

# A study of the UNBANKED & UNDERBANKED Consumer in the Tenth Federal Reserve District *Executive Summary*



FEDERAL RESERVE BANK of KANSAS CITY

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With 30 million unbanked or underbanked households nationally and 2.3 million across the Tenth Federal Reserve District<sup>1</sup>, which encompasses western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico, the Federal Reserve Bank of Kansas City recently conducted a qualitative research project to develop an in-depth and contextualized picture of how this consumer develops and implements strategies to manage their financial service needs.

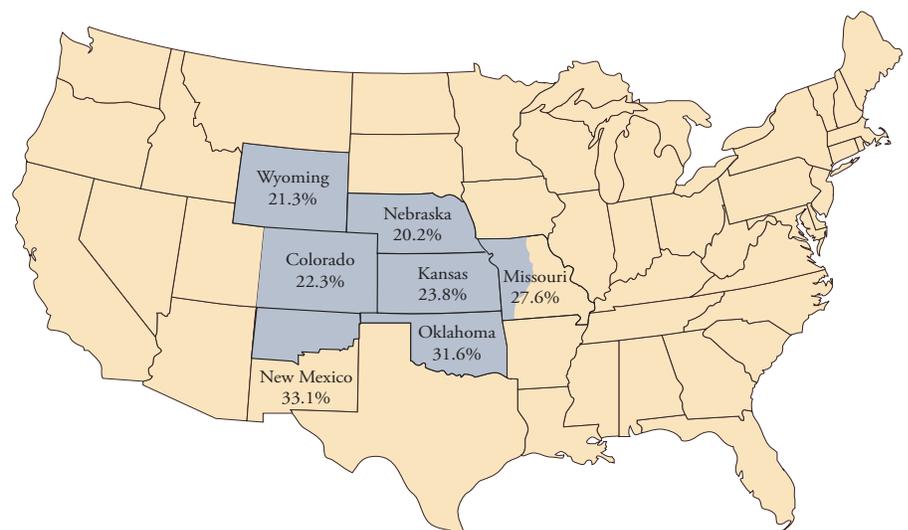
The project explored a broad range of reasons why unbanked and underbanked individuals choose to use non-bank entities for basic transactions in their financial lives.<sup>2</sup> Specifically, the research focused on the following: a) Why do underbanked individuals often mistrust banks, or at the least, choose other institutions to meet their financial service needs? b) How is that mistrust perceived and defined, developed over time, communicated to others, and compensated for by consumers? and c) How do underbanked consumers develop strategies for managing their payment needs outside the traditional banking system?

These questions were addressed through 24 focus groups (six of which were in Spanish and one was dedicated to Native Americans) held in Kansas City, Denver, Oklahoma City and Omaha. A total of 76 low- to moderate-income (LMI) unbanked and underbanked individuals were interviewed. Participants were selected based on their

usage of financial products, income, gender, ethnicity and immigrant status in order to ensure a diversity of perspectives and experiences. Based on the consistency of the data across the focus groups and with related quantitative studies, findings from this project are believed to be indicative of the experiences of unbanked and underbanked consumers in the United States.

The Federal Reserve Bank of Kansas City undertook this effort to complement existing quantitative research on this population, which includes nearly one in four households in the United States.<sup>3</sup> The research findings will assist financial institutions, community development partners and educators to develop products, services and delivery channels that are responsive to the needs, preferences and cultural settings of the unbanked and underbanked consumer segment.

## PERCENTAGE OF UNBANKED AND UNDERBANKED HOUSEHOLDS IN THE TENTH FEDERAL RESERVE DISTRICT



The national average is 25.6 percent

**Unbanked and underbanked individuals face external pressures and financial challenges that constrain their ability to use banks. Common circumstances shaping their choices include:**

- **Living paycheck-to-paycheck due to limited and unstable income:** Many participants commented about not having enough money left over at the end of each week to make it worthwhile to keep their money in a bank account. The participants' unpredictable cash flow and limited financial cushion meant that even small problems could quickly become an emergency. Uncertainty about real-time account balances, limits on availability of funds and minimum balance requirements were reported as reducing the usefulness of bank accounts.
- **Past experiences with banks were primarily negative, and the perceived benefit and relevance of a bank relationship was not clear.** Overdrafts, surprise charges, fees and disputes related to poor recordkeeping led many of the participants to adopt a cash system for budgeting and bill payment. Many participants mentioned that a family member opened a checking account for them before they were ready, and they soon got into trouble after they were on their own.
- **Consumer misinformation about bank services and products is a significant barrier to their usage:** Misunderstandings about how checking accounts and debit cards work, the complexity of managing account records and difficulty in understanding "fine print" lead to a perception of "hidden fees" and inadvertent mistakes. Participants reported frustration with overdraft fees that could result in owing hundreds of dollars and subsequent account closings with balances still due.
- **Family and friends support borrowing and saving:** Participants often mentioned relying on families and friends for both borrowing and saving needs. Many indicated they would like to be able to borrow money from a bank but do not apply for loans or credit as they expect to be turned down.
- **Retailers are often easier to use than banks:** Participants reported turning to retailers before banks due to simpler identification requirements, more transparent pricing, and no hidden fees and penalties. Identification requirements for opening an account or cashing a check were mentioned by immigrant Hispanic participants as the greatest barrier to having a relationship with a bank.
- **Unbanked and underbanked individuals expressed a strong need for physical control of and immediate**

**access to their money, and they do not believe banks can meet this need:** Many Hispanic participants described great efforts to keep their money safe by hiding it in secret locations, keeping cash on their person, giving it to a relative for safekeeping or participating in *tandas*<sup>4</sup> or other culturally derived money pools. Some participants also wanted to avoid unauthorized, surprise withdrawals for child support or for unexpected debt collection. Others were concerned that they may not be able to access their funds if they need to move quickly.

