

THE ROLE OF BANKS AND NONBANKS IN SERVING LOW- AND MODERATE- INCOME COMMUNITIES

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Low-income Americans use a variety of financial services to meet such routine financial needs as receiving income, converting income checks to cash, paying bills, sending funds elsewhere, borrowing, and building savings. Many use services from the same banking institutions that most middle-income Americans use: banks, thrift institutions, and credit unions. However, many others operate outside the banking system. They obtain their financial services from nonbanking institutions, such as check-cashing outlets, post office branches, corner stores, or supermarkets. Still others manage to carry out their daily activities without obtaining financial services at all, and operate largely within a cash economy.

Many bankers, analysts, and policy makers speculate about why the “unbanked,” those who do not have a bank account, do not participate in the banking system.¹ To date, it has been difficult to provide definitive answers when so little is known about their financial needs, the financial institutions and services they use, or how well their needs are being met. As a result, a critical policy question — to what extent do the unbanked choose freely not to have a bank account, and to what extent do they face barriers to banking — remains largely unanswered.

To understand better the answers to these questions, the Office of the Comptroller of the Currency (OCC) sponsored a survey of individuals living in low- and moderate-income neighborhoods of two major urban areas: Los Angeles County and New York City. The 1998-99 *Survey of Financial Activities and Attitudes* collected detailed information on the financial activities and attitudes of over 2,000 randomly

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selected individuals. Through statistical inference, their answers represent the experience of 2.6 million individuals living in the low- and moderate-income neighborhoods of these two major urban areas.²

The major objectives of this survey, as well as a summary of the survey design, are introduced in the *Survey of Financial Activities and Attitudes* section of this paper. The next section, *The Survey Population* provides background information on the survey population.

Financial Services and Sources provides information on the financial activities carried out by the survey population, with particular attention to unbanked individuals. It provides information on the services and institutions they used to receive their income and convert it to cash, pay bills, and hold savings. The survey data show that check cashing and money order purchases were prominent financial activities of the unbanked, and that check cashing outlets were market leaders in providing these services in the areas surveyed. The survey data also show that relatively few of the unbanked in the survey population held any savings at all, and that even fewer added regularly to their savings.

Financial Costs Incurred by the Unbanked examines the financial costs of two key financial activities of the unbanked, check cashing and money order purchases. It shows that many unbanked individuals paid relatively little for these services. This information on the financial activities of the unbanked and the financial costs they incurred supports two important conclusions:

- On the issue of equity, the low financial costs incurred by most unbanked individuals indicates that many may operate outside the banking system in order to economize, and not necessarily because they face barriers to having a bank account. However, a more definitive answer will require also examining the survey data on nonfinancial costs and the attitudes of the unbanked toward bank and nonbank services.
- The low financial costs incurred by most unbanked individuals also implies that banks may find it difficult to compete with nonbanks in this market. A more definitive answer will require examination of the survey data on the attitudes of the unbanked toward bank and nonbank services, as well as information (which cannot be answered by survey data) on the extent to which having a bank account helps the currently-unbanked to save.

Survey of Financial Activities and Attitudes

Purposes of the Survey

Early in the development of the survey, the OCC convened a forum of experts who discussed innovative ways of providing financial services to unbanked individuals.³ Forum participants included representatives of banks, technology providers, check-cashing outlets, bill-payment firms, and consumer organizations, as well as financial sector consultants, academic experts, and policy makers. Among other things, the discussions revealed that survey information on the unbanked would be useful to many, that surprisingly few surveys on this population had been conducted, and that few of those studies were publicly available.

Accordingly, the OCC sought to supplement the sparse information then available on the unbanked population with a survey that was intended to provide several public benefits. The *Survey of Financial Activities and Attitudes* has generated new data on the financial activities of unbanked individuals living in low- and moderate-income communities of two urban areas, the costs they incurred, and their attitudes toward bank and nonbank providers of financial services. The survey also obtained similar information for individuals who lived in the same communities, but who were “banked.” Knowing more about the characteristics of unbanked individuals and the differences between them and their banked neighbors should contribute to a better understanding of why so many Americans are unbanked.

The OCC hopes that the information generated by the survey will reduce the uncertainty that banks face in considering how to serve this potential market. The information may help inform bank efforts to design more appropriate products and more effective outreach methods, in order to increase financial access in low- and moderate-income communities. Public availability of the survey questionnaire and survey methodology may also reduce costs of market research by the private sector, which could further contribute to product development and outreach efforts.

Survey Implementation

Interviews for the survey began in September 1998 and ended in March 1999. Respondents in New York City and Los Angeles County were adults (18 years and older) selected through a multistage stratified random sample design. About half of the 2,006 interviews were conducted by telephone and half in person. Interviewers conducted approxi-

mately three-fourths of the interviews in English and about one-fourth in Spanish. Of all eligible respondents, 73 percent completed the interview, a response rate that strengthens the credibility of the survey results.

Several factors posed challenges to the development of a survey design that would achieve both good coverage and a high response rate.⁴ These included characteristics of the survey's target population, the sensitive topic addressed by the survey (*i.e.*, personal financial matters), and the paucity of prior research on the topic. Characteristics of the target population that were considered in developing the survey design include relatively high rates of a primary language other than English, relatively low rates of telephone service, and varying levels of literacy.

The Survey Population

The survey was conducted in census tracts with median household incomes less than 80 percent of the median household income of the metropolitan area. (In 1997, the median household income was approximately \$33,000 in New York City and \$35,000 in Los Angeles.) Sixty-five percent of the survey population in New York City had household incomes under \$30,000, compared with 48 percent of the survey population in Los Angeles County.

The sample of 2,006 randomly-chosen adults represents a survey population of 2.6 million individuals, of which 985,000 (37 percent) were unbanked. In addition to the unbanked, tens of thousands of individuals were "banked," but nevertheless routinely obtained financial services from nonbanks. They, too, represent a potential demand for additional services, and another opportunity for banks seeking to meet local financial needs.

Figure 1 shows that individuals with lower household incomes were more likely to be unbanked. Only 12 percent of high-income individuals (those with household incomes exceeding \$45,000) were unbanked. In contrast, 68 percent of low-income individuals (those with household incomes of \$15,000 or less) were unbanked. For them, being unbanked was typical rather than the exception.⁵

Figure 2 compares the survey population and the U.S. adult population. It shows that the survey population was younger than the U.S. population, had less education, and contained higher percentages of both minorities and immigrants. The survey population and the U.S. population were similar in the portion not working and in the ratio of females to males.

