WORKING PAPERS
RESEARCH DEPARTMENT

WORKING PAPER NO. 02-4
CHECK-CASHING OUTLETS IN A CHANGING FINANCIAL SYSTEM

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February 2002

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I. Introduction

Commercial check-cashing outlets provide payment services to millions of low- and moderate-income households. But this industry is in flux, and many check-cashing outlets, which I call "CCOs" for short, may not survive another decade, at least in their traditional form.

This paper discusses changes in the financial sector that threaten traditional CCOs. To provide some background for this topic, the first few sections of the paper explain the services provided by traditional CCOs, review data on the socioeconomic characteristics of check-cashing customers, and discuss why people choose to cash their paychecks or government transfer checks at CCOs. The paper then discusses four developments that may radically alter the check-cashing industry over the coming decade: the growing use of electronic payments, the development of automated check-cashing machines, the rise of payday lending, and the development of bank/CCO hybrids. These hybrids offer fee-based check-cashing services along with consumer banking services. In the concluding section of the paper, I speculate about how the check-cashing industry might evolve in response to these four developments.

II. What do check-cashing outlets do?

Check-cashing outlets cash checks for a fee. The owners of the outlets set their own policies concerning the type of checks that they are willing to cash and, outside of a few states that set binding fee ceilings, the fees that they charge. CCOs face the risk that the checks that they cash may be returned unpaid by the banks on which they are drawn. This can happen because the entity that issued the check does not have the funds to honor it, the check has been produced fraudulently, or because the person cashing the check is not the correct payee. Because of such risks, many CCOs cash only paychecks issued by local or national employers and checks issued by government agencies. Most CCOs charge a check-cashing fee that is a percentage of the face value of the check. Outside of a small number of states that have more restrictive fee ceilings, it is common for CCOs to charge between one-and-a-half and three-and-a-half percent of the face value of the check for cashing payroll or government checks.[1] If a CCO cashes personal checks, it often charges higher rates.[2]

In addition to cashing checks, CCOs commonly sell a variety of related payment services and convenience items. At almost all CCOs, for example, customers can pay utility bills, wire money, purchase money orders, make photocopies, and purchase pre-paid telephone calling cards.

Over the past decade, numerous CCOs in many states have begun to offer "pay-day loans," a form of consumer credit, in addition to their traditional payment services.[3] In a traditional payday loan, also known as a "payday advance" or "deferred deposit," a customer writes a personal check made out to the lender. The lender agrees to hold the check for the specified period of time, usually until the customer's next payday or for up to about two weeks, before depositing it. In exchange, the payday lender advances a cash payment to the customer that is somewhat less than the amount of the check. The difference, which is the "finance charge," determines the interest rate on the loan. In the states where payday lending thrives, lenders typically charge $15 to $25 for each $100 that they advance. That is, in a typical transaction, a borrower might write a check for $235 and receive a $200 loan. Most lenders limit their loans to under $500.

Over the past two decades CCOs have grown rapidly**.** In 1986 there were probably about 2,200 (Caskey, 1994). Yellow page listings from 2000 indicate that there are now about 10,000 CCOs (American Business Information, 2001). Because check-cashing outlets whose primary business is cashing checks rely on a high volume of small-value business, the vast majority of such CCOs is located in urban areas with populations of 100,000 or more. CCOs that are part of other businesses, such as a CCO located in a grocery store or one that derives significant income from payday lending, are found in small urban areas as well as large cities.

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[1] In approximately thirty states, there are no legal limits on the fees that CCOs can charge. Connecticut, Illinois, New Jersey, and New York are the most populous states that have low legal fee ceilings.

[2] ACE Cash Express is a publicly held firm that operates about 1,000 CCOs located in 15 states. Data in the firm's 2001 10-K filing with the S.E.C. indicate that the average face value of a check cashed by the firm in the fiscal year ending June 30, 2001 was $358. The firm's average fee for cashing a check was $8.38, or 2.3% of the average face value. ACE, like many other check-cashing firms, has well-developed software and procedures to reduce the chances that it will not be able to collect on the checks that it cashes. ACE, for example, cashes almost exclusively payroll and government checks; it cashes very few personal checks. In fiscal year 2001, 0.59 percent of the face value of the checks cashed by ACE were returned without payment. ACE, however, managed to collect 67 percent of the value of these returned checks, writing off the other 33 percent. The net write-offs were 0.2 percent of the face value of the checks cashed by ACE, or about 8.4 percent of its check-cashing revenue.

[3] As I discuss in more detail below, some CCOs offer payday loans in states where usury laws would not permit such loans by serving as "agents" for out-of-state banks that technically make the loans. For a detailed discussion of payday lending, see Caskey (2001) and Fox and Mierzwinski (2001).

III. Who uses CCOs for check-cashing?

There are unfortunately no fully satisfactory national surveys of who uses check-cashing outlets for cashing paychecks or other checks. Nevertheless, a fairly consistent characterization emerges from a diverse set of sources. [4]

In 1998, the Office of the Comptroller of the Currency (OCC), the agency that oversees national banks, conducted a high quality survey of the use of financial services by residents in low- and moderate-income census tracts in New York City and Los Angeles. The survey sampled 2,006 adults asking, among other things, numerous questions about how they receive and make payments. The survey was conducted by telephone and in face-to-face interviews. The interviews were conducted in English or Spanish depending on the respondent's choice. Because of careful design and persistent efforts, the OCC obtained a remarkable 70 percent response rate. Moreover, the OCC supplies a set of weights to convert the sample responses into responses representative of the 2.6 million adults living in the low- and moderate-income census tracts of the two cities.[5] For my purposes, the one drawback to the survey is that it focused on only the residents of two large cities who may not be representative of CCO customers elsewhere. Both of these cities, for example, have much larger Hispanic and immigrant populations than is typical of American cities. New York has a markedly lower percentage of homeowners than other American cities. Nevertheless, the results are quite interesting.

