In Feb. 1997, the Comptroller of the Currency held a forum on access to financial services for unbanked households in the United States called "Financial Access in the 21st Century". This is a summary of the proceedings document.

Most of the talk was not on credit but on savings and payment services. Not all households are creditworthy, but all households are depositworthy, and all households make payments. The problem of access to bank accounts for all matters since banks have become the point of access to the whole payments system in the United States. Bills and coins are legal tender; all people can hold them and all people must take them as payment. Bank accounts are not the same since they require a minimum balance and/or fees, but bank accounts are more and more the way payments are made. Whether the poor save or not, and whether the poor get and repay loans or not, the cost of the lack of access to payments through bank accounts will continue to go up. The government mandate to make all benefit payments through such accounts by the start of 1999 could push the development of new ways to provide access at low cost.

At the forum, two speakers presented their research. John Caskey, a professor at Swarthmore, said that 6-22 percent of U.S. households are unbanked. They tend to be poor, less educated, young, and non-white. I presume households headed by women tend to be unbanked more than households headed by men.

Fringe banking for unbanked households includes check-cashing outlets (CCOs), pawnshops, and rent-to-own stores. CCOs get a fee of 1.5-2.5 percent of each check cashed (Caskey, 1994). They also sell money orders, take bill payments, make wire transfers, and sell lottery tickets and other impulse items. Most CCOs are in low-income areas and stay open at night and on weekends, but some are next-door to banks or have their own window in the lobby of a bank. CCOs can compete with banks since their tellers take time to help customers fill out forms and to assure them that their payments have been recorded and will go through. Customers also use CCOs since banks will not cash a check on the spot unless the customer has an account with a balance high enough to cover the check. CCOs do not wait to cash checks, but they run the risk of a bounced check. Some CCOs will cash post-dated checks at a steep discount.

Pawnshops make loans that average $55 at annualized interest rates of 200-250 percent. Loans often go for car repairs, doctor bills, bets, or alcohol or drugs. Most borrowers say the loan is for an emergency. They care not for interest rates but for the amount of cash they can get fast. The loans are secured with gold, jewels, guns, musical instruments, cameras, air conditioners, or anything with low bulk and high worth that can be appraised and resold without much fuss. Taboos against usury, as well as the pure danger of the job, has led to a stigma on pawnshops, and their owners are often people in ethnic groups already outside the mainstream.

Rent-to-own stores also lend to the poor. In the eyes of the law, a rent-to-own deal is not a loan, but it is a loan in practice. For example, a sofa with a cash price of $800 migh rent-to-own for 12 monthly payments of $80. The nominal effective interest rate per month is about 2.9 percent. The monthly interest rate can go up to 12 percent. The store can repossess an item in a few days once a payment is missed. The renter must pay a fee or lose credit for the payments made before the missed payment. Still, some poor households may use rent-to-own loans for at least fourth reasons. First, the application is short, simple, and can be completed by phone. Second, approval/rejection can take just an hour, and the purchase can be delivered the same day. Third, people who cannot get credit cards or loans from banks can get rent-to-own loans. Stores may not even check on an applicant with a credit bureau. Fourth, often there is no down payment.

Robert Townsend, a professor at the University of Chicago, described his research in a

Hispanic neighborhood in Chicago. He pointed out that access to deposits, loans, and payment services not only lets borrowers take advantage of productive opportunities, but it also lets savers buffer risks. Savings help to insure against unemployment, sickness, or the death of relatives. Due to the high costs of small loans for both bank and borrower, Townsend emphasized the worth to the poor of low-cost, low-minimum-balance, low-fee deposit accounts.

In the forum, Claskey, Townsend, and the others discussed why some households might not have a permanent relationship with an insured depository institution. Some households have chosen to be unbanked. For example, culture and habits mean some households live paycheck-to-paycheck without extra cash to save at the end of the month. Some unbanked households used banks in the past but had a bad experience such as a default on a loan.

Some people dislike banks since they feel judged by the teller. They do not feel this way about CCOs, where the teller is often a former customer. In some cases, the teller at an CCO speaks a language other than English. Also people may go to CCOs or pay bills at grocery or drug stores since they like high-touch more than high-tech.

Some households avoid banks since they want to hide their finances and illegal activities. They may want to evade taxes or attempts to enforce child-support payments, to avoid debt collectors, or to avoid immigration officals.

The non-use of banks can make sense when their use costs a lot. For example, a household with a daytime job in a low-income neighborhood may not be able to make it to a distant branch of a bank open for just a few hours and just in the daytime. Low balances can lead to high fees on deposit and checking accounts, and low balances also can lead to high fees for bounced checks. Unless a household has a large lump sum to keep in an account, to hold an account may not be worth the effort nor the cost.

Other reasons for being unbanked are external. For example, rules that limit the assets held by households who get government assistance may also discourage saving. For a low-income household that self-insures through a network of family and friends, savings could be fair game to be claimed by members of this network. There is evidence that banks discriminate on the basis of race (Munnell *et al.*, 1996).

Some unbanked people cannot read and write, or they may lack the skills needed to fill out forms or to manage a checkbook on their own. Others may lack a permanent mailing address because of the migrant nature of their work. Some lack common forms of identification.

Banks have cost and non-cost reasons not to make an effort to reach the unbanked. The cost reasons are based on the fact that small loans, small deposits, and small payments cost more per dollar than big ones. Banking is a retail business, and most costs are the same regardless of the size of the transaction. All this means that the cost per dollar of financial services for low-income households may be more than for rich households. Many banks claim that their attempts to go down market have been thwarted by losses.

Even if banks were willing and able to charge high prices to recoup to high costs of small products for low-income households, the profit would be small compared to the work required due to the small size of the low-income market. Also, no bank wants to be labeled as unfair since it charges the poor more than the rich, but the public and the press would not see that smaller transactions have higher average costs. Banks need to learn how to brand products aimed at the low-income market.

Banks require high minimum balances since they do not use technology that lets them to profit from low-balance accounts. Banking is a retail business without great economies of scale.

Except for their cost of funds, the big expenses for banks are for wages and for brick-and-mortar branches, and the need for branches and for tellers increases with products aimed at the low-income market. ATMs are one way for banks to avoid these costs, but ATMs are not the whole answer. People may fear for their safety upon exit from an ATM, they may desire to deal with people, or they may not trust that deposits made through the ATM will be counted.

Banks have high costs also because their employees desire a quiet life. Banks do not need to compete as much as some other firms. They can set their own terms in part since they are protected by deposit insurance and since they are the only source of large, long-term loans for households. New banks need to get charters, and that restricts new entrants who might drive costs down. Exit is also controlled by prudential regulation and supervision. Safety and soundness is good, but it may also lead to staidness and laziness. When most bank employees got their degrees, they did not dream of nights and weekends in small branches in low-income neighborhoods.

A lot of talk at the forum focused on the fact that U.S. government benefits must be transferred electronically through accounts in financial institutions by the start of 1999. Many households who now get a check in the mail do not yet have an account, and this creates both a regulation-based and profit-based incentive. Someone will bear the cost of reaching these households. No one knows whether the mandate will force households to use banks and bear the costs that seem to block access with current technology, or whether someone will come up with a technology that will attract these households with access at a lower cost. The direct deposit may also affect savings if households are less tempted to spend cash in their pockets.

Sources

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