

Innovations in Personal Finance for the Unbanked:

Emerging Practices from the Field



I. Transactions and Basic Banking

Cash & Save, Union Bank of California

Bethex Federal Credit Union and RiteCheck Partnership

Florida Central Credit Union

Northeast Community Federal Credit Union

II. Access and Second-Chance Accounts

Extra Credit Savings Program—ShoreBank

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Stretch Loan, ASI Federal Credit Union

NorthSide Community Federal Credit Union: Hot Funds/Cold Cash



The American financial system—arguably among the most sophisticated and efficient in the world—facilitates savings and investment for millions of American families. In these households, each generation learns the habits of their parents and comfortably embraces banks, savings institutions, mortgage banks, credit unions, insurance companies, and other mainstream financial enterprises. These households graduate from simple savings and checking accounts to more sophisticated products, such as credit accounts, investments, and home mortgage loans. In this way, they create and build wealth to benefit their families and the next generation.

Millions of American households, however, rarely, if ever, use mainstream financial services. Vast segments of low-income, minority, and immigrant families have not yet been exposed to such wealth-building opportunities. Estimates of the “unbanked,” people without any banking relationship, range from 10 million to 22.2 million households, comprising 25 million to 56 million adults. According to the Federal Reserve, these households are disproportionately found among lower-income households, African-American and Hispanic households, households headed by young adults, and households that rent their homes.

These unbanked households, as well as a sizable portion of those in low-income neighborhoods with a bank account, operate in a cash economy and rely on a variety of high-cost financial services offered by check cashing outlets, payday and title lenders, pawnshops, rent-to-own stores, and other alternative providers. The dollars that flow through the alternative or fringe financial sector may top \$168 billion annually, with at least 280 million transactions, yielding \$5.4 billion in fees for the alternative service owners. While these alternative,

fringe financial service providers offer convenient services and easy access to cash, their services often come at a very high cost to low-income families.

Heavy reliance on these high-fee-for-service providers greatly limits a household’s ability to save and undermines its long-term financial prospects. According to some estimates, fringe services for cash conversion and bill paying alone can cost a \$20,000 income household between \$86 and \$500 a year, while the same services at a bank would cost only \$30 to \$60. Five hundred dollars per year saved for 10 years at an interest rate of only 4 percent would grow to more than \$6,000—an amount sufficient for a down payment on a modestly priced home. Moreover, because many of these households also resort to payday loans, pawnshops, and rent-to-own retail, the actual costs of using fringe financial services is likely even higher.

Enhancing basic financial service options for lower-income and minority households is a strategic priority for the Fannie Mae Foundation. If these households use less-expensive financial services, they can start saving and building assets in order to enjoy the same financial benefits, ultimately including homeownership, that millions of Americans currently enjoy. The Foundation views individual wealth building as critical to building economic vitality in distressed, underserved communities. As part of this commitment, the Fannie Mae Foundation brings together in this collection a number of emerging practices that connect unbanked, underserved low-income households in distressed, low-income communities to the financial mainstream. These practices use a variety of product mixes and innovative services to respond to the immediate and longer-term financial service needs of unbanked consumers. Furthermore, these practices

have the potential to increase the efficiency of financial markets in low-income and minority neighborhoods through increased competition and product innovation.

All of the personal financial case studies covered in this collection offer a low-cost account option at a depository, federally insured banking institution—the first step toward building savings and beginning longer-term wealth accumulation. These accounts are competitively priced (via use of partnerships, banking technologies, and networks), and make creative use of existing financial service delivery channels, including check-cashing outlets. Many of these practices combine delivery of financial services with the financial planning and financial education that are essential to the ability of this consumer segment to build/rebuild credit history and get on the path to savings and wealth building. While there is currently limited performance information on many of these practices—because they are new and their viability as sustainable (or profitable) businesses is subject to how they fare in the marketplace over the years—the practices do offer useful insights about approaches and strategies for product development as well as policy creation targeted to lower-income consumers.