Table 1 provides an overview of the ways in which people in the survey receive their incomes and where people cash checks. The table presents the data for all of the individuals in the survey as well as for two subgroups: those with deposit accounts and those who do not have deposit accounts of any type. For shorthand, these two subgroups are labeled "banked" and "unbanked" individuals.[6] As shown in the table, about half of the adults in the survey population receives most of their income in the form of checks. Among those who sometimes cash checks, 39 percent report that they usually do so at a check-cashing outlet. Not surprisingly, among people who do not have deposit accounts, a significantly higher percentage usually cash their checks at CCOs than among people who have deposit accounts. Almost 80 percent of individuals with bank accounts usually cash their checks at banks.

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[4] The check-cashers' national trade association (FISCA, 2000) recently commissioned a survey of the customers of CCOs. For our purposes, the main problem with the design of the survey is that it surveyed a random selection of customers entering the CCOs. Some of these customers likely cashed checks but others may have entered to purchase money orders, transit tickets, prepaid phone cards, or to obtain payday loans. Thus the results are unlikely to be representative of the subset of customers who cash checks at CCOs.

[5] Table 1A in the appendix provides an overview of the socioeconomic characteristics of the adults in the survey population.

[6] Unless specifically indicated otherwise, throughout the paper I use the work "bank" to mean a depository institution of any type.

Table 1
Forms of Income and Locations for Cashing Checks among Residents of Lower-Income Census Tracts in New York City and Los Angeles
(Percentages may not sum to 100 due to rounding, nonresponses, or other factors)

	Percentage among the survey population	**Percentage among banked individuals**	**Percentage among unbanked individuals**
Way in which most income was received			
Direct deposit	23.8	37.7	0.0
Check	49.4	48.7	50.5
Cash	10.9	6.2	18.8
Electronic transfer to nonblank	6.4	0.4	16.6
None of these ways or no income	8.6	5.9	13.1
Total number surveyed	**2,006**	**1,369**	**637**
Most common location for cashing checks (among those who cash checks)			
Bank	53.1	79.1	21.2
Workplace	2.0	1.9	2.1
Check cashing outlet	39.3	15.6	68.4
Friend or family	0.8	0.0	1.9
Supermarket	3.3	1.8	5.1
Total number surveyed	**832**	**513**	**319**

Source: Author's estimates using data from OCC

A recent survey of households in metropolitan Chicago found broadly similar levels of use of CCOs in that region as the OCC found in New York and Los Angeles (Rhine et al, 2001). But, since CCOs are more prevalent in large urban areas, especially in dense urban areas, these percentages should not be taken as indicative of those in smaller urban areas or in rural areas. In 1996**,** for example, I commissioned a telephone survey of 900 households earning $25,000 or less living in Oklahoma City, Atlanta, and in small urban areas in Pennsylvania. [7] In the survey, 83 percent of the households reported that they usually cash their checks at banks, 8 percent reported usually using grocery stores, and only 5 percent said that they usually used commercial check-cashing outlets (Caskey, 1997). Among the 199 households without bank accounts, 49 percent said that they usually cashed checks at banks, 23 percent usually used grocery stores, and 17 percent usually used CCOs. Such surveys may understate, however, the role of check-cashing outlets outside of the largest urban areas. In many communities, especially where CCOs are not abundant, grocery stores have a separate counter offering fee-based payment services almost identical to those of CCOs. In my survey, for example, although only 17 percent of households without deposit accounts reported usually using CCOs for check cashing, 41 percent reported that they usually pay a fee to cash their checks. This strongly suggests that many people cashing their checks at grocery stores pay a fee to do so.

[7] The small urban areas are Allentown, Bethlehem, Harrisburg, Lancaster, and Reading.

In late 2000 and early 2001, Michael Stegman and Robert Faris (2001a) commissioned a telephone survey of 1,501 households earning $30,000 or less living in urban and rural areas of North Carolina. As shown in Table 2, they found fewer than 1 percent of lower-income households cashing checks at CCOs but 12.5 percent cashing checks at grocery stores. In North Carolina, grocery stores that cash checks for a fee must hold a state check-cashing license. Of the approximately 1,000 licensed check-cashing locations in the state in late 2000, over 600 were held by grocery stores. In October of 2001, I made a small number of telephone calls to grocery stores with check-cashing licenses in the state. Every store that I called charged fees for check cashing and some required a minimum amount of purchase at the store. This reinforces the notion that in many communities there may often be little practical difference between using a grocery store for check cashing and using a dedicated CCO.

