One is remedial, focusing on helping people reduce their debt service burdens and address outstanding credit problems. The other type is oriented toward wealth-building activities, such as identifying cost-savings in family budgets and accumulating savings for retirement, education, or the purchase of a home.

This is not to say that the outlets should conduct such financial counseling programs themselves. Not only are such programs costly to offer, but banks may not be the appropriate institutions to deliver the information. CBOs are likely to be more effective because well-run CBOs will understand the particular financial literacy needs of members of their communities and have staff who can communicate comfortably and effectively with them. In addition, as not-for-profit organizations, CBOs can apply to philanthropic foundations and government agencies to fund their financial counseling programs.

WHY IT IS REALISTIC TO EXPECT BANKS TO IMPLEMENT THE PROPOSED OUTREACH STRATEGY

If banks are to implement this outreach strategy, they must receive an acceptable financial rate of return on their investment. As delivering financial services to lower-income communities counts towards banks' Community Reinvestment Act obligations, banks may accept a slightly lower return on capital than normal. Naturally, the higher the expected returns from pursuing the outreach strategy are, the more likely banks will be to embrace it.

There are a number of measures that banks can take to ensure that they earn an adequate rate of return from their outlets. To keep their operating costs low, the outlets should have flexible staffing because demand for check-cashing services is closely tied to the paydays of local businesses and arrival dates for government transfer payments. In addition, the outlets should be small, perhaps taking no more than 1,000 square feet, as many check-cashing outlets do. Banks might also investigate using automated check-cashing machines to cash paychecks, dispense money orders, and initiate utility bill payments within the outlets. Several such machines have been developed, based around ATM platforms, and some preliminary reports of their performance and customer acceptance are favorable.

Well-located outlets should have strong revenues. Assuming that they attract a moderately high volume of check-cashing business and levy reasonable check-cashing fees in the neighborhood of 1.5 percent, the outlets should earn about $100,000 per year from check-cashing and other payment service fees.[7] In addition to this income, the outlets will earn income from their traditional banking services. If these two businesses can be combined in one outlet with substantial economies of scope, the outlets should be at least moderately profitable.

Reinforcing my argument that it is realistic to expect banks to implement all or many elements of this general approach, a small number of deposit institutions have already begun to do so. The pioneer in this regard is Union Bank of California (UBC). In 1993, UBC, a bank that currently has about $40 billion in assets, created "Cash & Save" outlets to offer check-cashing services and banking services in the same location.[8] Since that time, the structure and operations of these outlets have changed, and they will likely continue to change as UBC refines its initiative. As of early 2003, UBC had thirteen Cash & Save outlets, mostly located in Los Angeles and San Diego.

In addition to providing traditional consumer banking services, the Cash & Save outlets provide the full range of commercial check-cashing outlet services. They cash government checks and paychecks for nondepositors. The check-cashing fee is 1.5 percent of the face value of paychecks and 1.0 percent for government benefit checks. The outlets sell money orders (with stamped envelopes), originate domestic and international wire transfers of funds, handle the payment of utility bills, sell prepaid phone cards, provide fax and photocopying services, and in some locations sell bus tokens and passes.

Through its Cash & Save outlets, UBC offers ETAs; low-cost, low-minimum-balance checking accounts; and low-cost, low-minimum-balance savings accounts. The Cash & Save outlets also offer two plans to help check-cashing customers build savings. The first is the "Nest Egg" savings account. One can open this account with as little as a $10 deposit, but the account holder must also commit to depositing at least $25 per month for one year. The account does not include access to an ATM card, and it is not intended as a transaction account. Anyone can open this account, even people with a history of writing bad checks or with severely impaired credit records. Account holders pay no fees for the account, and they receive a passbook interest rate on their savings. They cannot withdraw funds from the account until the end of the year, but the bank, at its discretion, does allow some emergency withdrawals. An account holder can close the account at any time. The second savings-building account is the "Combo" account. This is the Nest Egg account combined with the bank's Money Order Plan. To open a Combo account, one must deposit at least $10 in a Nest Egg account and commit to depositing at least $25 per month into the account for one year. As a Combo account holder, one pays a 1.0 percent check-cashing fee and receives six free money orders each month.