**Unbanked and underbanked individuals reported complex financial management strategies using a mixture of products and service providers to satisfy their financial services needs based on cost, comfort and convenience considerations:**

- **By using cash and money orders, participants make certain that payments are made and finalized with no risk of additional charges due to insufficient funds or overdraft fees.**
- **Participants openly acknowledged the risk and high cost of using alternative financial service providers:** Payday lenders, pawn shops and, to a lesser extent, auto title lenders, were noted as channels that should be avoided if at all possible.
- **Participants were satisfied with the way they track and transact business with their money:** Despite the extra effort it requires to conduct payment transactions, many had developed cash management systems that work for them, with the exception of savings and credit building. The unbanked participants managed their financial life on a cash basis using low-cost, convenient transaction providers such as Walmart, grocery, convenience and Mexican food stores; borrowing or saving money with trusted family members; or using loan pools. The underbanked reported using a combination of cash, money orders and prepaid debit cards.

**Unbanked and underbanked individuals developed these strategies through personal experience and the influence of others:**

- **Family influence, both positive and negative, emerged as the key influence that shaped the development of financial strategies:** Schools were a distant second as an influence and only relevant as a positive influence to younger consumers or those with children. Community and faith-based organization outreach was not reported as a strong influence.

- **Participants wanted to learn more about managing their money and were aware of programs both in the schools and in the communities:** Participants expressed a desire for financial education, specifically around savings and how to access credit, and to repair or restore credit so they can borrow money for cars and homes at lower interest rates than are available through alternative sources. However, only one participant stated that he or she had taken a course.
- **Participants believed it was important for parents to be role models in teaching children money management skills, whether or not they had benefited from positive role models themselves:** Many participants had negative experiences in their late teenage years with poor management of their checking accounts and hoped that others could avoid the same experience.
- **Savings accounts were mentioned as the desired entry product among unbanked participants,** followed by a checking/money management account, if they were to put their money in a bank. Both unbanked and underbanked participants viewed a bank account as a key milestone on the path toward building a good credit history, access to mortgages and other loans.

**Unbanked and underbanked individuals expressed a desire, with few exceptions, to use banks and rejoin the financial mainstream. Participants stated the following characteristics of an ideal bank product for cash management:**

- **Low-cost, simple payment methods:** Bank fees need to be predictable, simple and transparent. Payments need to have finality to limit returned checks due to insufficient funds.
- **Limited identity requirements:** Participants want to open bank accounts and be able to withdraw funds without having to provide multiple forms of identification.
- **Access to money without delay:** Participants want to be able to access funds quickly at all hours and with limited restrictions tied to funds-availability policies.
- **Confidence that money will be safe:** Participants were aware of the rise of FDIC bank failures and wanted protection from fraud and identity theft.
- **Assistance with savings and budgeting:** Some participants mentioned interest in receiving financial education services from a bank to assist with savings, budgeting and credit repair.

## CONCLUSIONS

**Responding to the financial needs of unbanked and underbanked individuals can improve both their financial outcomes and that of the banking industry.**

The unbanked and underbanked consumer represents a significant portion of the financial services market. This research shows that they are satisfied with the strategies they have developed to meet their financial service needs using cash and alternative services providers. Unbanked and underbanked individuals are finding checking and savings accounts with significant fees, potential penalties and nontransparent policies are less relevant to their financial lives. The findings also show, however, that the unbanked and underbanked realize they could benefit from strengthened relationships with mainstream financial institutions to achieve medium- and long-term financial goals, such as building savings and accessing credit.

Federally insured depository institutions have significant opportunities to attract deposits and expand consumer markets if products and services are developed to address the issues raised by study participants. By understanding and responding to the situations, preferences and needs of unbanked and underbanked consumers as presented in this study, financial institutions, policymakers and community organizations can improve the financial outcomes of both this market segment as well as the banking sector itself.

The Federal Reserve Bank of Kansas City is using the findings of this research to assist its stakeholders in the banking, community development and government sectors to better understand and address the financial service needs of unbanked and underbanked individuals. Additional information about this research, the issues it addresses and its application is available by visiting <http://unbanked.kcfed.org> or contacting Tammy Edwards at [tammy.edwards@kc.frb.org](mailto:tammy.edwards@kc.frb.org) or 816-881-2123.

## ENDNOTES

<sup>1</sup>FDIC National Survey of Unbanked and Underbanked Households, 2009.

<sup>2</sup>For the purposes of this study, unbanked individuals are individuals who do not have a checking or savings account. Underbanked individuals have a checking or savings account at a bank or credit union, but use nonbanks for financial services such as check cashing, money orders, bill payment, remittances or borrowing. These definitions closely conform to those used in the FDIC National Survey of Unbanked and Underbanked Households, 2009.

<sup>3</sup>For survey data on the demographic characteristics of the unbanked and underbanked, see the FDIC National Survey of Unbanked and Underbanked Households at [www.economicinclusion.gov](http://www.economicinclusion.gov).

<sup>4</sup>A “tanda” is a form of informal savings pool operated by individuals with close cultural and social ties. Common in different forms throughout the world, immigrant communities often operate them within the United States.