Characteristics of the Banked and Unbanked

Figure 3 compares the banked and the unbanked portions of the survey population. It shows that compared to the banked, a much higher percentage of unbanked do not work. On average, the unbanked are much less educated, with fewer than half holding a high school diploma, and are younger than the banked. The unbanked in the two urban areas surveyed are more likely than the banked to be foreign born and more likely to be Hispanic (but less likely to be non-Hispanic Blacks or Whites). On average, the unbanked have lower household incomes than the banked, and are more likely to receive government means-tested benefits such as welfare, Supplemental Security Income (SSI), Women, Infants, and Children (WIC) nutrition program payments, and Food Stamps.

Financial Services and Sources

Bank accounts provide three key functions: a way for people to receive their income and convert it to cash, a way to make payments, and a way to store savings. This section describes how people in low-income communities, both banked and unbanked, carried out these three functions.

Receiving Income and Converting It to Cash

Figure 4 shows that the great majority of the banked who received income (93 percent) did so either by check or by direct deposit (where their payment was deposited electronically and automatically to a bank account). Most banked individuals in the survey population used their bank account to receive income, either through direct deposit or by depositing their check.

For the unbanked, the most common way of receiving income was by check (Figure 4). None of the unbanked received income through direct deposit, but 19 percent received income by electronic benefits transfer, where their payment was sent electronically and automatically to a check cashing outlet or other nonbank. Income recipients then travelled to the nonbank, where they were presented with a paper check, which they could cash there or elsewhere.⁶ Thus, 78 percent of the unbanked with income payments — both those who were sent a check (59 percent) and those who claimed their check at a nonbank (19 percent) — then had to convert their income checks to cash, usually for a fee.

Among the unbanked, a surprisingly large 19 percent received primarily cash income. They, plus the 14 percent of the unbanked who received no income and the 8 percent who signed their checks over to other individuals, meant that fully 41 percent of the unbanked in the survey population did not obtain financial services from an institution for receiving or converting income (Figure 6). This substantial portion of the unbanked also incurred no financial costs from check cashing or other services for the receipt and conversion of income.

Income Conversion Services

As noted earlier, about half of the banked who received income payments received them primarily by check. Of these, 82 percent typically deposited their checks to their bank account (either all or in part), and 15 percent primarily cashed their checks. Most of the banked used their bank accounts to convert their income to cash or other negotiable media, either through cash withdrawals, automated payments, or by writing personal checks. Only a small portion of the banked (7.5 percent) used check cashing services to convert their income payments to cash.

In contrast, among the unbanked who received income, the great majority (78 percent) received income checks (either provided directly to them or sent electronically to a nonbank). The great majority of them (88 percent) then cashed their checks. As Figure 6 shows, check cashing services were used by 59 percent of the entire unbanked survey population. Unlike the banked, check cashing services figured prominently among the financial activities of unbanked individuals. Where did they obtain check-cashing services?

Sources of Check-Cashing Services

Most of the unbanked who cashed their checks primarily used the services of check-cashing outlets (71 percent), as shown in Figure 5. Despite the check cashing signs seen in stores throughout low-income communities, only five percent of the unbanked primarily cashed their checks at supermarkets or other stores.

Instead, banks were the second most important source of check-cashing services for the unbanked. Among the unbanked who primarily cashed checks, 23 percent did so at a bank. One clue as to why so many unbanked individuals cashed their checks at a bank is provided in the section that follows, *Financial Costs Incurred by the Unbanked*,

which shows that most who cashed their checks at banks did so at little or no cost. Most likely, the unbanked presented their checks at the bank of issue, which often cashed these checks at little or no cost to the check recipient.⁷ (Instead, the bank of issue is paid by the companies or government agencies that contract with them to issue the payroll or benefit checks.) The substantial numbers of unbanked individuals who cashed their checks at a bank exemplify the efforts that many of them made to economize on financial costs in conducting their routine financial activities.⁸

Continuum in Bank and Nonbank Services

Most of the unbanked cashed their checks at a nonbank. However, many others obtained check cashing services at a bank.

A substantial portion of the banked who cashed checks did so at a nonbank, especially at a check cashing outlet. Within this group, those who had only savings accounts were more likely to obtain services from a check cashing outlet (32 percent) than those with a checking account (21 percent). In contrast, checking account holders were more likely to cash checks at a bank (69 percent) than were those who had only a savings account (29 percent).

Thus, the survey data show no sharp dichotomy of the banked using only bank services and the unbanked using only nonbank services. Rather, they show more of a continuum in the use of bank and nonbank services. Those who had only savings accounts often occupied a middle ground, with many using both bank and nonbank services.

Overview: Income Receipt and Conversion Services

The percentages reported in the preceding figures were developed on the basis of various subgroups of the survey population, such as the percentage of those who received income or the percentage of those who cashed checks. Figure 6 puts these numbers into perspective for the various stages of income receipt and conversion, with percentages developed on the basis of the entire unbanked survey population.

Figure 6 shows that check-cashing outlets are the service providers most commonly used by the unbanked to receive and convert their income. Yet, only 42 percent of the unbanked obtained check-cashing services at a check cashing outlet. Thus, the costs incurred by the unbanked to receive and convert income are not synonymous with fees charged at check cashing outlets. Many of the unbanked had no need

for such services, and many others made deliberate effort, sometimes requiring considerable resourcefulness, to seek out free or low-cost check cashing services elsewhere.

Making Payments

Bank accounts provide a second key function: a way to make payments conveniently. This paper focuses on bill payments because they are usually large in size and there are serious consequences for nonpayment, such as eviction from one's dwelling unit or cutoff of utility services. Most of the unbanked (92 percent) reported paying regularly-recurring payments such as utility bills (electric, gas, water, phone, or cable TV), credit card or loan payments, or rent. This section describes how people in low-income communities, both banked and unbanked, paid their bills.

Most banked individuals in the survey population paid bills primarily with personal checks (Figure 7). As might be expected, personal check usage was much more common for checking account holders than for those who had only a savings account (and who presumably used the personal checks of others).

Some of the banked paid bills with money orders or cash. Very few checking account holders used money orders or cash to pay bills, but most of those who had only a savings account did so, with 50 percent primarily using money orders and 29 percent primarily using cash.

Most of the unbanked who paid bills primarily used money orders (42 percent) or cash (41 percent). A substantial portion of the unbanked also used bill payer services (15 percent). For a fee, their bills were paid electronically at the check cashing outlets, supermarkets, and other stores that offered these services.

In summary, almost half of the unbanked did not use any kind of financial service to pay bills (Figure 9). Thirty-eight percent of the unbanked paid bills primarily in cash and eight percent did not pay bills. Most of the 52 percent of the unbanked who did use financial services paid bills with either money orders or through bill payer services. Where did the unbanked obtain these two services?

Sources of Bill Payer Services and Money Orders

Figure 9 shows that the great majority of unbanked individuals who paid bills through bill payer services used check cashing outlets, with supermarkets and other stores a distant second. The unbanked did not obtain bill payer services from banks.

The single most common financial instrument used by the unbanked to pay bills were money orders. Most unbanked individuals purchased money orders from check-cashing outlets, but some bought them at U.S. post office branches or at supermarkets or other stores.