Table 2
Most Common Location for Cashing Checks among Lower-Income Households in North Carolina
(Asked of those who sometimes cash a check)

	Percentage among all Households	Percentage of Banked Households	Percentage of Unbanked Households
Bank	79.4	91.6	56.6
Grocery store	12.5	6.6	23.5
Workplace	4.1	1.6	9.0
Check-cashing outlet	0.7	0.2	1.4
Other	3.3	0.0	9.5

Source: Stegman and Faris (2001a)

Drawing on the OCC data from New York City and Los Angeles, Table 3 provides a range of socioeconomic characteristics for the people who usually cash their checks at CCOs. It contrasts these with the socioeconomic characteristics of individuals who usually cash their checks at banks or who receive most of their income by direct deposit to their bank. As shown in the table, people who usually cash checks at CCOs tend to be younger and less well educated than those who mainly use banks. They are also more likely to rent their homes and more likely to have low household incomes. They are less likely to be non-Latino white. Only about 22 percent of the regular users of CCOs have deposit accounts; about half of these have savings accounts but not checking accounts. Among regular CCO customers, 74 percent report that they do not have any financial savings while, among those mainly using banks to cash checks or receive direct deposits, 24 percent report that they do not have any financial savings.

Table 3
Characteristics of CCO Customers in New York City and Los Angeles

(Percentages may not sum to 100 due to rounding or omitted category "other")

	Percentage among those mainly cashing checks at CCOs	Percentage among those mainly cashing checks at banks or receiving direct deposit
Age		
18 to 29 years old	37.3%	26.2%
30 to 64 years old	46.6%	64.8%
65 or older	10.7%	6.9%
Percentage male	50.9%	50.3%
Highest completed level of education		
Less than high school degree	46.9%	25.4%
High school degree or equivalent	38.8%	34.7%
More than high school	14.2%	39.9%
Household composition		
No children in household	40.7%	46.7%
One or two children	42.6%	40.5%
Three or more children	16.6%	12.8%
One or more other adults in household	81.6%	79.5%
Housing status		
Rent home	89.4%	62.2%
Own home	8.1%	33.2%
Employment status & nonlabor income		
Working full or part-time	57.1%	73.9%
Not working	40.6%	18.5%
Social security, veteran, or pension benefits	9.6%	11.2%
Welfare, SSI, or food stamps	29.4%	5.4%
Household income in 1997		
$15,000 or below	41.9%	7.9%
$15,001 to $30,000	32.3%	28.6%
$30,001 to $45,000	14.3%	32.7%
More than $45,000	11.5%	30.8%
Self-reported race & ethnicity		
White non-Latino	1.8%	14.4%
Black non-Latino	39.7%	38.4%
Latino	55.0%	44.0%
Banking status		
Some type of deposit account	21.8%	87.3%
No deposit account	78.2%	12.7%
Saving account only	13.7%	13.1%
No financial savings, including pension accounts	74.2%	24.0%

Source: Author's estimates using data from OCC

Another relevant survey is the telephone survey of 900 lower-income households living in Oklahoma City, Atlanta, and smaller cities in Pennsylvania that I commissioned in 1996. Because telephone surveys do not reach a representative sample of households, much less lower-income households, and because the survey covered only specific geographic regions, the results are not necessarily representative of check-cashing customers generally. Nevertheless, it is interesting that the results from this survey broadly agree with those of the OCC's survey. As shown in Table 4, among households who reported cashing checks at a CCO ten or more times in the previous year, 37 percent had a deposit account. Among households who cashed checks but never used a CCO to do so, 85 percent had deposit accounts of some type. The CCO users also tend to be younger, less well educated, have lower household incomes, and are more likely to be African-American than are those cashing checks who never used a CCO.

One potential problem with the OCC survey and my own 1996 survey is that they largely exclude middle- and high-income households. This is not likely, however, to distort the general profile of CCO customers. Both surveys find that check-cashing customers tend to be lower-income. In addition, both find that they tend to be "unbanked," meaning that they do not have deposit accounts of any type. As shown in Table 2A in the appendix, which is based on data from the 1998 Survey of Consumer Finances, while 38.1 percent of all households with annual incomes under $10,000 do not have deposit accounts, only 0.7 percent of those with incomes over $50,000 are without deposit accounts.

These descriptive statistics characterizing CCO customers broadly agree with how large check-cashing firms characterize their own customers. ACE Cash Express (2001, p. 4), a publicly-held firm with about 1,000 CCOs, stated in its 2001 10-K filing:

> …the Company's core customer group is composed primarily of individuals whose average age is 29 and who rent their house or apartment and hold a wide variety of jobs in the service sector or are clerical workers, craftsmen, and laborers. These customers tend to change jobs and residences more often than average, have annual family incomes of approximately $30,000, often pay their bills with money orders…

Similarly, Dollar Financial (2001, p. 8), a check-cashing firm with publicly-held debt, reported in its 2001 10-K filing:

> Based on a 2001 customer survey conducted in several of the Company's markets and the Company's operating experience, the Company believes that its core check cashing customer group is comprised of individuals between the ages of 18 and 44. The majority of these individuals rent their homes, are employed, and have annual household incomes between $10,000 and $35,000 with a median income of $22,500.

