

Understanding the unbanked:

Kansas City Fed listens to consumers through regional focus groups

Because she lives paycheck-to-paycheck most months, Destany, a 24-year-old resident of Omaha, Neb., considers budgeting for each month's expenses an essential part of tracking her finances.

But, a checking or savings account isn't a part of the newlywed's money management strategy. Instead, she pays for everything with cash or money orders.

"It's not a necessity of ours," Destany says of checking and savings accounts. On payday, she takes her check to a store to be split into money orders and cash, which she then delivers by hand to utility companies or other creditors

"We pretty much just get money orders,

and then we'll just go and pay them," Destany says. "(We) pay cash for the phone, utilities ... and things like that."

Anything left over after the bills are paid, which is often very little, is kept at home rather than in a savings account, she says. Destany's experience outside the traditional banking system is not uncommon, says Steven Shepelwich, a senior Community Affairs advisor at the Federal Reserve Bank of Kansas City's Oklahoma City office. Shepelwich and his colleagues recently conducted a qualitative study to examine the attitudes and strategies of the unbanked, those who do not use banks, and the underbanked, those who use banks minimally.

“Most consumers say they understand a bank account can help them reach goals like owning a home, buying a car or improving their credit,” Shepelwich says. “However, many choose not to use banks and turn to informal ways of handling their money, even if those methods are less secure and, often, more costly.”

Destany is one of several dozen people who shared their experiences in a series of focus groups the Kansas City Fed hosted last winter to better understand the attitudes and strategies of the Tenth Federal Reserve District’s unbanked population. The District includes western Missouri, Kansas, Colorado, Nebraska, Oklahoma, Wyoming and northern New Mexico.

“Unbanked and underbanked consumers are finding checking and savings accounts less relevant to their financial lives, but research shows that access to safe and affordable bank services is a key step in achieving personal financial stability,” said Tom Hoenig, president of the Federal Reserve Bank of Kansas City. “We hope this study will provide an understanding of these challenges and assist financial institutions, policymakers and community organizations in improving the outcomes for all involved.”

As a result of the focus groups, which involved small group interviews with 76 unbanked or underbanked individuals in Kansas City, Omaha, Denver and Oklahoma City, a clearer picture emerged of why some people decide to forgo a relationship with a bank, Shepelwich says.

“Throughout the focus groups, unbanked individuals described financial hopes and worries that are familiar to most people: the importance of saving, establishing a good credit history, managing their debt and sticking to a budget,” he says. “But, often low and unstable incomes and sometimes a lack of financial knowledge or understanding about banking become the largest barriers for the unbanked.”

Who are the unbanked?

Recent studies estimate that more than 30 million households in the United States—and

more than 2.3 million in the District—are unbanked or underbanked, meaning they rely on nonbank businesses for all or some of their financial service needs, such as check cashing, bill payment, remittances or borrowing.

The focus groups conducted by the Kansas City Fed’s Community and Public Affairs departments sought to uncover the reasons why the unbanked mistrust banks, how that mistrust developed over time and how these consumers manage their finances outside the traditional banking system.

“This information will help us better understand the needs of the unbanked consumer and how financial educators and institutions can better assist them in establishing financial security and stability,” says Tammy Edwards, assistant vice president of Community Affairs at the Kansas City Fed. “This study is just one way we support the Federal Reserve’s objectives of promoting community development and fair and impartial access to credit.”

The focus groups revealed that many unbanked consumers faced financial pressures



EACH DAY, AN ESTIMATED 2.3 MILLION HOUSEHOLDS across the region—more than one in four—go to payday lenders, check cashing outlets, convenience stores and other nonbank businesses to meet their financial service needs. A new study by the Kansas City Fed provides insight into why some consumers choose to manage their money outside the traditional banking system.

and other challenges that constrained their ability to use banks. For example, Shepelwich says, many participants lived paycheck-to-paycheck and had limited or unstable incomes.

“Because there was no money leftover at the end of the week, and there was no money to save, they didn’t see any benefit to opening a savings account,” he says. “In addition, limits on the availability of funds and minimum balance requirements also reduced the perceived usefulness of bank accounts.”

Past negative experiences with banks, confusion about bank products and services, and a strong need for physical control of money were also cited as reasons why the focus group participants did not use banks.

A participant from Denver who works part-time and receives disability benefits said a bad experience led him to now “do mainly everything with cash and money orders.”

“In the past, I had lots on credit cards and was in a lot of debt,” the man said. “Now, I pay cash for everything.”

Another participant said he stopped using banks after overdraft fees piled up.

Many of the participants noted the ease and convenience of being able to cash checks, pay bills and get money orders at the same place they shop. The participants said the simple and

transparent fees charged by retailers made them the preferred choice. Retailers are conveniently located and provide services at night and on Sundays.