Only three percent of the unbanked reported buying even one money order primarily from a bank in the prior year, and only 0.3 percent of the unbanked bought money orders from a bank to pay bills and other regularly-recurring payments. This is rather surprising given the large numbers of unbanked individuals who cash their checks at banks, the fact that banks have the legal authority to offer money orders, and that many banks do offer money orders.

Overview: Paying Bills

The bill-paying activities of the survey population revealed a continuum of usage, rather than a strict dichotomy of “banked” and “unbanked” activity. The banked used both bank and nonbank services, although most checking account holders used personal checks, and most savings account holders used money orders and cash.

In the case of bill-paying, however, this continuum does not show the same kind of symmetry as seen with income receipt and conversion services, where many of the unbanked also used both bank and non-bank services. Many banks offer bill payer services and money orders, but the unbanked rarely bought money orders from banks, and none reported using bill payer services at banks. While banks have the legal authority to offer money orders and bill paying services, they apparently have not priced, designed, or marketed them in a way to attract many unbanked (or banked) individuals in low-income communities.

The percentages reported in the preceding figures were developed on the basis of various subgroups of the survey population, such as the percentage of those who paid bills, or the percentage of those who paid with money orders or bill payer services. Figure 9 puts these numbers into perspective for the various aspects of bill payment activity, with percentages developed on the basis of the entire unbanked survey population.

Store of Savings

Bank accounts provide a third key function: a way to store savings. This section describes how people in low-income communities, both banked and unbanked, stored their savings.

Formal and Informal Savings Instruments

In order to capture information on how the unbanked saved, the survey questionnaire defined savings in terms of a broad array of formal and informal savings instruments.⁹

- Formal savings instruments included the respondent's bank account, another person's bank account, money market funds, other mutual funds, stocks, bonds, certificates of deposit, U.S. government savings bonds, pension or retirement plans, tax-deferred savings plans, thrift plans, or funds kept in a bank safe deposit box.
- Informal savings instruments included cash, uncashed checks or money orders, gold, or jewelry that might be sold for cash, investments in property or a business, funds lent to others at interest, and contributions to a savings circle.

Many informal methods of saving are convenient and entail little or no cost. While jewelry and gold must be sold before these savings can be used, a number of jewelry stores and pawn shops in low-income communities stand ready to buy or sell gold and jewelry, thereby increasing their liquidity. Still, many of these informal ways of saving are vulnerable to loss or theft and generate no interest income.

Stock of Savings

Within the survey population, 78 percent of banked individuals held savings, whereas only 30 percent of unbanked individuals held savings. Among the banked who held savings, 94 percent held savings in formal instruments, most commonly in their bank account. The most common informal method of saving used by the banked was investment in property or a business.

Among the unbanked who held savings, 40 percent held savings in formal instruments, typically the bank account of another person. Sixty percent of the unbanked saved in informal ways. The most common informal method of saving used by the unbanked was to hold cash, jewelry, or gold.

Flow of Savings

Figure 10 shows that saving regularly was a challenge, particularly for unbanked individuals. Among the banked, 51 percent added to their

savings at least once a month, as compared with only 14 percent of unbanked individuals.

In part, this difference may be due to the large difference in average income between banked and unbanked individuals (Figure 3). Indeed, even among the banked, Figure 10 shows that higher-income individuals were more likely to save regularly than lower-income individuals. Yet, even when controlling for income, banked individuals were more likely to save regularly than unbanked individuals with similar household incomes (Figure 10).

Correlation and Causation

The survey data show that individuals with higher incomes and those with a bank account are more likely to hold savings and save regularly. Do these patterns mean that having a bank account improves an individual's ability to save? The answer to this question has important implications for government policy and for the design and pricing of banking services that are attractive to unbanked individuals. Unfortunately, survey data cannot answer this important question, since the data show only correlations, not causation. These correlations are consistent with several possible scenarios:

- For example, it is possible that having a bank account does not affect savings behavior. The correlations in Figure 10 might simply reflect the fact that those who have developed the habit of saving, and who accumulate savings, are then motivated to open a bank account in which to keep their savings. Also, those with higher incomes may be better able to save, after meeting their basic needs, than can those with low incomes. This scenario would imply that better savings habits, or actions that raise income, would be more likely to increase savings than would efforts to improve the availability of bank accounts.
- However, it is possible that having a bank account does increase saving, at least for some of the unbanked. If so, there would be real value in offering bank accounts that are designed and priced in ways that attract the unbanked. For example, the survey data on savings suggest that lowering minimum opening balances could make bank accounts more available to many of the unbanked who do not have savings, and who could not otherwise open an account.

Based on the first scenario, policy makers might focus on job training as a way to raise incomes and thereby increase savings. Or they might support school bank programs or public education messages that encourage people to form good saving habits.

Based on the second scenario, however, policy makers might focus on increasing access to bank accounts, in order to increase savings. A well-designed bank account that helped the poor to gradually accumulate savings and get ahead, or even avoid falling behind, might contribute significantly to financial and economic development in low- and moderate-income communities.

Random Assignment Experimental Studies

As noted earlier, survey data cannot reveal which of these two scenarios (or others) better explains the patterns shown in Figure 10. The answer would require information from a different sort of study, one that used techniques, such as random assignment experimental design, to show whether or not a well-designed bank account can increase saving by the poor.¹⁰

In order for such a study to be effective, the experiment must feature a bank account that is designed to meet the needs of the currently-unbanked. The danger in conducting a random assignment experimental design with a poorly designed bank account is that if program participants did not increase their savings (relative to the control group), the study might falsely conclude that bank accounts do not help the poor to accumulate savings. Thus, it is important in carrying out such a study to provide a bank account with the price and nonprice features that are attractive to currently unbanked individuals.

Financial Costs Incurred by the Unbanked

The previous section presented information on how unbanked individuals received and converted income, paid bills, and stored savings. This section estimates the annual costs they incurred in carrying out the first two functions. Estimates of annual check cashing costs were developed from answers supplied by unbanked respondents to survey questions on the cost of the most recent check they cashed and the number of checks they typically cashed per month. Estimates of annual money order costs were developed from their answers to questions on the cost of the most recent money order they purchased and the number of money orders they typically purchased each month.¹¹

Check-Cashing Costs

Number of Checks

Among the unbanked who cashed income checks, the great majority (97 percent) reported receiving four or fewer income checks per month. Lower-income individuals, particularly government means-tested benefit recipients, received fewer income checks per month than higher-income individuals and non-benefit recipients.

For example, those with household incomes of \$15,000 or less averaged 2.0 checks per month, while those with household incomes over \$30,000 averaged 3.0 checks per month. Among the unbanked who cashed income checks, much of this difference is due to the fact that most of those (67 percent) who receive means-tested government benefits receive only one income check per month, while most of those (85 percent) who do not receive such benefits receive more than one income check per month.