Table 4
Characteristics of CCO Customers in Oklahoma City, Atlanta, and Smaller Urban Areas in Pennsylvania

	Percentage among those cashing checks at CCOs 10 or more times	Percentage among households cashing checks, but never at a CCO
Age		
18-24	15.8	4.8
25-34	31.6	23.0
35-49	29.8	31.9
50-59	17.5	38.0
60 or older	5.3	2.2
Highest education level		
No high school degree	17.2	11.4
High school or GED	43.1	38.5
Vocational/technical school	10.3	11.3
Some college	15.5	17.9
Two-year college degree	5.2	8.2
Four-year college degree or more	8.6	12.6
Household income		
Less than 5,000	10.7	7.5
$5,000 to 9,999	17.9	10.6
$10,000 to 14,999	28.6	18.1
$15,000 to 19,999	19.6	19.8
$20,000 to 24,999	23.2	37.8
Over $25,000	0.0	6.3
Self-reported race & ethnicity		
White nonhispanic	32.1	65.2
Black nonhispanic	55.4	26.2
Hispanic	7.1	3.1
Other	5.4	5.4
No type of deposit account	63.2	15.1
No financial savings, excluding pensions and bank account	89.5	76.4
Total number responding to question	57	691

Source: Caskey (1997)

IV. Why do people cash checks at CCOs?

There are no satisfactory formal surveys asking people why they go to a CCO to cash their checks rather than a bank, but available information points to a common-sense explanation. In the case of people without bank accounts, many urban banks refuse to cash checks for non-depositors unless the check is drawn on the bank to which it is presented. In addition, banks commonly charge $1 to $3 for money orders; CCOs usually charge $1 or less.[8] Unlike CCOs, banks do not sell stamped envelopes in which to mail the money orders and they do not serve as payment agents for utility companies. That is, individuals without bank accounts who go to CCOs to cash their paychecks can conveniently address all of their payment needs at the CCOs. They cannot do so at most banks.

The natural follow-up question is: Why don't people have bank accounts? Several household surveys have addressed this issue. The details differ across the surveys, but there is a broad consensus in their findings. The most common reasons that people give for not having a deposit account include: they do not need an account, generally because they have almost no month-to-month savings; deposit account fees are too high; or banks require too much money to open or maintain an account.[9]

In the North Carolina survey by Stegman and Faris, for example, they asked households without accounts to give the major reason that they do not have an account. They then coded the responses into one of seven categories. As shown in Table 5, almost 49 percent of the respondents cited bank fees or minimum balance requirements and 32 percent said that they did not need a bank account, presumably because they have no savings at the end of a pay period.

[8] Stegman and Faris (2001) found that 61 percent of the lower-income families they surveyed bought a money order in the previous year. Among those buying money orders, the mean number purchased in a year was 46. In Caskey's 1996 survey, 69 percent of unbanked households reported that they purchased 11 or more money orders over the previous year (Caskey, 1997). Data from the OCC survey indicates that 81 percent of unbanked individuals reported purchasing 12 or more money orders over the previous year, 37 percent reported purchasing 24 or more. A survey of check-cashing outlets in four cities conducted for the U.S. Treasury Department by Dove Consulting in early 2000 found that a typical CCO sold over 1,000 money orders a month (Dove Consulting, 2000). The average fee for purchasing a money order at a CCO in the four cities varied between $0.40 and $0.80. Unfortunately, I am not aware of any surveys of money order fees at banks, but my own recent survey of ten banks in the Philadelphia metropolitan area found them charging $2 to $5 per money order.

[9] Concerns about bank fees and minimum balance requirements are closely related to people's financial savings. Many banks do not impose significant fees on checking accounts when depositors are always able to maintain a balance of about $500 or more or on savings accounts when depositors are always able to maintain a balance of about $200 or more (Board of Governors, 2000).

Table 5
Main Reason Given by Unbanked NC Households for their Banking Status

Reason	Percentage of Respondents
Too expensive (fees or minimum balance requirements)	48.5
Don't need an account	32.0
Not allowed to have an account	5.7
Not enough security or privacy	4.7
Unfriendly atmosphere or language barriers	4.7
Difficult or inefficient to use	4.2
Bad location or hours	0.3

Source: Stegman and Faris (2001a)

In my 1996 survey of 900 lower-income households, I also asked households without deposit accounts, why they do not have an account. I provided respondents with a list of possible reasons from which they could select one or more. They could also provide a reason that was not on the list. As shown in Table 6, 53 percent of the respondents cited "don't need account because we have no savings" as a reason, making this the most frequent reason cited; another 45 percent cited bank fees or minimum balance requirements.

Table 6
Reasons Given in Caskey Survey for
Why Households Do Not Have Deposit Accounts

Reason/reasons given for why households do not Have deposit accounts	Percentage Giving this Reason
Don't need account because I have no savings	53.3
Bank account fees are too high or banks require to much money to open or maintain an account	45.2
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 or location	8.5

Source: Caskey (1997a)

As shown in two tables above, other reasons that people give to explain why they do not have a deposit account include concerns about privacy, a lack of comfort interacting with banks, language barriers, a perception that banks are unfriendly, and banks not letting them open accounts.[10] People who banks do not permit to open accounts likely have histories of writing bad checks or have severely impaired credit records. People who say that they do not open an account out of a desire for privacy may have a number of concerns, including:

- fear that a creditor might seize the savings of a delinquent debtor;
- fear that a former spouse might seize the savings of an individual behind on his child-support payments;
- fear that welfare eligibility would be threatened by a substantial account balance or by a history of deposits from under-the-table earnings;
- a desire to hide earnings from the tax authorities; or
- fear that a bank might report suspected illegal immigrants to the Immigration and Naturalization Service or that the INS could use bank records to discover their presence.

