

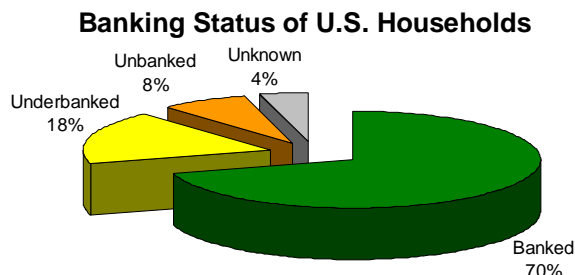
The Unbanked and Underbanked Opportunity

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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.¹



Source: FDIC

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).²

¹ "FDIC National Survey of Unbanked and Underbanked Households," December 2009. www.fdic.gov.

² The CFSI Underbanked Consumer Study, June 8, 2008. The Center for Financial Services Innovation, www.cfsinnovation.com.

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.³

Key topics to be covered in this document include:

- Why are Households Unbanked
- Demographics
- Payment Opportunities
- Lending Opportunities
- Savings Opportunities

Why Are Households Unbanked

The number one reason indicated in the recent Federal Deposit Insurance Corporation (FDIC) survey for being unbanked was "do not have enough money to need account." The second highest reason was "did not need or want an account/do not see value of account." There are also a variety of other reasons including high service charges, limited check writing, high minimum balance requirements, and "do not trust banks."

The study also separated unbanked households that had previously banked from those who had never banked. For individuals who no longer have a banking relationship, the account may have been closed by bank or by consumer. For those

³ Ramsey, Tim. "Study on the United States Underserved Banking Market," 2006 Prepaid Card Expo.

who never banked, two factors with significantly higher representation were “there are language barriers at banks” and “banks do not feel comfortable or welcoming.”

Some conclusions provided as part of the study indicated:

- While most banks are aware of the underbanked and unbanked opportunity in their market areas, few have made it a priority.
- Many banks offer some type of financial education materials, but few participate in outreach efforts that are effective at attracting and maintaining underbanked and unbanked individuals as long-term customers.
- Most banks offer a basic checking account, but few offer services such as deposit, payment, credit, and electronically based products specifically focused on the unique needs of the underbanked and unbanked population.
- Banks are concerned about potential regulatory issues related to anti-money laundering and have continued concern about the profitability of the underbanked and unbanked individuals.⁴



A similar study by CFSI indicated paying bills is the top reason for having a checking account. However, cash is still the most common method of payment for bills by underbanked consumers. The top reason for not having a bank account was the perception of “not having enough money to make the account useful.”

⁴ “FDIC National Survey of Unbanked and Underbanked Households,” December 2009. www.fdic.gov.

For underbanked customers, the top three reasons for financial outlet satisfaction provided were:

- It doesn’t take a lot of time (28%)
- The people who work there are always helpful (26%)
- I am treated with respect (22%)

For underbanked customers, the top three reasons for financial outlet dissatisfaction provided were:

- The fees are too high (35%)
- Making transactions takes too long (13%)
- I’m never sure how to do what I need to do (10%)⁵

Demographics

Research indicates that demographics for underbanked households vary widely based upon racial and ethnic minorities. For example, a 2009 FDIC study found minority and lower-income populations represent a disproportional representation of the unbanked and underbanked population.

The probability by ethnicity for unbanked households is 21% for blacks, 19% for Hispanic, and 15% for American Indian/Alaskans. By contrast, the ratios were 3% for Asians and 3% for whites.

For underbanked households, the probability by ethnicity is 31% for blacks, 28% for American Indian/Alaskans, and 24% for Hispanic. The ratios were 7% for Asians and 14% for whites.

The FDIC study found “overall, almost 54 percent of black households, 44.5% of American Indian/Alaskan households, and 43.3 percent of Hispanic households are either unbanked or underbanked.”

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

⁵ The CFSI Underbanked Consumer Study, June 8, 2008. The Center for Financial Services Innovation, www.cfsinnovation.com.

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 having 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.”

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.⁶

Payment Opportunities

A variety of products and services are currently offered by non-bank alternative financial services

⁶ “FDIC National Survey of Unbanked and Underbanked Households,” December 2009. www.fdic.gov.

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.



Check Cashing Service

While most banks allow customers to 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 potential 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.

Prepaid Debit Cards

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.⁷

⁷ The 2010 Federal Reserve Payments Study: Noncash Payments Trends in the United States: 2006-2009.

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.

Remittance and Bill Payments

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 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.

Bundled Solutions

Another opportunity for banks is to bundle existing products and services to create a value

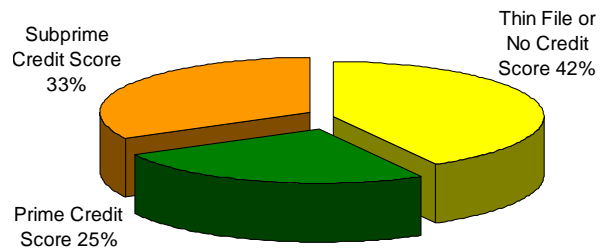
proposition specifically for the underbanked and unbanked population. For example, banks that have debit cards and online bill payment may wish to bundle these products in a “check-less account” to specifically serve this new market segment.

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.

Lending Opportunities

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.

Underbanked Consumer Credit



Source: Center for Financial Services Innovation

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.⁸

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?

⁸ The Center for Financial Services Innovation, www.cfsinnovation.com.

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

Savings Opportunities

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%)⁹

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 beneficial relationship between the bank and the saver. This should be viewed as the

⁹ The Center for Financial Services Innovation, www.cfsinnovation.com.

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).¹⁰

Conclusion

Underbanked and unbanked households 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.

¹⁰ Assets for Independence Program Summary. www.acf.hhs.gov.

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, more revenue, and a higher degree of customer satisfaction.

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Wisemar is a management consulting firm providing dynamic solutions for the alignment of people, processes, products, and technology. The firm specializes in helping financial services clients through business process improvement, change management, and corporate strategy engagements. Wisemar was founded based on one simple principle – “client satisfaction.”

Wisemar leverages experienced senior consultants with a structured engagement process to deliver consistent positive results for clients. Wisemar executives and consultants have worked with the majority of the top 50 US banks; regional, community, and direct banks; and many of the top vendors and partners in the financial services space. This diverse experience helps provide the framework necessary to deliver innovative best practices to clients to help them improve performance. Wisemar is headquartered in Charlotte, NC.

For more information, please visit www.wisemar.com or contact us at 704-503-6008.