Costs Per Check Cashed

Most of the unbanked who cashed checks at a bank (81 percent) did so at no cost, most likely because the bank was the bank of issue. Most of the unbanked who cashed checks at a store (63 percent) also did so at no cost, presumably as a result of the store's marketing decision to accommodate customers.

Relatively few of the unbanked who cashed checks at a check cashing outlet (9 percent) did so at no cost. Nevertheless, check-cashing outlets were the most common source of check cashing services used by the unbanked. Most unbanked individuals who used check cashing outlets (82 percent) cashed their check for \$5 or less, paying on average \$3.38, or 1.1 percent of the face value of the check.¹²

Among unbanked individuals who cashed checks, low-income individuals tended to pay higher costs per check than higher-income individuals. For example, those with household incomes of \$15,000 or less paid an average of \$3.08 per check (0.84 percent of the face value of the check), while those with household incomes of more than \$30,000 paid an average of \$2.40 per check (0.65 percent of the face value). Most of this difference was due to the fact that higher-income unbanked individuals were more likely to cash checks at banks (37 percent), usually at no cost, compared with only 11 percent of low-income unbanked individuals.

Annual Costs of Check Cashing

Annual costs of check cashing for the unbanked were developed by combining information on the number of checks cashed per year and the cost per check cashed.

The survey data show that 66 percent of the unbanked incurred no costs of receiving or converting income. Either they did not cash income checks in the prior year (51 percent) or they cashed checks at no cost (15 percent). Thus, only 34 percent of the unbanked population incurred any financial costs of check-cashing. Of these, only 33 percent incurred annual costs of \$100 or more in check cashing costs, and this group represented only 11 percent of the unbanked survey population.

Among the unbanked with check-cashing expenses, high-income unbanked individuals (with over \$30,000 in household income) were more likely to incur at least \$100 in annual check-cashing costs than were low-income individuals (with \$15,000 or less in household income). Within this group, 48 percent of high-income individuals incurred at least \$100 in annual check-cashing costs, compared with only 26 percent of low-income individuals.

Check cashing outlets were the financial institutions most commonly used by the unbanked. However, focusing on the prices charged by check-cashing outlets could lead one to focus on the relatively high prices that are paid by their customers, such as the \$4.95 average cost of cashing a check at check-cashing outlets in Los Angeles. Such prices can easily generate annual costs in excess of \$100, especially for higher-income individuals. However, focusing instead on the activities of the unbanked survey population could lead one to focus on the fact that two-thirds pay nothing in the way of check-cashing costs, and that check cashing costs are less than \$100 per year for two-thirds of those who do incur such costs.

Money Order Costs

Number of Money Orders

The great majority (92 percent) of those who purchased money orders bought three or fewer money orders per month: on average 1.9 per month. Low-income individuals bought fewer money orders each month than did higher-income individuals. For example, those with household incomes of \$15,000 or less bought an average of 1.4 money orders per month, while those with household incomes of over \$30,000 bought an average of 2.7 money orders per month.

Costs Per Money Order

Most providers charged about \$1 per money order. Although they charged somewhat higher-than-average costs per money order, check-cashing outlets sold many more money orders than did the other providers. Among unbanked individuals, 42 percent purchased money orders from check-cashing outlets, 13 percent from U.S. post office branches, and 9 percent from supermarkets and other stores. As noted earlier, very few of the unbanked purchased money orders from banks (3 percent).

Annual Money Order Costs

Fully 64 percent of the unbanked incurred at least some money order costs during the year. However, many bought money orders only occasionally, so their annual costs were quite low. Forty-six percent of the unbanked incurred annual money order costs of less than \$25, and only 17 percent incurred annual money order costs of \$25 or more.

Among the unbanked who did incur money order costs, high-income individuals (those with over \$30,000 in household income) were more likely to incur at least \$25 in annual money order costs than were low-income individuals (those with \$15,000 or less in household income). Within this group, 45 percent of high-income individuals incurred at least \$25 in annual money order costs, compared with only 17 percent of low-income individuals.

Annual Financial Costs Incurred by the Unbanked

Within the unbanked survey population, 14 percent cashed checks but did not purchase money orders, spending an average of \$59 annually. Thirty-two percent purchased money orders but did not cash checks, spending an average of \$19 annually. Another 35 percent cashed checks and purchased money orders, spending an average of \$105 annually. The remaining 19 percent obtained neither service, and incurred no financial cost.

Figure 11 shows the distribution of the annual costs of check cashing and money orders that the unbanked incurred. While most of the unbanked (73 percent) incurred some costs, in most cases, these costs were not high. Only 17 percent of the unbanked survey population (168,000) incurred annual costs of \$100 or more from cashing checks and purchasing money orders.

The average annual cost incurred by unbanked individuals was higher in Los Angeles than in New York City.¹³ For example, 21 percent

of unbanked individuals in Los Angeles (88,000 individuals) incurred annual costs of \$100 or more for check cashing and money orders, compared with only 14 percent of unbanked individuals in New York City (78,000 individuals).

Yet the costs incurred by the unbanked, even in Los Angeles, were much lower than had been expected prior to the survey. Anecdotal evidence had suggested that it was rather typical for the unbanked to incur much higher costs for these two services. Policy concerns over equity, and concerns that barriers might be keeping the unbanked from opening a bank account, were motivated by the assumption that most of the unbanked were paying high costs for services from nonbanks.

However, since the survey results described in this paper focus on financial costs only, they do not preclude the possibility that at least some of the unbanked face barriers to obtaining a bank account. Certainly, they show that some unbanked individuals incur high costs in conducting their routine financial activities, even though the great majority of the unbanked incur low costs, or pay nothing at all. In addition, it is quite possible that unbanked individuals may prefer to have a bank account even though they now pay relatively little for nonbank services. A more definitive view as to whether the unbanked face barriers to opening a bank account will first require an examination of the survey data on nonfinancial costs and on the attitudes of the unbanked toward bank and nonbank services.

Potential for Bank Competitiveness

What do the survey findings imply for banks that might hope to attract the unbanked away from more expensive nonbank services to a less expensive bank account?

The first thing to consider is the price that a bank might reasonably charge for a simple, low-cost, yet profitable transactions account. Based on information on the low rate of savings by the unbanked discussed earlier, it seems reasonable to assume that most of those who are now unbanked are unlikely to hold balances of any significance in a bank account, at least initially. Rather than relying on net earnings on account balances, banks would have to rely primarily on fees to cover the costs of providing the account plus earn a reasonable profit. It has been estimated that a bank would require revenues of about \$100 per year for providing a simple transactions account.¹⁴

By using \$100 as a rough starting point, only 17 percent of the unbanked survey population would find such a bank account less

expensive than what they now pay each year in check cashing and money order fees. On the basis of financial cost alone, therefore, banks could expect to attract only a small portion of the unbanked to a bank account. This percent might expand to as many as 33 percent of the unbanked, if adults living in the same dwelling unit pooled their resources and opened a joint bank account.¹⁵ If the unbanked valued some features of bank accounts that they could not obtain from non-bank services, even more of the unbanked might open a bank account. If a well-designed bank account did help the currently-unbanked save more than they do now, then as their balances grew and banks relied less on account fees to cover the costs of bank accounts, still more unbanked individuals might open a bank account.