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 apparent legitimate basis for the concerns (Caskey, 1997b). Interestingly, both of the surveys reviewed above find that among the least important reasons people give for being unbanked are the hours and locations of bank branches.

As noted earlier, about 20 percent of the people who regularly cash checks at CCOs do have deposit accounts. Why would they go to a CCO? There are two explanations. First, as indicated in the surveys, a significant share of these CCO customers has only savings accounts, not checking accounts. They may cash their checks at a CCO because, in addition to cashing the check, they need to purchase and mail money orders or wish to pay utility bills in person. CCOs are one-stop centers for such services; banks are not. Second, even someone with a checking account may want to cash a paycheck at a CCO if the balance in her account is not sufficient to cover the check. In this case, many banks would refuse to cash the check insisting, instead, that she deposit it and wait a few days for it to clear before gaining access to the cash. As ACE Cash Express (2001, p. 2), the largest operator of check-cashing stores, states in its 2001 10-K filing,

> …check-cashing store are willing to assume the risk that checks they cash will "bounce." For instance, it is not unusual for a bank to refuse to cash a check for a customer who does not maintain a deposit account with the bank and to require its depositors to maintain sufficient funds in an account to cover a check to be cashed or to wait several days for the check to clear. As a result, the Company believes that check-cashing stores provide and attractive alternative to customers without bank accounts or with relative small balances.

[10] These reasons are cited much less commonly in the Caskey survey than in the Stegman and Faris survey. One explanation may be that respondents in the Caskey survey were allowed to give more than one reason to explain their lack of a bank account while the Stegman and Faris survey asked them to name the most important reason.

V. Four Developments that Could Shape Check-Cashing's Future

Although check-cashing outlets have grown over the past decade, there are a number of new developments that might threaten or alter the pattern of future growth. This section discusses four such developments.

A. Gradual decline in the use of paper paychecks

The core business of check cashing outlets is cashing people's paychecks for a fee. One threat to the future of this business is the gradual decline in the use of checks for paying wages or for making government transfer payments. As shown in Table 7, although there is variation by demographic segments in the degree to which people use direct deposit, the percentage is growing across all categories.

Table 7
Percentage of Households Using Direct Deposit

	1995	**1998**
All households	46.8	60.5
By age of household head:		
Under 30 years old	31.1	45.2
30-60 years old	42.9	58.0
Over 60	63.2	74.8
By household income:		
Less than 50% median HH income	32.7	44.3
50-80% median HH income	43.1	58.8
80-120% median HH income	48.3	66.1
More than 120% median HH income	58.3	70.4
By education of household head:		
No college degree	40.4	54.4
College degree	61.0	72.6

Source: Mester (2001)

People without bank accounts cannot participate in traditional direct deposit programs but numerous firms have developed and are promoting "payroll cards" that enable all employees to receive electronic transfers of their wages.[11] There is much variation in the details of these cards but most have the following features. An employer gives its participating employees an ATM-type card. A participating bank creates "limited-access" deposit accounts for all workers receiving the card. The account has limited access because it can only receive electronic deposits of wages from the employer and allows the employee to access the funds in the account only by using the issued payroll card at an ATM machine or as a debit card at a merchant. In some cases, an account holder can also pre-authorize payments from the account for utility bills, mortgages, etc. In any case, the account cannot be overdrawn so it can be offered to people with severely impaired credit histories or who have a history of mismanaging a checking account. The fees that employees pay for using the payroll cards vary widely depending on the company that developed the card, the fees levied by the participating bank, and the willingness of an employer to shoulder some of the costs.

To date, there are no reliable reports on the success of such payroll cards but it is reasonable to believe that they might become popular. Employers may favor them because direct deposit is lower cost and usually involves fewer glitches than issuing paper checks. Many workers without bank accounts may resist the new cards for a variety of reasons, but an insistent employer may win the battle.

For several years, check-cashers have foreseen the growing use of electronic payment methods and have responded in two ways. Some have sought to replace the fee income from cashing checks with fee income from servicing electronic payments. Many CCOs, for example, became locations where people who have direct deposit can convert their account balances into cash and use their funds to buy money orders, pay utility bills, and make wire transfers. In addition, many check-cashers have formed partnerships with banks to offer direct deposit to their customers who desire this service or who feel pressured by employers or government agencies to enroll in direct deposit. There are variations in the details of the plans that the CCOs and banks offer, but the general outline is as follows. The customers go to a CCO to complete the paper work necessary to open an electronic-access-only deposit account at the participating bank, which might be located far away from the CCO. When customers received payments into their accounts, the check-casher will advance the cash value of the balance in the account less a fee, and debit the account electronically to cover the cost of the advanced funds and the fee. There are no data available indicating how many CCO customers are participating in these programs, but several check-cashers have told me that they are not popular. This is not surprising. For people receiving paper checks, the arrangement may appear confusing and the fees are often as high as simple check-cashing fees (Dove Consulting, 2000).

The second way that check-cashers have responded to the rise of electronic payments is to introduce new non-payments products that they hope can generate revenue to replace lost check-cashing fees. This is one reason that so many CCOs have begun to

[11] Jennifer Grier (2000) profiled the payroll card developed by Directo, Inc. Probably the largest player in this market is now Visa U.S.A. which, partnering with several large banks, launched its Visa Payroll Card in the summer of 2001.

offer payday loans. Similarly, many CCOs have increased the effort and storage space they devote to selling mobile phones, watches, or other such products.