The case studies are grouped under three major categories based on the primary products offered to low-income consumers:¹



I. Transactions and Basic Banking

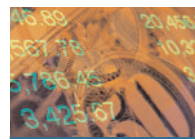
Case studies in this category include practices that provide transaction services similar to those offered by check-

cashing establishments to engage low-income consumers in a depository relationship. The practices offer check-cashing, money-wiring, and utility bill-payment services, along with ancillary services (such as paid phone cards, photocopying, and metro cards) that are often offered by check-cashing establishments.



II. Access and Second-Chance Accounts

Case studies in this category primarily focus on issues of inadequate income and poor account management histories that keep low-income consumers from using the financial mainstream. These practices help consumers take advantage of their Earned Income Tax Credit returns to start a savings account, receive financial education to rebuild their damaged credit history, and get payroll debit cards that eliminate the need for cashing payroll checks.



III. Alternative Payday Lending and Basic Banking

The practices in this category provide alternatives to high-cost payday loans in the organizations' communities and help financially vulnerable households avoid getting into a vicious debt cycle. To engage low-income consumers in a depository relationship, they offer low-cost, short-term personal loans with the same features as payday loans.

The Fannie Mae Foundation hopes that the information in these case studies will inform the industry's efforts to

¹ The case studies featured in this collection partly draw from materials generated under two research projects sponsored by the Fannie Mae Foundation: (1) "Expanding the Reach of Mainstream Financial Markets to Distressed Communities," by the National Community Investment Fund, 2002; and (2) "Financial Innovations Roundtable," by Southern New Hampshire University.

design more appropriate products and more effective delivery channels and will contribute to improving access to wealth-building opportunities in underserved,

distressed communities. The Foundation seeks to stimulate new ideas about meeting the financial service needs of low-income, low-wealth households and communities.



Case Studies

The following is a brief summary of the practices featured in this collection of personal finance case studies. For each case study, there is a short stand-alone summary that provides basic information about the practice and highlights its unique product features and partnerships. Following this summary, each case study provides a brief history and background about the organizations offering the practice; the business model; products and pricing; consumer segment served; technology; distribution channels; and the education, outreach, and marketing components.

I. Transactions and Basic Banking

▼ *Cash & Save, Union Bank of California (UBOC).* Cash & Save in Southern California is a hybrid check-cashing and transitional network of bank branches to help low- to moderate-income check-cashing customers make the transition to traditional banking services. It offers a full range of check-cashing services, including payroll and government check cashing (without requiring a UBOC bank account); transitional banking services; and full-service banking products, deposits, and mortgages. In 2000, Union Bank of California bought a 60 percent stake in Nix Check Cashing and created the Nix Alliance. As of May 2002, 20 Nix outlets offer Cash & Save transitional banking services through this alliance.

▼ *Bethex Federal Credit Union and RiteCheck Partnership.*

This partnership combines traditional banking services offered by Bethex with check-cashing, money-wiring, and utility bill-payment services offered by RiteCheck, a large check-cashing outlet in New York. The partnership helps the institutions offer a spectrum of transaction, deposit, and credit products that otherwise would not have been possible. RiteCheck provides Bethex customers free check-cashing services on Bethex-issued checks (Bethex picks up the fee for these services) and reduced rates on non-Bethex checks. Meanwhile, RiteCheck benefits from increased business brought by Bethex customers and gets to offer depository services to its customers, thus enhancing its image in the community.

▼ *Florida Central Credit Union (FCCU).* FCCU provides low-cost mainstream alternatives to fringe financial services that operate in the Hillsborough neighborhood of Tampa, FL, including affordable alternatives to check cashing and payday lending. By paying a small membership fee, FCCU customers gain access to such banking services as savings and checking accounts and financial counseling. The two FCCU branches in the Hillsborough neighborhood give low-income individuals a chance to use lower-cost versions of the products that they are familiar with, such as check cashing, while increasing their exposure to



bank accounts and help in saving money for investment and future needs.

▼ *Northeast Community Federal Credit Union (NCFCU)*. At a branch in the Tenderloin neighborhood of San Francisco, NCFCU offers “lifeline” financial services to low-income, immigrant, and homeless populations. Member services include saving accounts, limited check cashing, direct deposits, money orders, and “Grace Loan,” a payday loan alternative. NCFCU serves the community by providing an alternative to fringe financial providers, thus helping members begin to build wealth. Providing financial education and one-on-one financial counseling to its members is an important component of NCFCU’s business model. NCFCU has greatly benefited from the backing of its local community partners, including community-based organizations, credit unions, banks, and local businesses.