The other approach that banks have taken to combine check-cashing and consumer banking services is to partner with existing check-cashing operations. This approach has much lower start-up and learning costs for the banks, but also limits the range of banking services that can be delivered through CCOs. In early 2000, UBC entered into a joint venture with Nix Check Cashing, a firm with numerous CCOs in Southern California. In this initiative, UBC placed ATM machines, capable of taking deposits as well as dispensing cash, inside thirty of Nix's CCOs. It also placed telephones with direct connections to a UBC representative in the CCOs. Using the telephone connection and assistance from a CCO teller, a customer can open a UBC deposit account or complete a loan application. In New York in early 2001, a small credit union, Bethex Federal Credit Union, which serves a predominantly low-income population, formed a partnership with a commercial check-cashing firm, RiteCheck Check Cashing. With its 11 CCO outlets, RiteCheck refers to Bethex its customers who might wish to open a deposit account or to take out a small loan. RiteCheck will cash the paychecks of Bethex members for a fee that is somewhat lower than its normal fee. Bethex, in turn, pays RiteCheck a small transaction fee so its members can, without charge, deposit checks at a RiteCheck outlet or obtain cash from their Bethex accounts (Stegman and Lobenhofer, 2001). Effectively, the RiteCheck outlets function as limited service branches for the credit union. Another New York credit union, Actors Federal Credit Union, has recently initiated a similar partnership with a second check-cashing firm, Manhattan Money Branch. In addition, Bethex, RiteCheck, and others have been working to implement a system that would enable any check-casher that participates in a three-state, regional ATM-type network, known as Paynet, to provide basic payment services to the members of participating credit unions.

CONCLUSION

This chapter proposes a strategy for bringing the unbanked into the banking system. I fully acknowledge that even if this strategy were widely implemented, it would not reach all of the unbanked. Nor would it succeed in helping all those it does reach to build savings, improve credit histories, or lower the cost of their financial services. Nevertheless, with over 10 million unbanked households in the United States, even a modest rate of success could mean significant improvements in the quality of life for hundreds of thousands of lower-income families.

NOTES

1. Throughout this chapter, I use the term "bank" in its generic sense, meaning that it includes commercial banks, saving banks, savings and loans, and credit unions.

2. In the survey, respondents were allowed to give more than one reason.

3. As indicated in the report by the Board of Governors of the Federal Reserve System (2000), in 1999, all banks imposed fees for writing a check with insufficient funds to cover it. In that year, the average fee was $17.71. As banks generally also charge a fee to businesses that deposit such checks (the average fee in 1999 was $6.28), merchants will commonly impose a charge (usually $10 to $15) on customers who write checks that bounce.

4. As indicated in table 8.4, among unbanked lower-income households, only 14 percent carry a major credit card. Among lower-income households with deposit accounts, 59 percent do. Data from the *Survey of Consumer Finances* are similar (as cited in Hogarth and O'Donnell, 1999).

5. Banks entering the check-cashing business should employ the standard software and operating procedures marketed to check-cashing outlets. These have been carefully refined over many years to speed check-cashing and related transactions, while minimizing fraud and the risk of cashing checks that bounce. Using standard software and operating procedures, most check-cashing transactions take less than one minute. CCOs that employ these procedures and that cash mainly payroll checks and government checks report that losses from cashing "bad" checks amount to well under 0.25 percent of the face value of the checks they cash.

6. Stegman (1999) provides an excellent discussion of the economics and politics behind the development of ETAs and a more detailed description of their features.

7. The largest publicly traded check-cashing firm is ACE Cash Express, Inc. Its 2002 SEC 10-K filing indicates that a mature store's annual revenues from check-cashing fees total about $130,000. Its revenues from bill payments, money transfers, and money order sales total about $30,000. ACE's typical fee for cashing a check is 2.2 percent of the face value of the check.

8. I thank Yolanda Scott Brown of Union Bank of California for the description of the operations of the Cash & Save outlets.

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