

UNCHARTED TERRITORY

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What is the biggest untapped market opportunity for U.S. banks? It is the unbanked and underbanked. Alternative financial services providers understand these customers hold different needs, unique preferences, and have created solutions to fill this void.

An unbanked household has no checking or savings account, while an underbanked household has a checking or savings account and also uses alternative financial services (AFS). AFS includes non-bank money orders, non-bank check-cashing services, pay day loans, rent-to-own agreements, pawn shops, and refund anticipation loans.

With an estimated 9 million unbanked and another 21 million underbanked U.S. households the opportunity is significant. Put another way, it is 25% of U.S. households. In terms of people, this figure represents approximately 60 million potential adult customers.



Another study conducted by the Center for Financial Services Innovation (CFSI) identified the underbanked and unbanked population to be 40 million households (106 million individuals).

In addition to these staggering statistics, a recent study by BearingPoint and Visa indicated that there are an additional 11 million unregistered immigrants that are unbanked. The average income for the underserved household is \$27,500, and the combined income for unbanked and underbanked households may be \$1.1 trillion. Furthermore, it is estimated that unbanked consumers spend between \$300 - \$400 per year in fees such as check cashing and money orders.

The unbanked and underbanked households also vary across regions, with the highest occurrence in the Southern Region.

Other Unbanked Findings:

<<< Unmarried households are three to five times as likely to be unbanked compared to married couple family households.

<<< Seventy-one percent of unbanked households have household earnings of less than \$30,000.

<<< Proportion of unbanked households decreases as age and education increases.

<<< Most common reason for not having a banking account is: “not hav-

Other Underbanked Findings:

<<< Unmarried households are about twice as likely to be unbanked compared to married couple family households.

<<< Proportion of underbanked households decreases as age increases and often includes both lower-income (below \$30,000) and middle-income households (\$30,000 - \$50,000).

<<< Most common products used are non-bank money orders (81%) and check-cashing services (30%).

<<< Many underbanked households seek credit services from payday lenders or pawn shops rather than banks. The primary reason is convenience or easier to qualify for a loan.

<<< Sixteen percent of underbanked households have used a prepaid card, while 4% receive income through a payroll card.

A variety of products and services are currently offered by non-bank alternative financial services providers. Many banks already have the capability to offer these same products, but may need to adjust their marketing and promotion to address the specific concerns and needs of the unbanked and underbanked. Additionally, partnering with third-party providers may assist in developing a comprehensive solution to specifically meet the needs of these segments.

While most banks allow customers to

tial customers may be helpful in building long-term relationships, as well as seeking out potential cross-sell opportunities. This process must be carefully designed to comply with the Know Your Customer regulations.

The prepaid debit card market has exploded in recent years. From 2006 to 2009, the number of transactions increased from 3.3 billion to 6.0 billion which is a 21% compound annual growth rate. This growth rate exceeds Automated Clearing House (ACH), credit card, and debit card transaction growth.

There are one-time use and reloadable debit cards. Some cards are tied to a specific retailer or purpose, while others are general purpose cards. Consumers have indicated these cards are safer than using cash and offer convenience and ability to purchase products via multiple channels (phone, internet, etc.). An innovative service in prepaid cards allows linkage with traditional online billpay services. Another best practice in reloadable functions is a service such as eBillme to request third party payment or deposit of funds via e-mail.

Given the impact of the Durbin amendment to the Dodd-Frank financial reform bill, banks will need to find new ways to replace traditional debit card transaction revenue. By leveraging a general purpose reloadable debit card, banks can serve the needs of customers who do not qualify or simply do not want a credit card or traditional debit card tied to a bank account. Banks can receive a revenue stream through fees generated on initial card sales, reloads, and interchange fees. By leveraging a reloadable card, the bank may also be able to generate loyalty over time that results in additional bank products and services sold within the relationship.

Money transfer services such as Money Gram and Western Union are in high demand for the underbanked and unbanked population. Banks may be able to displace these payments with traditional bank products or share in the revenue via a partnership agreement. Opening up the branch as a convenient avenue for money

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ing enough money to feel they need an account.”

<<< The unbanked households are split between households that previously banked and those that have never had a bank account.

<<< When asked about opening a bank account in the future, nearly 50% of unbanked households indicated “not likely at all.”

cash checks or process “on us” checks, non-customers are generally turned away. These underbanked and unbanked individuals often use a check cashing service where they pay a fee to access these funds.

Banks can capture a portion of this market by developing a process for allowing non-customers to cash checks. Face-to-face interaction with these poten-

transfer services may also allow for the potential to cross-sell other bank products and services.

Bill payment is a common need. Banks can offer their existing bill payment platform as well as partnering with next-day and same day payment solutions to meet specific customer demands. Bundling of products and services may assist in establishing attractive price points for customers that yield desirable margins for the bank.

Another opportunity for banks is to bundle existing products and services to create a value proposition specifically for the underbanked and unbanked population. For example, banks that have debit cards and online bill payment may wish to bundle these products in a “check-less account” to specifically serve this new market segment.

