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**Banking Practices and Needs of the Low Income Population of
Southwest Virginia**

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Abstract

Southwest Virginia has fallen behind the rest of the Commonwealth in almost every area of economic and social development. Unemployment is higher, educational attainment is lower, and a considerable portion of the population is completely out of the workforce (Weldon Cooper Center for Public Service, 2011). Research conducted by the FDIC and the Center for Financial Services Innovation (CFSI) indicates households that meet these criteria are likely unbanked or underbanked¹.

High quality banking services are an important component to economic development. Banking services can lead to increased savings and investment in income generating assets such as tools and education. Access to credit can also provide much needed income smoothing in times of emergency. Unfortunately, for a variety of reasons, many households in Southwest Virginia either do not have access to high quality financial services or do not use them.

Many households instead rely on low quality alternative financial services (AFS) such as payday lending, title loans, pawnshops and check cashing services. Use of low quality AFS often lead to unhealthy cycles of debt and unnecessary loss of income to exorbitant interest rates as high as 400% APR (Center For Responsible Lending, 2009). Also, low quality AFS do not offer avenues for building credit and savings and often have unclear terms.

This research shows a potential market exists in Southwest Virginia for high quality financial services tailored specifically for low to moderate-income households. This research also offers some recommendations for how this demand can be satisfied in a sustainable and profitable manner.

The problems Southwest Virginians face cannot be solved by any one economic development initiative. Poverty is a persistent problem that has no easy solution, but access to high quality financial services is one of many possible tools that can be used in mitigating some of the challenges that face this region.

KEY FINDINGS
65,400 (26%) of Southwest Virginia households are unbanked/underbanked.
An estimated 47,700 (73%) of unbanked/underbanked Southwest Virginia households use low quality alternative financial services.
Fees paid to access alternative financial products in 2011 amounted to \$17 billion

¹ Unbanked households are classified as having no checking or savings account. Underbanked households have a bank account, but rely on low quality AFS such as payday loans, title loans, pawnshops and check cashing services.

Low Levels of Income and Education in Southwest Virginia

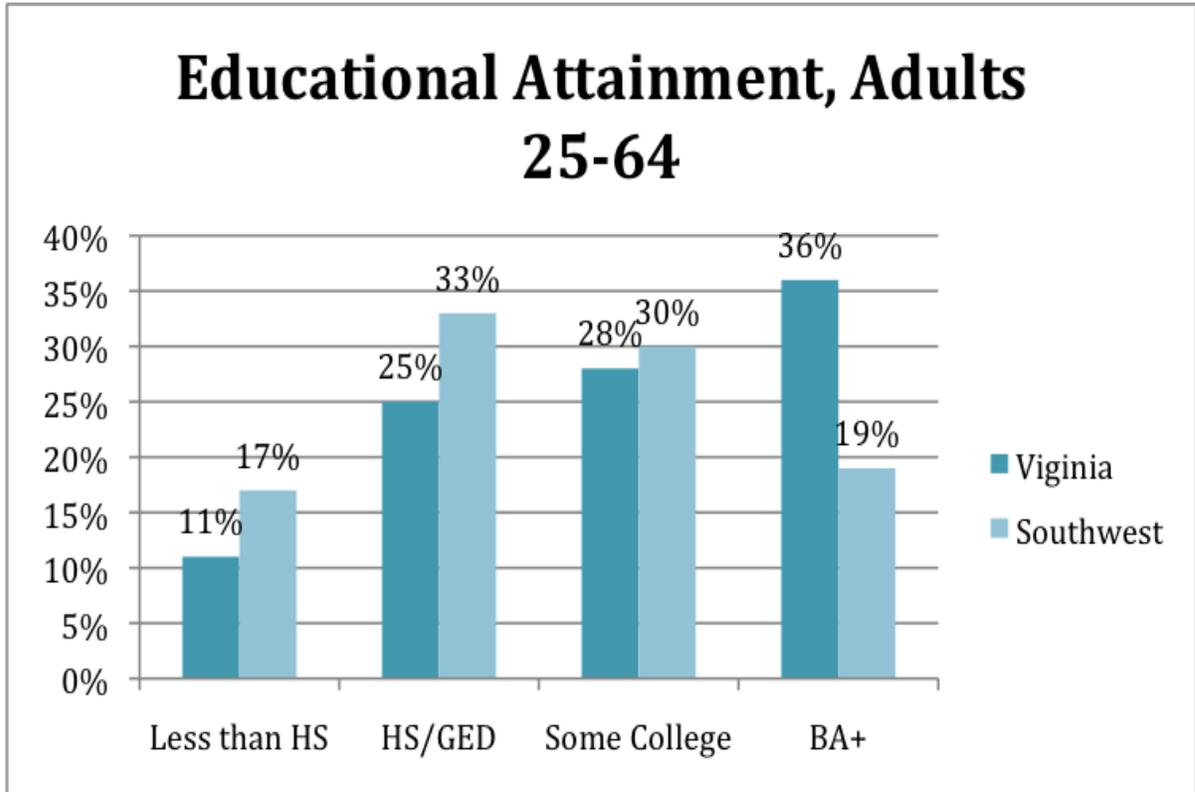
Approximately 252,000 households currently live in Southwest Virginia (including Bland, Buchanan, Carroll, Craig, Dickenson, Floyd, Giles, Grayson, Lee, Montgomery, Pulaski, Russell, Roanoke, Scott, Smyth, Tazewell, Washington, Wise, and Wythe counties) (U.S. Census, 2012). More than 33% of Southwest Virginia households earn less than \$25,000 per year and 19% of households are below the federal poverty line. 32% of Southwest Virginia households do not have adequate income to meet regular expenditures such as housing, food, and transportation without help from government programs, family and friends, or local organizations (Weldon Cooper Center, 2011).