Thus, depending on a number of factors in addition to financial costs, a sizeable percentage of currently-unbanked individuals might be attracted to a well-designed, low-cost, yet profitable bank account.

Summary and Conclusions

This initial analysis begins to answer some of the questions that were set out as reasons for developing the *Survey of Financial Activities and Attitudes*.

Why So Many Individuals Are Unbanked

The survey data presented in this paper focuses on financial activities and financial costs. As such, it cannot provide a complete answer to the first question — why are there so many unbanked individuals? A complete answer will first require additional analysis of the survey data on respondent attitudes and on non-financial costs.

How Unbanked Individuals Conduct Their Financial Activities

The survey data provide considerable information on how unbanked individuals conduct their financial activities. This paper focused on how the unbanked received and converted income to a negotiable medium, paid bills, and stored savings.

An estimated 19 percent of unbanked individuals received income, paid bills, and (may have) saved without using any financial services at all. Rather, they operated in a cash economy.

Most other unbanked individuals obtained one or more financial services in order to cash checks, buy money orders, and/or use bill payer services. Most obtained these services from a nonbank, such as

a check cashing outlet, although some unbanked individuals cashed checks at a bank, most likely the bank of issue, where they paid little or nothing for the service. Almost none of the unbanked obtained money orders or bill payer services from banks, even though they commonly paid their bills in these ways, and even though banks are authorized to offer these services and commonly do so.

The survey data show that most of the banked used their bank account to receive and convert income (through direct deposit or check deposits), pay bills (through personal checks), and store savings (in the bank account). However, a significant portion of the banked, particularly those with only a savings account, cashed checks or bought money orders at a nonbank. They primarily obtained these services from check cashing outlets, although the post office, supermarkets, other banks, and other stores were sources for some.

These patterns of financial activity demonstrate that there was not a dichotomy within the survey population, where unbanked individuals used only the services of nonbanks and banked individuals used only the services of banks. Rather, the data show more of a continuum along which individuals in the survey population operated. This continuum was evident in many dimensions: how individuals received income, how they converted it to cash or other negotiable media, how they paid bills, where they obtained check cashing services and money orders, and how they saved.

Costs Incurred by Unbanked Individuals

The survey data showed, surprisingly, that most of the unbanked did not incur high annual costs for two common financial activities, check cashing and money order purchases.

Most of the unbanked obtained check cashing and/or money order services at little or no cost. Only about 17 percent of the unbanked survey population incurred annual costs of \$100 or more. Those who incurred higher annual costs tended to have higher household incomes than those with lower annual costs.

At the other end of the spectrum, many of the unbanked simply did without these services — sometimes because they did not need them, and some in order to economize. This group incurred no financial costs. For them, the equity concern should not be measured solely in terms of their lack of financial costs, but also in their doing without financial services, and their possibly higher transactions costs and greater risk of loss.

Barriers to Bank Accounts for the Unbanked

An initial concern motivating the development of the survey was whether demand barriers were preventing many of the unbanked from obtaining a bank account. Anecdotal evidence suggested that many were paying high costs for check cashing and other nonbank services. This raised the question of why they did not economize by opening a bank account, and whether barriers might be preventing them from doing so.

Barriers in Demand

The survey data show that most unbanked individuals incurred relatively low annual costs in operating without a bank account. This suggests that many people may be unbanked, not because they face barriers to obtaining a bank account, but because they can better economize on the costs of financial services without having a bank account.

This does not preclude the possibility that there may be demand barriers, at least for some of the unbanked. For example, the survey data show that minimum opening account balances may pose a significant problem for the many unbanked who have not accumulated any savings. However, before coming to any conclusions on the demand side, it is first necessary to examine nonfinancial costs incurred by unbanked individuals and their attitudes toward bank and nonbank services.

The survey data showed that individuals with higher incomes and those who had a bank account were more likely to have savings. However, survey data can only show correlations; it cannot inform us as to whether having a bank account would help currently unbanked individuals to save. Rather, a different kind of study, employing a random access experimental design and a well designed bank account, should be carried out to answer this important question.

Barriers in Supply

The survey data do raise questions about possible barriers on the supply side. In particular, it is not clear why banks do not effectively provide the unbanked with some of the services commonly used by the unbanked, such as cashing checks with immediate availability, or providing attractive money orders or bill paying services. These too, and not simply credit services, are important components of the financial service needs in low-income neighborhoods.

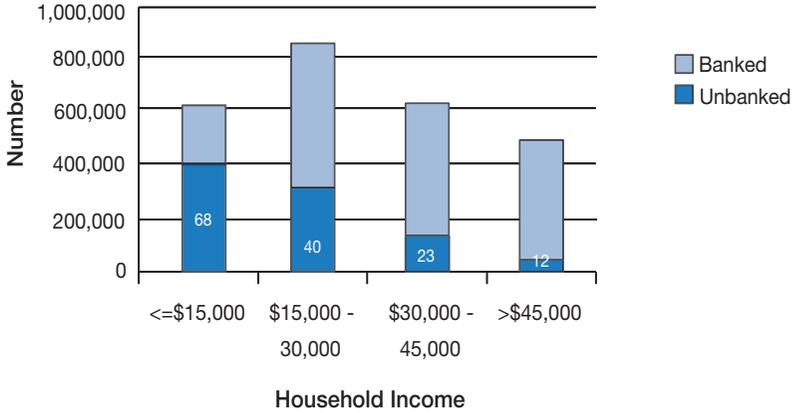
Check cashing, money order, and bill payer services present a real opportunity for banks seeking to better meet financial needs in their service areas. Yet few banks have gained a sizeable market share in these services. A good study of supply might reveal whether there are informational, operational, attitudinal, legal, regulatory, or other factors that prevent banks from effectively competing with nonbanks in supplying these financial services in low-income neighborhoods.

The survey data also suggest that regulatory efforts intended to help the unbanked can backfire if not crafted carefully. For example, binding regulatory ceilings on check casher fees could limit revenues to the suppliers of these services. They could make it more difficult for banks to enter this market by first offering check cashing services, and eventually attracting some of the unbanked to bank accounts and other services.

Negative regulatory attitudes, about whether it is proper for a bank to offer check cashing, money order, or bill payer services, could also discourage banks from offering these services in innovative and profitable ways. But those banks that succeed in doing so could not only increase financial competition in low-income communities, but could also provide more low-income individuals with a bridge to a broader range of financial services.