Limits can be applied to overdraft capabilities and banks can require electronic statements to keep ongoing account maintenance cost low. Thinking creatively and using existing components can decrease time to market and leverage fixed costs across more customers. Banks who are creative, innovative, and focus on meeting the needs of the underbanked and unbanked can generate incremental revenue and profits.

There is a misconception that all underbanked and unbanked consumers have either no credit file or a poor credit ranking. While this may be true for the majority of this population, a 2008 study by the Center for Financial Services Innovation indicated that one-quarter of underbanked consumers had a prime credit score.

These are potential borrowers who would typically qualify for existing bank lending products. With a communication and marketing strategy, banks can reach

out to this population right now.

In addition to the opportunity for the prime credit borrowers, there is also the largest portion of consumers (42%) that have thin or no credit file. These are potential borrowers who simply do not have a credit history or perhaps a very “thin file” with limited information. Because they cannot qualify for traditional bank lending products these individuals often turn to high interest, short-term loans from payday lenders.

To address this issue, many industry vendors have begun developing alternative credit data and scoring methods. These alternative credit reports provide payment history for non-credit bureau payments such as rent, utility bills, and payday loans.

With an alternative credit score banks can have the information they need to make credit decisions without a traditional credit history. The customer will generally receive longer terms and lower interest rates and fees than with alternative financial services, while banks will benefit by attracting new profitable customers.

For the subprime credit borrowers, bank may wish to consider a second-look program or pass-through partnership to a third-party provider. There are often lenders willing to make loans to a wider range of borrowers. If the bank can “say yes” to the immediate lending needs then perhaps a long term relationship can be established that will lead to future products and services.

Of course, discretion should be used when evaluating the merits of a subprime credit program especially given the tremendous meltdown in the real estate lending market over the past 3-4 years. The bottom-line is these borrowers need

money and banks can generally benefit by meeting this demand.

Often it seems banks only want to lend to the super-high credit quality borrowers. With everyone competing for this same small niche, why wouldn't a bank at least attempt to serve a portion of these underserved customers?

Building a risk-adverse process designed to build value for the individuals and the bank is a win-win scenario.

The underbanked and unbanked typically lack savings that would be needed in the event of an emergency. The top goals for savings include:

- <<<< An emergency (70%)
- <<<< Retirement (65%)
- <<<< Sending Children to College (49%)
- <<<< Buy a Home (38%)
- <<<< Buy a New Car (34%)

The most common reason referenced for not having a banking account is: “not having enough money to feel they need an account.” So how do banks bridge the gap and help give these customers a positive start in savings and wealth building?

Lack of savings creates stress, worry, and prevents the independence that can be generated through self-reliance. Lack of savings may also increase dependence on government-paid health-care, welfare, and retirement. Savings can help individuals to self-liberate, build self-confidence, and become truly self-sufficient.

The first step with savings is consumer education specifically for the underbanked and unbanked population. Literature may explain why savings is important and provide an avenue for starting to save. However, this is only applicable if the material is actually distributed to target market. Consider the reasons for saving and offer solutions that fit those specific needs such as education savings, retirement savings, and emergency savings.

Bank savings accounts for this target group should have no fees and low minimum balance requirements. Statements can be sent via e-mail or online to keep bank costs low. The savings account can be the beginning of a long-term mutually

ABOUT THE AUTHOR

Brian King is President at Wisemar, Inc. Prior to joining Wisemar, King was Senior Vice President at BenchMark Consulting International. King's previous roles also include senior executive roles for two national vendors, senior vice president at Wells Fargo Bank, and product development, marketing, and strategic planning roles within Bank of America.



beneficial relationship between the bank and the saver. This should be viewed as the beginning of a partnership where the bank is helping solve real-life consumer problems and building dreams.

Another option for banks is to leverage existing programs for the underserved. Many banks already participate in the national government program, Assets for Independence. This initiative provides matched savings opportunities via Individual Development Accounts that are targeted to provide a “hand-up” out of poverty to low-income families. While not applicable to all underbanked and unbanked households, this is a program that can offer matching funds based on each dollar contributed (from \$1 - \$8 based on federal and nonfederal funds).

Underbanked and unbanked house-

holds differ in many ways. These two groups should be viewed as similar, but different when planning for customer education, marketing, and acquisition strategies. Given the significant proportion of the U.S. population within these categories, banks who do not take action to serve these individuals will continue to be displaced by alternative financial service (AFS) providers of services such as prepaid cards, check cashing, and remittance payments.

Many banks generalize the unbanked and underbanked segment as higher risk. With lower incomes and lower credit scores, perhaps these households are not as attractive as the mass market or the mass affluent. However, there are a large number of unbanked and underbanked that need traditional bank products. In fact, a portion of these individuals already

qualify for existing bank products and services. Additionally, new services and products can be developed to specifically target the unmet needs of this unbanked and underbanked segment.

Banks may be well-served to find innovative and creative approaches to expand their offerings to cater to this untapped market. Ultimately it is a win-win. For the customer, bank products can provide lower transaction fees, lower loan interest rates, and higher deposit savings rates than AFS. For the bank the benefits include more profit and the ability to spread fixed costs over a larger customer base.

As you consider your organization, think of how you can meet the needs of the unbanked and underbanked and build solutions or partner with existing providers to generate more customers. ❖

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