II. Access and Second-Chance Accounts

▼ *Extra Credit Savings Program, ShoreBank (ECSP)*. ECSP is a partnership between ShoreBank and the Center for Economic Progress (formerly Center for Law and Human Services) in Chicago. The ECSP reaches out to people who are eligible to receive the federal Earned Income Tax Credit and provides them with free tax preparation services. When they come to get their taxes done, they are offered free financial education and encouraged to open a bank account in which their tax credit can be deposited directly. Now in its fourth year, ECSP has led to the opening of about 500 accounts. The program has had a clear effect on the financial habits of participants in terms of how they handle money and how they think about their financial future.

▼ *Directo Program*. Directo, an Atlanta-based financial technology company, offers a payroll-based debit card called DirectoCard (or DirectoCash), a convenient, secure, low-cost alternative to a traditional checking account. The customer gets the card through an employer and a participating bank. Directo works with the bank to open the demand deposit account for the cardholder/customer. Employee compensation is directly deposited into an electronic bank account. Funds can be withdrawn at any ATM, and purchases, often with a cash-back option, are available at point-of-sale terminals. The DirectoCard holder can get additional cards and use them to transfer funds to as many as 10 family members or significant others anywhere in the world at a fraction of the cost of a regular money transfer. This is an especially important benefit to immigrant workers, who frequently send money to relatives in their native countries.

▼ *Get Checking*. Get Checking is an innovative partnership that uses financial education to give unbanked individuals with past financial difficulties a chance to reenter the financial mainstream. The program provides an introduction to banking and practical money management skills. People who successfully complete the program can open a qualifying checking or saving account at participating financial institutions in more than 30 communities in 11 states where the program currently operates. Get Checking was jointly developed by eFunds Corporation, Consumer Credit Counseling Services of Milwaukee, the University of Wisconsin Extension, and the University of Wisconsin–Milwaukee School of Continuing Education.

▼ *Compass Center*. The Compass Center, a nonprofit homeless service provider in Seattle, offers basic banking services to homeless people free of charge or at

nominal cost. Individuals can have their Federal entitlement payments electronically deposited to their bank accounts and maintain bank accounts for savings and safekeeping of cash. Representative Payee Services are also available for those who are disabled, receive government payments, and require a third party to administer their finances. The Commerce Bank of Washington plays a crucial role in helping the Center with its banking services to homeless clients. It maintains a master account for the Center that is used for making credits and debits to its individual client accounts. Several other local banks (including Key Bank) and other community partnerships support Compass Center operations.

III. Alternative Payday Lending and Basic Banking

▼ *Stretch Loan, ASI Federal Credit Union.* Stretch Loan is a revolving line of credit offering Southern Louisiana's ASI credit union members from \$200 to \$500, a small cushion to tide them over until their next paycheck. With an annual interest rate of 12 percent and a weekly fee of \$3, Stretch Loan is an attractive low-cost alternative to local payday loans whose annualized

percentage rates can rise to several hundred percentage points and trap households in a vicious cycle of debt through rollovers. ASI positions the Stretch Loan as an entry into longer-term asset building and financial self-sufficiency for its members. To this end, ASI offers one-on-one counseling and seminars on personal finance management.

▼ *NorthSide Community Federal Credit Union (NorthSide): Hot Funds/Cold Cash.* In Chicago, NorthSide's Hot Funds/Cold Cash loan serves as a low-cost alternative to payday loans for its members. Designed as a small consumer loan with an interest rate of 16.5 percent and an initial \$10 loan fee, the program offers credit up to \$500 repaid with equal monthly payments over a six-month term. Unlike payday loans, Hot Funds/Cold Cash loans cannot be rolled over and can be repaid with partial payments. In April 2002, Northside started offering a modified version of Hot Funds/Cold Cash called Payday Alternative Loan (PAL). PAL allows borrowers to take a second loan if the outstanding loan amount does not exceed \$500 and the balance on the first loan is \$250 or less.

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