B. Automated check-cashing machines

A second threat to traditional check-cashing outlets is the development and deployment of automated check-cashing machines. Several companies market these machines which look like traditional ATM machines. Customers insert their paychecks into the machines. The machine uses a personal identification number or some other method to identify the customer, it reads information from the check, and uses a software algorithm to determine whether or not it should cash the check. If the check is approved, the machine dispenses the cash for the check. If the check is not approved, the machine returns the check to the customer. Frequently, the machines are equipped with telephones linked to a processing center. A customer can use the telephone connection to obtain or provide information that the machine does not handle or for person-to-person guidance. In many cases, an individual at the processing center can override the check-cashing algorithm and instruct the machine to issue cash for a check that it initially rejected.

The motivation behind the development of such machines is obvious. As indicated by the SEC filings of ACE Cash Express and data from the Dove Consulting report, a typical CCO has annual operating costs of about \$100,000 to \$180,000. Payroll, rent, and utilities account for almost half of these costs. If a machine could replace the payroll and occupancy expenses while maintaining a CCO's check-cashing revenue, the owner of the machine could make very attractive returns.

The most prominent firm to undertake this strategy was Innoventry, a joint venture capitalized with hundreds of millions of dollars from Wells Fargo Bank, Capital One, Cash America and other investors. Innoventry began deploying check-cashing machines in the late 1990s and by early 2001 it had placed over 1,000 in department stores, supermarkets, and convenience stores in numerous states. By September of 2001, Innoventry ceased operating and began to liquidate its assets. The company provided no official explanation for its failure, but rumors indicate that some potential customers feared that the machine would "eat" their paycheck without returning cash. In addition, there are rumors that the machine had trouble reading and processing paychecks, which are non-standard in appearance, and required frequent human intervention. There are also rumors that the servicing costs on the machines were high.

Despite this experience, a small number of firms are continuing to develop and deploy automated check-cashing machines. Following Innoventry's failure, the major actor is 7-Eleven stores, which as of mid-2001 was piloting automated check-cashing machines in about 100 of its locations. If such machines prove to be cost effective and significant numbers of check-cashing customers begin to use them, this would obviously threaten the survival of traditional staffed check-cashing outlets. A less dramatic change would be for CCOs to deploy the machines in their lobbies to supplement traditional teller services. ACE Cash Express, for example, has placed automated check-cashing machines in many of its outlets. In the medium term, it hopes that the machines can reduce labor costs at the outlets and attract customers by shortening lines at the teller windows. In the long run, if the machines prove to be reliable and acceptable to customers, ACE could use the machines to replace some outlets.

C. The rise of payday lending

A decade ago, only a small percentage of check-cashing outlets made payday loans in any formal way. This is no longer true. Although there are no formal surveys, it is likely that over half the CCOs in the U.S. now consider payday lending to be a significant part of their business.[12] And the new revenue gained from payday lending undoubtedly explains much of the growth of check-cashing outlets over the past five years.

The majority of CCOs that offer payday loans are located in states where payday lending can be conducted profitably under state laws.[13] But increasing numbers of CCOs located in states with restrictive usury laws are making payday loans by serving as "agents" for banks located in states with more favorable usury laws. Under this arrangement, the banks technically book the loans. The lenders claim that the relevant usury statutes in such cases are those in which the banks are located.

There are at least five reasons why so many CCOs began to offer payday loans. Most importantly, it was widely reported that firms making payday loans were earning high rates of return. In addition, CCOs that cashed personal checks had already developed skills in assessing the risks associated with these checks. Third, some of the check-cashing clients of CCOs were people with bank accounts who could not afford to wait a few days for a paycheck to clear. They are natural potential customers for payday advance loans. Fourth, numerous CCO operators were looking for new sources of revenue to augment check-cashing fees or to replace them if the growth of electronic payments significantly reduced the number of clients receiving paychecks. Finally, in many ways the businesses are natural complements. Most CCOs are open long hours and their employees often spend time behind the counter with no customers to serve. They can use this time to telephone payday loan clients to remind them that their loans are maturing and to urge them to take measures to ensure that they do not default. In addition, the busiest time for CCOs is often tax season since many CCOs function as service centers for tax preparation and electronic filing and they cash tax-refund checks. Payday lenders, on the other hand, commonly report that loan volume is the lowest when clients receive tax refunds since many clients use this money to pay off their loans.

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[12] Robert Rochford (1999), Deputy General Counsel for the check-cashers trade association, Financial Service Centers of America (FiSCA), testified before a U.S. Senate Forum on payday lending, "At present over half of the check cashing locations in the United States are providing deferred deposit services and many other are interested in doing so. Next year, well over two-thirds of FiSCA's locations will be in the deferred deposit services business."

[13] Until recently, North Carolina was one such state. Its Office of the Commissioner of Banks reported that in 1999, there were 201 licensees with 1,017 offices. Of these, 59 licensees did check cashing but not payday lending, 87 did both, and 55 did payday loans only.