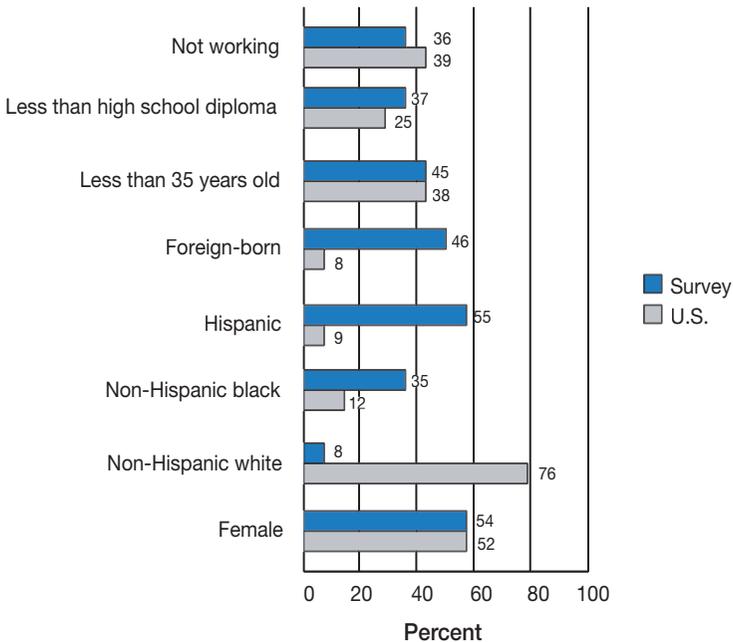
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Figure 1
Banked and Unbanked by Household Income



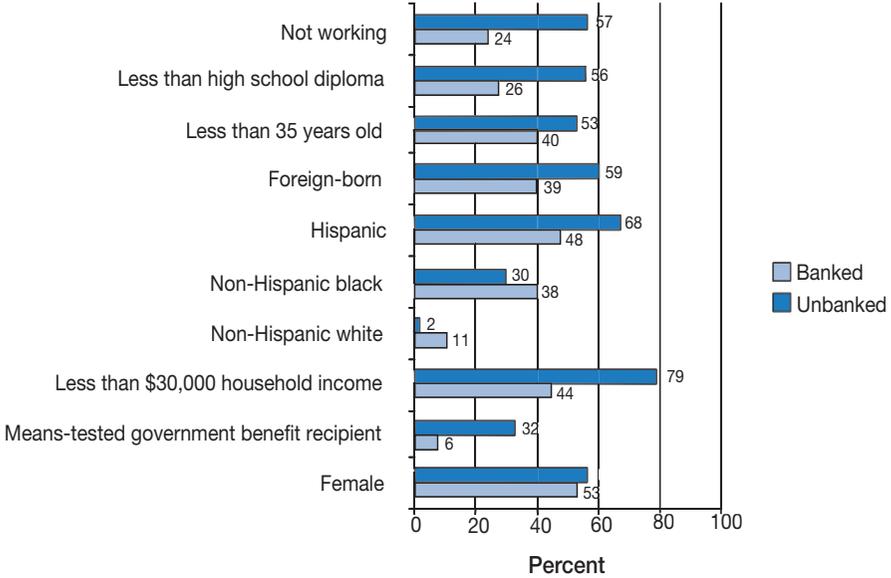
Source: Survey of Financial Activities and Attitudes.

Figure 2
Comparing the Survey Population and the U.S. Population



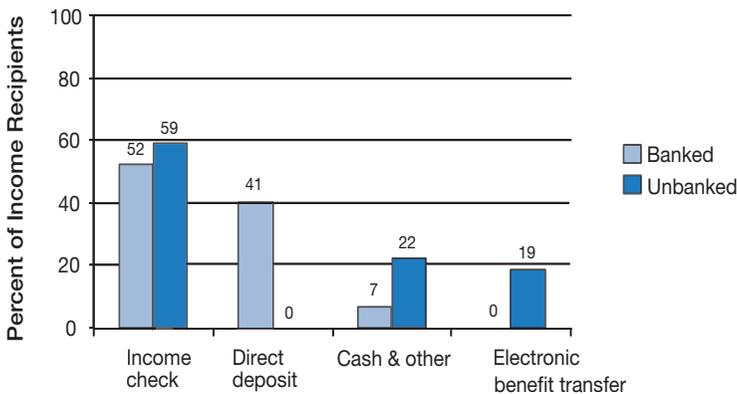
Source: Survey of Financial Activities and Attitudes (18 years and over),
 1990 U.S. Census (18 years and over except for working status, 16 years and over).

Figure 3
Comparing Banked and Unbanked Within the Survey Population



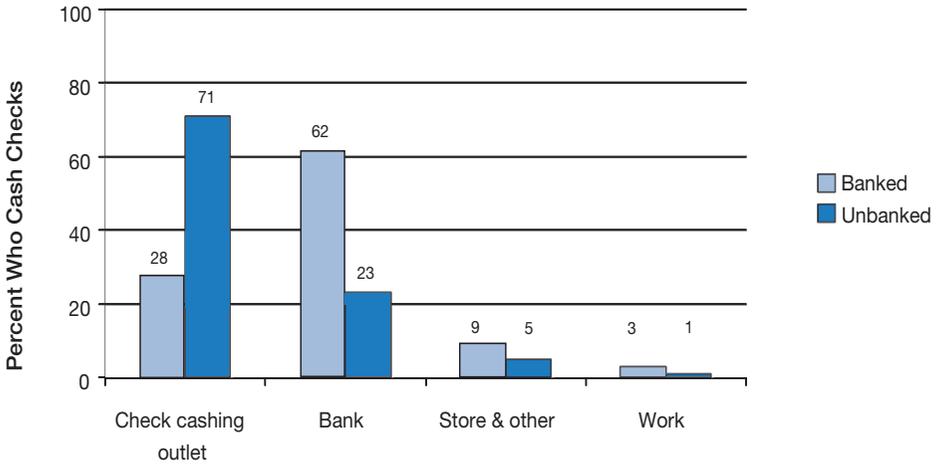
Source: Survey of Financial Activities and Attitudes.