The impact of family, culture

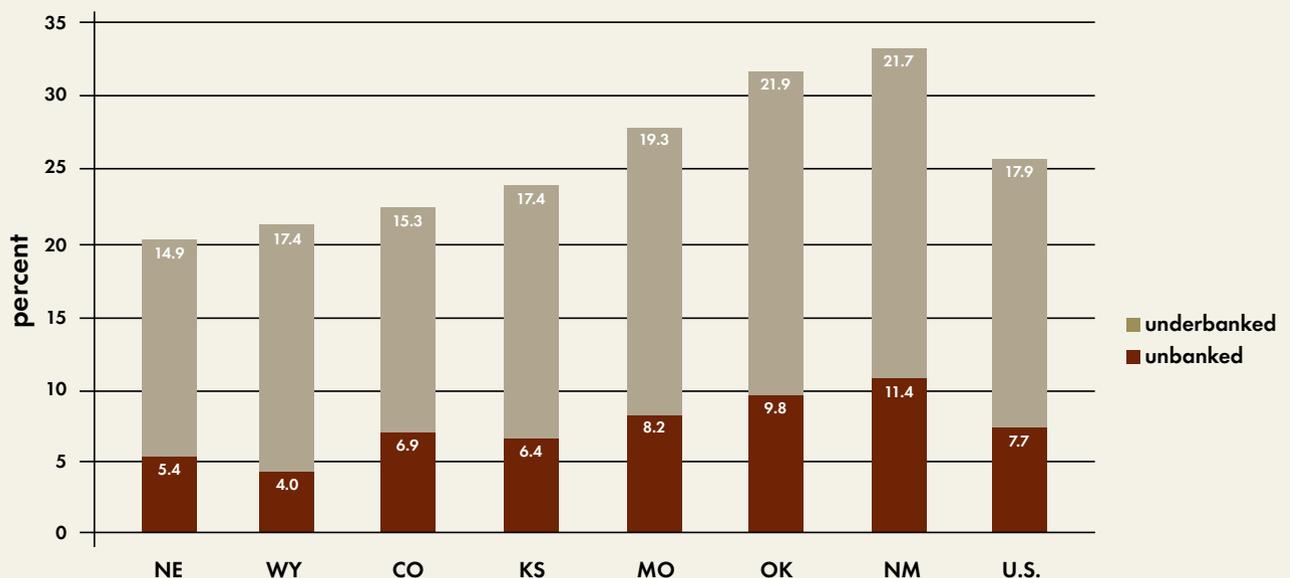
For many of the unbanked and underbanked surveyed by the Kansas City Fed, families and culture were among the strongest factors that led to their decisions to use alternative financial service providers rather than banks, Shepelwich says.

“Many participants in the focus groups said a family member had helped them open a bank account before they were ready to handle the responsibility of managing their money, which led to problems with their account and, eventually, the perception that banks were not necessarily useful for them,” he says.

A young mother who participated in the study said she started with a checking account her parents helped her open. However, she soon realized she was not ready to manage the account, and she could not keep track of her debit card transactions. Soon, her account was closed. The experience damaged her credit and, she says, has kept her out of the banking system.

Other participants noted family members’

The unbanked and underbanked population in the Tenth District



attitudes about banks played a pivotal role in their own feelings about financial institutions. Several said they remembered their parents keeping money in the house, either in a closet or in a box under a bed.

Cultural factors also played a large role in how some Hispanics perceived banks. Language barriers, identification requirements, and comments from friends and family about high fees and negative banking experiences were considerable obstacles for this segment of the unbanked population, Shepelwich says.

Also notable is the use of culturally derived money pools, known as “tandas,” which some Hispanics use as a way to save for larger purchases, such as a down payment for a car or house. A tanda starts with about a dozen people contributing to a pool of money every week or bi-weekly. The tanda organizer receives the amount of the pool in the first week. The contributors then decide among themselves or hold a raffle to determine the order of who receives the pool for the remaining weeks. The tandas are potentially risky, considering that the organizer or participants could leave after receiving their part of the pool.

Reaching the unbanked

In Fort Morgan, Colo., an agricultural community with a large migrant worker population, 60 percent of the adult population may be unbanked, according to some estimates.

John Sneed, president and CEO of Fort Morgan State Bank (FMSB), says the area’s immigrant population, made up of workers from Mexico, Puerto Rico, Somalia, Nigeria and other countries, is often distrustful of banks and the services they offer.

“Like many people all over the world, these workers rely on referrals,” Sneed says. “If someone in their family or friend circles likes the bank, then they will come and talk with us. If someone doesn’t like us, the worker won’t even look at you.

“We also have to educate them that banks in the United States are not like the banks in their home countries,” he adds. “Their money is guarded” by regulators.

Several years ago, FMSB began looking

at ways to better serve the area’s growing unbanked population. Soon, one of the area’s largest employers, Cargill, an international food producer, approached the bank seeking a partnership. A majority of the local plant’s employees were immigrants who did not use checking or savings accounts, and Cargill was looking for a way to promote direct deposit services.

In 2007, the bank opened a branch inside the Cargill plant that offered check cashing along with deposit services and a 24-hour ATM. During employee orientation meetings, Cargill explains the bank’s services, which include a free checking account, a complimentary box of checks, direct deposit and interest bonuses for savings accounts.

“Our biggest success has been educating our customers who have become financially independent and confident to open deposit accounts and get loans,” Sneed says. “The challenge has been to remain patient during this process. Because of the banking practices in many of their home countries, their trust in any bank is nonexistent.”

Education is the key to better reaching the unbanked, Shepelwich says.

“Through our focus groups, we learned that many unbanked individuals have a need for simple, affordable and easy-to-understand banking services,” Shepelwich says. “Combating the misperceptions and the knowledge barrier can go a long way in helping this group establish financial security.”



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FURTHER RESOURCES

The full report on the unbanked, an executive summary, summaries for financial institutions and financial educators, and other resources are available at unbanked.kcfed.org. A link to a recent quantitative study of the unbanked by the FDIC is also available.

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.