Although many firms provide both check-cashing and payday loan services, there are also “monoline” firms that provide one or the other service, but not both. CCOs that do not provide payday loans are often located in states where usury laws do make it profitable and where, out of concerns over possible legal or regulatory battles, the CCOs are reluctant to try to by-pass state laws by partnering with out-of-state banks. In the case of monoline payday lenders, many cite several advantages from staying out of the check-cashing business. For one, their stores have much lower cash needs, reducing their need for security. In addition, they think that some of their clients might be uncomfortable lining up with check-cashing customers, who tend to have lower incomes than do payday loan customers, and seeking a personal loan from someone standing behind bullet-proof glass. Dollar Financial (2001, p. 7), a company that operates CCOs that make payday loans and monoline payday loan stores, reports in its 2001 10-K filing that its monoline payday loan stores offer "…unsecured short-term loans in a friendly office-like environment. [This]… appeals to a broader market segment than that which currently utilizes the Company's check cashing stores."

D. Development of the bank/CCO hybrid

A fourth development that may affect check-cashers is the growth of bank/CCO hybrids.[14] A small number of banks and credit unions have begun to offer the full range of fee-based check-cashing services at selected branches or to offer banking services through particular CCOs. Union Bank of California is the pioneer in this field. Beginning in 1993, it opened check-cashing windows at some of its branches in lower-income areas. Subsequently, it opened new minibranches that have the appearance of check-cashing outlets but that offer both CCO services and consumer banking services. Both types of branches operate under the brand-name "Cash & Save" and are managed by a separate division of the bank. As of early 2001, Union Bank operated 12 Cash & Save branches in Southern California.

In 2000, Union Bank formed an alliance with an established check-cashing firm in California and purchased 40 percent of the firm's equity. Subsequently, the check-cashing firm, known as Nix Check Cashing, placed Union Bank ATMs in its lobbies. The ATMs can take deposits as well as dispense cash. In addition, the CCO’s clerks can use an internet connection to Union Bank to help people open bank accounts, apply for loans, and conduct other consumer banking transactions while standing in the CCO. A small credit union in New York City, Bethex Federal Credit Union, has also initiated a partnership with a local check-cashing firm, RiteCheck Cashing, that enables the firm's outlets to provide Bethex's members with a variety of services, including the ability to obtain cash from their accounts, make deposits, and cash checks (Stegman and Lobenhofer, 2001). Bethex pays the CCO a fee for handling these transactions on its behalf.

[14] As noted earlier, many CCOs have had partnerships with banks that enable CCO customers to receive payments electronically to a bank account and convert the payment into cash at the CCO. As described below, a true bank/CCO hybrid goes well beyond this.

The motivation for such arrangements is multifaceted. Banks might offer fee-based check-cashing services in some of their branches in order to gain additional sources of revenue. It is widely reported, for example, that due to pressures created by the Community Reinvestment Act, many banks operate branches in lower-income areas that do not meet their minimal profitability standards.[15] If banks could add check-cashing revenues to these branches, this could augment their profitability. In addition, a bank seeking to bring unbanked households into the banking system might offer check-cashing services as a way to build bridges to this community. Banks could also see benefits from paying fees to CCOs to induce them to provide services to the banks' customers. To the extent that the CCOs can function as low-cost replacements for bank branches, this could substantially cut banks' operating costs. Not only could the CCO handle many consumer banking transactions, but it may also be able to meet the payment needs of many of the bank's local business clients. CCOs, in turn, could obviously benefit from such arrangements, earning a new source of revenue from the transaction services they provide bank customers. Bank/CCO hybrids could also benefit bank and CCO customers. CCO customers would have convenient access to financial savings services and bank customers could gain additional locations in which to conduct their business.

Whether or not bank/CCO hybrids will threaten or benefit CCOs depends on the success of the pioneering models discussed above and on whether or not banks taking this approach decide to compete with exiting CCOs or form partnerships with them.

VI. Speculations on the Future of Commercial Check Cashing

On the whole, economists have an unenviable forecasting record and there is no reason to believe that I am likely to be the exception. Nevertheless, one cannot review the four developments discussed above without wondering how they are likely to change the check-cashing industry over the next decade.

In my view, it is likely that the growth of electronic payments will reduce slowly but noticeably the check-cashing revenues of CCOs over the next ten years. This will lead some CCOs to exit the business. The surviving outlets will be those with the best locations and CCOs that are able to replace declining check-cashing revenues with new sources of income.

Automated check-cashing machines will likely become much more common in the next few years. My guess is that most will be deployed in financial institutions, such as CCOs and banks, or in businesses that already provide CCO services, such as grocery stores. That is, the machines are likely to supplement traditional means of service rather

[15] *The New York Times* (Barnes, 2000) profiled one such bank. It should be noted, however that the major emphasis of the Community Reinvestment Act is on mortgage loans to lower-income households. There is very little public policy reward to banks that make special efforts to provide payment and entry-level savings services to lower-income households (Stegman and Faris, 2001b). If there were, this would provide an additional impetus to the development of bank/CCO hybrids.

then replace them. Such deployments would lower the cost of servicing the machines. More importantly, customers are more likely to use the machines if they know that some-one is immediately available to respond to any problems with the machine. Moreover, many customers will want to conduct a series of transactions, such as cashing a check, buying money orders, and paying utility bills. Although the machines can be designed to handle such a range of transactions, in these cases many customers will likely prefer to interact with a human teller rather than a machine. The teller may be less intimidating and more capable of handling unusual payment needs. In addition, the teller, who conducts numerous payment transactions every day, may remain much faster at them than a person who only goes to an automated check-cashing machine once every few weeks.