Figure 4
Ways of Receiving Income



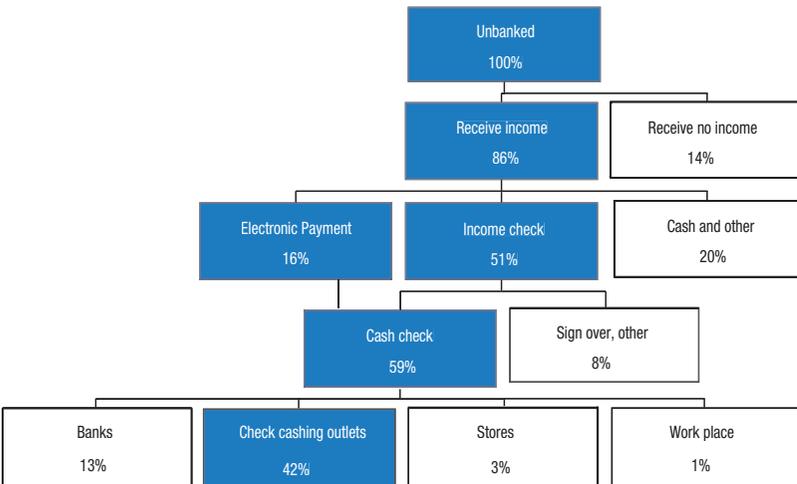
Source: Survey of Financial Activities and Attitudes.

Figure 5
Check Cashing Service Providers



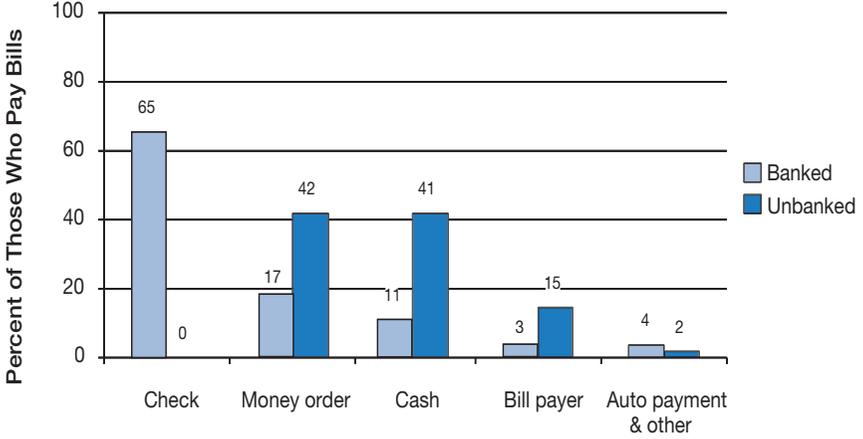
Source: Survey of Financial Activities and Attitudes.

Figure 6
Receiving and Converting Income by the Unbanked



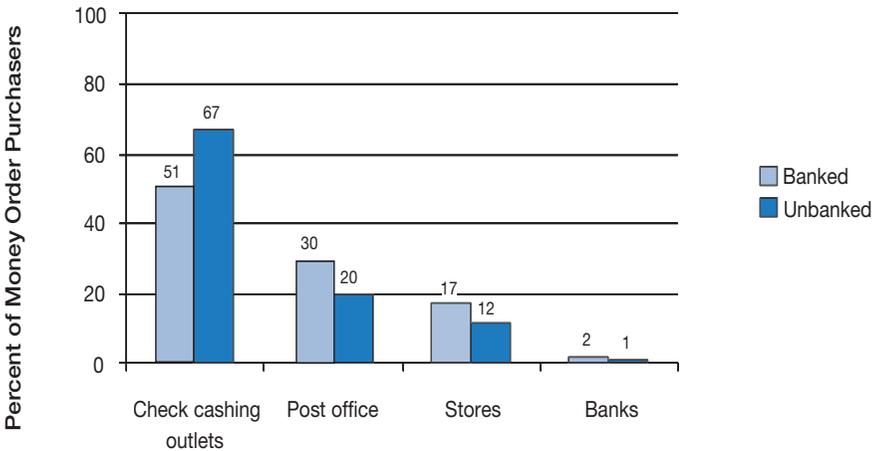
Source: Survey of Financial Activities and Attitudes.

Figure 7
Ways of Paying Bills



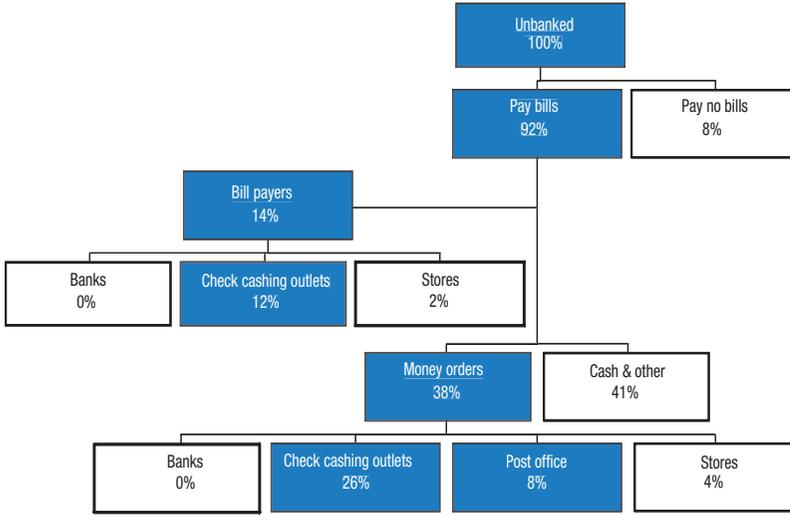
Source: Survey of Financial Activities and Attitudes.

Figure 8
Money Order Providers



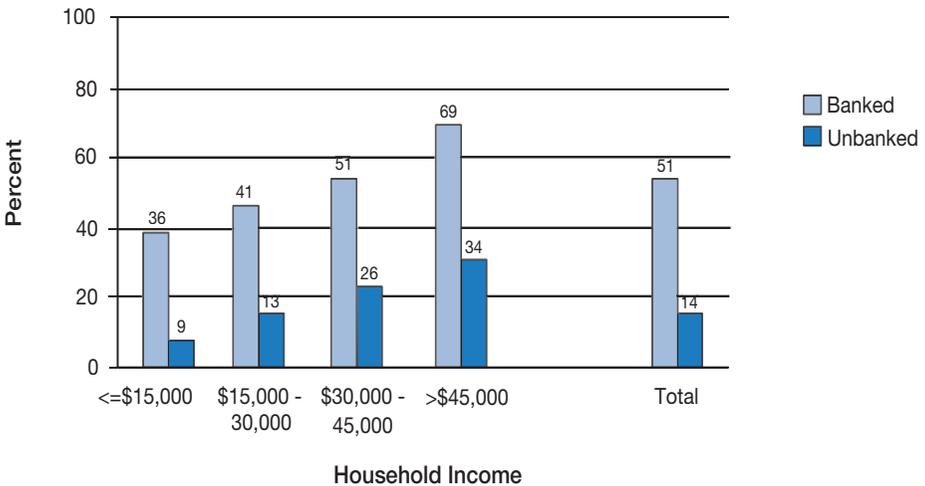
Source: Survey of Financial Activities and Attitudes.

