9 Banking the Poor: Policies to Bring Low- and Moderate-Income Households in the United States into the Financial Mainstream

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9.1 The “Unbanked” and the “Underbanked”

Twenty-two percent of low- and moderate-income American families - over 8.4 million families earning under $25,000 per year - do not have either a checking or savings account. Most of the unbanked are low- or moderate-income: 83% of the unbanked earn under $25,000 per year. Many of the “unbanked” as well as other households using alternative financial services - the “underbanked” - face high costs for basic financial services. I first explain the consequences of inadequate access to banking services. In § 9.2, I explore key barriers to banking the poor as well as nascent efforts to overcome these barriers. In § 9.3, I analyze changes in the electronic payment systems that hold out promise for banking the poor at lower cost and risk than in a checking account paradigm. In § 9.4, I propose fundamental reforms to transform financial services for the poor. I then conclude.

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9.1.1 The Alternative Financial Sector

In lieu of bank-based transaction, saving, and credit products, the unbanked and other low-income households often rely on the more costly alternative financial sector (AFS). AFS providers offer a wide range of services, including short-term loans, check cashing, bill payment, tax preparation and rent-to-own products, in low-income urban neighborhoods. These AFS providers are currently the only means available for many low-income persons to access basic financial services. Let me sketch, by way of example, three important AFS industries.

Check Cashers

For many years, check cashers have been used by low-income individuals to cash checks, pay bills and wire funds. John Caskey referred to these customers as employing the “cash and carry” method of financial management. Upon receiving a paycheck, they cash the check and pay their bills immediately. While check cashers offer essential services, the fees involved in converting paper checks into cash are high, relative to income, and relative to transactions middle and upper-income families use—depositing a check into a bank account, or electronic direct deposit.

Check cashing fees vary widely across the country and between types of checks, but typically range from 1.5% to 3.5% of face value. The industry reports that it processes 180 million checks totaling $55 billion annually, generating $1.5 billion in fees. Almost all of these checks are low-risk payroll (80%) or government benefit (16%) checks. While even payroll checks are not without some credit and fraud risk, average losses from “bad” checks at check cashing firms are low. For example, Ace Cash Express (ACE) reports that 0.5% of the face value of checks bounce, but net losses after collection are 0.2%. By comparison, 0.64% of the face value of interbank checks were returned in 2000.

Payday Lending

Payday lenders provide short-term (usually two-week) consumer loans to low- and moderate-income working people who have bank accounts but lack credit cards, have poor credit history, or are tapped out on credit

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