Whether or not increasing numbers of CCOs begin to make payday loans will largely depend upon the outcome of ongoing legal and regulatory battles. In states where payday lenders can charge about $15 or more for each $100 advance, payday lending can be profitable. Moreover, as discussed earlier, CCOs are well placed to compete in this market and have an incentive to develop such services to augment or replace declining check-cashing revenues. Currently about half of the states permit payday lenders to charge 15 percent or more for two-week loans (Fox and Mierzwinski, 2001). In addition, as noted earlier, in states where regulations do not permit payday lending, or the usury laws do enable it to be profitable, payday lenders often still operate by booking the loans at banks located in more permissive states.

Charging 15 percent for a two-week loan is inherently controversial. Opponents to payday lending argue that only desperate or ignorant people would use such high rate loans and that no lender should be allowed to take advantage of such individuals. Noting that many payday loan customers borrow numerous times in sequence over the course of a year, critics of payday lending also charge that these loans "entrap" the borrowers. Proponents argue that the product is costly to provide and meets the legitimate credit needs of some people who have no better alternatives. People on both sides of the issue are lobbying actively to change state laws in ways that favor their goals. In addition, opponents to payday lending have launched several legal challenges to arrangements whereby lenders book the loans with banks located in permissive states in order to avoid restrictive state usury laws. If the courts uphold these challenges this will restrict the growth of payday lending and force CCOs located in the restrictive states to look elsewhere for new sources of revenue.

Finally, I think that it is likely that bank/CCO hybrids will be successful and become more common over the coming decade. The driving factor will be the opportunity to augment the revenues of both businesses without increasing their expenses commensurately. My guess is that banks will generally prefer to develop such hybrids by forming partnerships with existing CCOs. Check-cashing outlets are probably better designed to offer banking services than are most bank branches to offer check-cashing services, so partnerships could save banks significant infrastructure costs. In addition, a CCO partner would provide a bank with immediate inside knowledge of the check-cashing business.

One can imagine, however, factors that could impede the development of bank/CCO hybrids. One impediment could be the controversy surrounding payday lending. Most banks may be reluctant to partner with CCOs that provide this service for fear that they too will be called "loansharks who entrap desperate borrowers." CCOs that offer payday loans, on the other hand, may be reluctant to drop the product in order to partner with a bank if payday lending is a highly profitable element of their business. If banks cannot partner with existing CCOs, they may be reluctant to open their own bank/CCO hybrids. To do so would mean learning a new business and incurring infrastructure costs that may not be recouped, especially if the "unbanked" migrate steadily to electronic forms of payment.

In summary, over the next decade many traditional CCOs may close as paychecks continue to decline relative to electronic payments. Automatic check-cashing machines are likely to replace some CCOs and, perhaps, many employees at surviving CCOs. If the opponents of payday lending are unable to change the laws and regulations that permit it to operate profitably, then many CCOs will likely evolve into small loan businesses, dropping check-cashing services or relegating them to a mere supporting role. Other CCOs will augment their revenue by become agents for banks, taking bank deposits, dispensing cash, assisting with loan applications, and meeting the payment needs of banks' local business clients.

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Table 1A
Socioeconomic Characteristics of the Survey Population in the OCC Survey
(Percentages may not sum to 100% due to rounding, nonresponses, or the omitted category "other")

Characteristics of the Survey Population	**Percentage among the survey population**
Age	
18 to 29 years old	29.8%
30 to 64 years old	59.3%
65 or older	8.0%
Male respondent	45.7%
Highest completed level of education	
Less than high school degree	37.8%
High school degree or equivalent	38.0%
More than high school	24.2%
Household composition	
No children in household	40.7%
Children in the household	59.1%
One or more other adults in household	81.6%
Housing status	
Rent home	75.3%
Own home	21.2%
Employment status & nonlabor income	
Working full or part-time	57.7%
Not working	35.7%
Social security, veteran, or pension benefits	8.9%
Welfare, SSI, or food stamps	15.9%
No personal income	8.6%
Household income in 1997	
$15,000 or below	24.2%
$15,001 to $30,000	32.5%
$30,001 to $45,000	24.6%
More than $45,000	18.6%
Self-reported race & ethnicity	
White non-Latino	7.9%
Black non-Latino	33.1%
Latino	53.4%
Banking and savings status	
Some type of deposit account	63.1%
No deposit account	36.9%
No financial savings, including pension accounts	47.9%

Table 2A

Percentage Families without Deposit Accounts
1998 Survey of Consumer Finances

Family characteristic	**Percentage without deposit account**
All families	9.5
Income (1998 dollars)	
Less than 10,000	38.1
10,000-24,999	13.5
25,000-49,999	4.2
50,000-99,999	0.7
100,000 and more	0.0
Age of head (years)	
Less than 35	15.4
35-44	9.5
45-54	6.5
55-64	6.1
65-74	5.9
75 or more	10.3
Race or ethnicity of respondent	
Nonwhite or Hispanic	24.2
White non-Hispanic	5.3
Current work status of head	
Working for someone else	7.3
Self-employed	4.6
Retired	12.8
Other, not working	30.9
Housing status	
Owner	3.8
Renter or other	20.8

Source: Kennickell et al