Figure 9
Bill Paying by the Unbanked



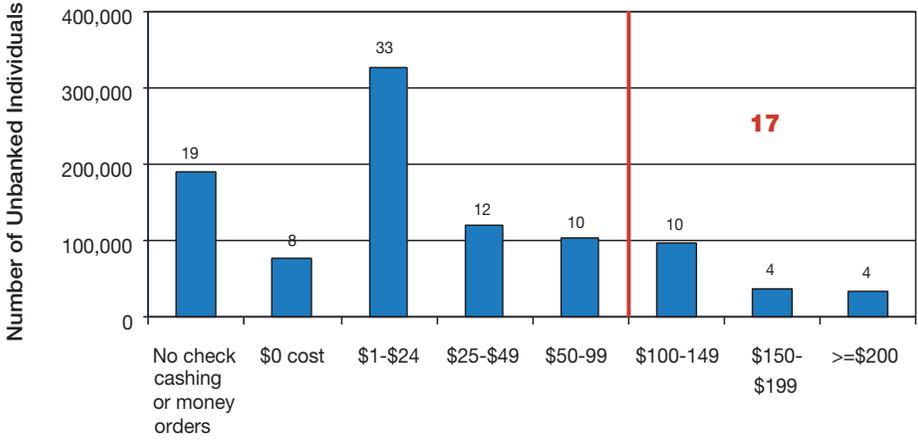
Source: Survey of Financial Activities and Attitudes.

Figure 10
Banked and Unbanked Who Save Regularly



Source: Survey of Financial Activities and Attitudes.

Figure 11
Annual Financial Costs Incurred by the Unbanked



Source: Survey of Financial Activities and Attitudes.

Notes

- ¹ “Banked” individuals are those who had a deposit account (either individually or jointly with another individual) at a depository institution at the time of the survey. “Unbanked” individuals are those who had no such account at the time of the survey. Deposit accounts may be checking, savings, or similar accounts at a commercial bank, thrift institution, or credit union. For simplicity, all such accounts are generically termed a “bank account” in this paper, and depository institutions are generically termed “banks.”
- ² Nationwide, 9.5 percent of American households had no transactions accounts in 1998: see Arthur B. Kennickell *et al.*, “Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances,” *Federal Reserve Bulletin* (January 2000) pp. 8-9.
- ³ The forum proceedings, “Financial Access in the 21st Century (1997),” OCC, Washington, D.C., can be obtained at: <http://www.occ.treas.gov/occfinaac.pdf>, or ordered from the OCC by calling 202-874-4960.
- ⁴ Issues related to the survey design are addressed in: Constance R. Dunham, Fritz J. Scheuren, and Douglas J. Willson (1998), “Methodological Issues in Surveying the Nonbanked Population in Urban Areas,” in *Proceedings of the Survey Research Methods Section, American Statistical Association*, pp. 611-616.
- ⁵ The Survey of Financial Activities and Attitudes (SFAA) shows higher rates of unbanked at each level of household income than the Survey of Consumer Finances (SCF). One reason for this difference is that the SCF measures unbanked households, not unbanked individuals. Thus, if one out of three adults in a household had an individual bank account, the SCF would consider the household “banked,” even if only one individual had effective control of the account, whereas the OCC survey would consider only one individual to be banked and two to be unbanked. Another reason is that SCF surveys the entire nation, whereas the SFAA is a survey of two urban areas that contain high percentages of some groups (*e.g.*, minority and foreign-born), which tend to have higher unbanked rates than others with the same incomes.
- ⁶ At the time of the survey, government sources at the state and federal levels were working actively to reduce the number of payment checks they issued and, instead, to make these payments electronically, either by direct deposit or electronic benefits transfer. Thus, the percent of unbanked who receive electronic benefits transfers may be even higher at present.
- ⁷ This hypothesis is consistent with the survey data that show that 71 percent of the banked who cashed their income checks reported doing so at a bank where they did not hold a bank account, often the bank of issue.
- ⁸ To the extent that some of the unbanked incur added time and travel costs of using the bank of issue, however, their ability to economize is reduced. In addition, some receive checks issued by non-local banks and thus do not have a practical way of cashing them at the bank of issue.

- ⁹ Some respondents offered additional categories, not all of which could be classified as formal or informal. For example, a number of immigrants noted that they kept savings in their country of origin. Some of them noted how they stored their savings, such as in a bank account in that country, but others did not explicitly identify how they stored their savings.
- ¹⁰ In random assignment experimental studies, participants are randomly assigned in a lottery-like process either to a program group (which would have access to a well-designed bank account), or to a control group (which would not have access to the bank account). Over time, the study would collect information on the savings behavior of the participants in both groups, and the outcomes would be compared.
- ¹¹ The estimates of the total annual costs incurred by the unbanked for these services include the costs of check cashing incurred by any unbanked respondent who cashed any income checks during the prior year, not by only those who primarily received income by check and primarily cashed their checks. The estimate incorporates the check-cashing activities of those who received electronic benefit transfers as well as those who cashed income checks received directly. The estimates include the costs of buying money orders by any respondent who bought at least one money order in the prior year, not by only those who primarily paid their bills with money orders.
- ¹² Note that at the time of the survey, check cashers in New York State were restricted to charging 1.1 percent of the amount of a check or 60 cents, whichever was greater. 3 NYCRR section 400.12. In New York City, 89.1 percent of the unbanked who cashed checks at check cashing outlets did so for \$5 or less, paying on average \$2.61 (0.7 percent of the face value of the check), while in Los Angeles County, 69.0 percent of those who cashed checks at check cashing outlets did so for \$5 or less, paying on average \$4.95 (1.6 percent of the face value).
- ¹³ However, it is not clear whether regulated ceilings on check cashing charges, lower average household incomes in the New York City survey area, or possibly greater competition among check cashers in New York City has had the greater influence on the lower check cashing fees there than in Los Angeles. In New York City, most of the unbanked who cashed checks paid check cashing fees that were less than 1.1 percent of the face value of the check, the regulated ceiling at the time of the survey. Seventy-seven percent of unbanked New York City respondents who cashed checks paid fees of 1.0 percent or less of the face value of the check.
- ¹⁴ See the remarks of Seamus McMahon, First Manhattan Consulting Group, in *Financial Access in the 21st Century*, op. cit., pp. 25-26.
- ¹⁵ Eighty-three percent of the survey population lived in dwelling units with two or more adults. If it is assumed that the other adults living in an unbanked respondent's dwelling unit were also unbanked and incurred similar financial costs, then 128,000 dwelling units contained unbanked individuals who together incurred at least \$100 in annual financial costs. Under these assumptions, an estimated 325,000 currently unbanked individuals would pay the same amount or less for a bank account than they now pay for conducting routine financial activities without a bank account.

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The article is also available at

<http://www.chicagofed.org/cedric/2001/sessionone.cfm> in "Session One: The Unbanked and the Alternative Financial Sector."