TABLE 1.

Southwest Virginian Households		
Total Households	252,180	100%
Less than \$25,000/ year	84,060	33%
Below poverty line	47,914	19%
Inadequate income	80,698	32%

Not only are there a high percentage of households below the poverty line in Southwest Virginia, but also systemically low levels of academic achievement. Southwest Virginia trails behind the rest of Virginia in almost every area of educational attainment. The percentage of the adult population with a bachelor's degree or higher is only 19% (Weldon Cooper Center, 2011).

FIGURE 1.

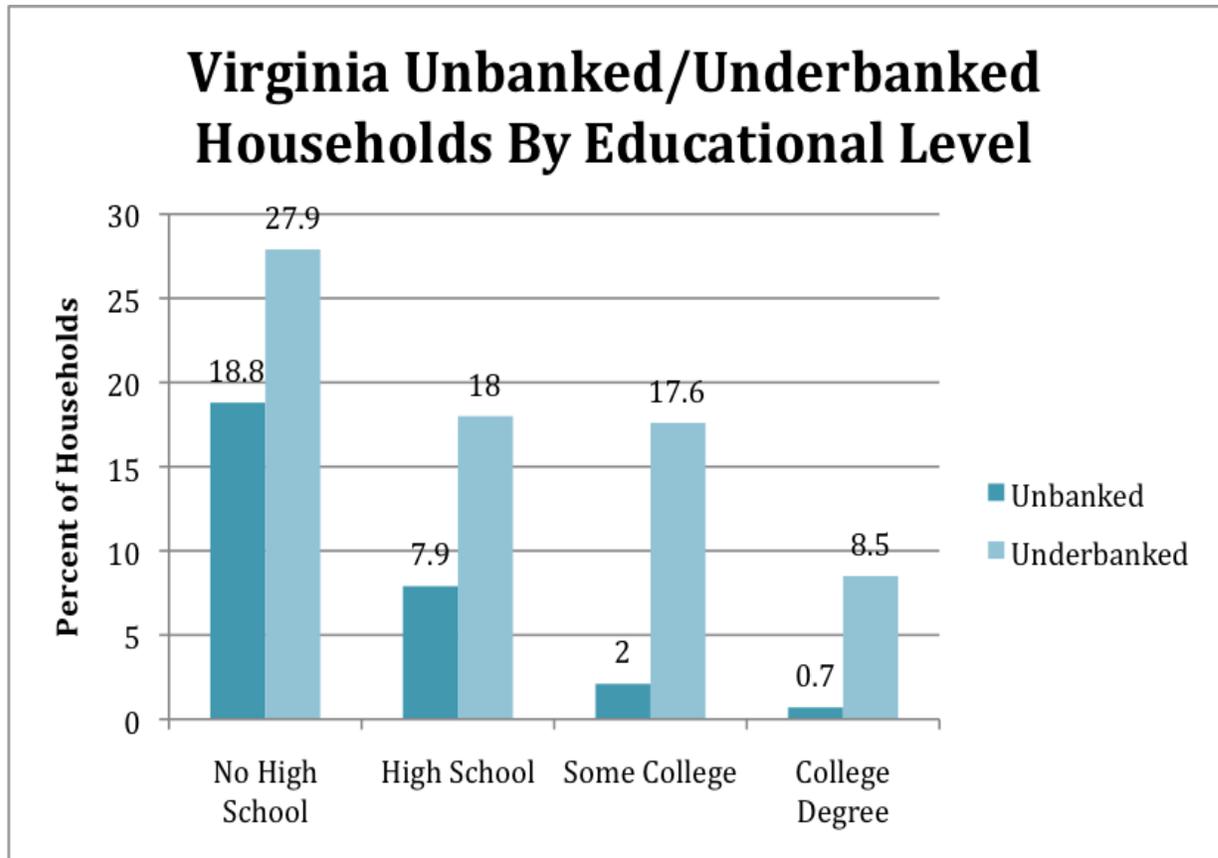


Weldon Cooper Center (2011)

Income, Education, and the Unbanked/Underbanked

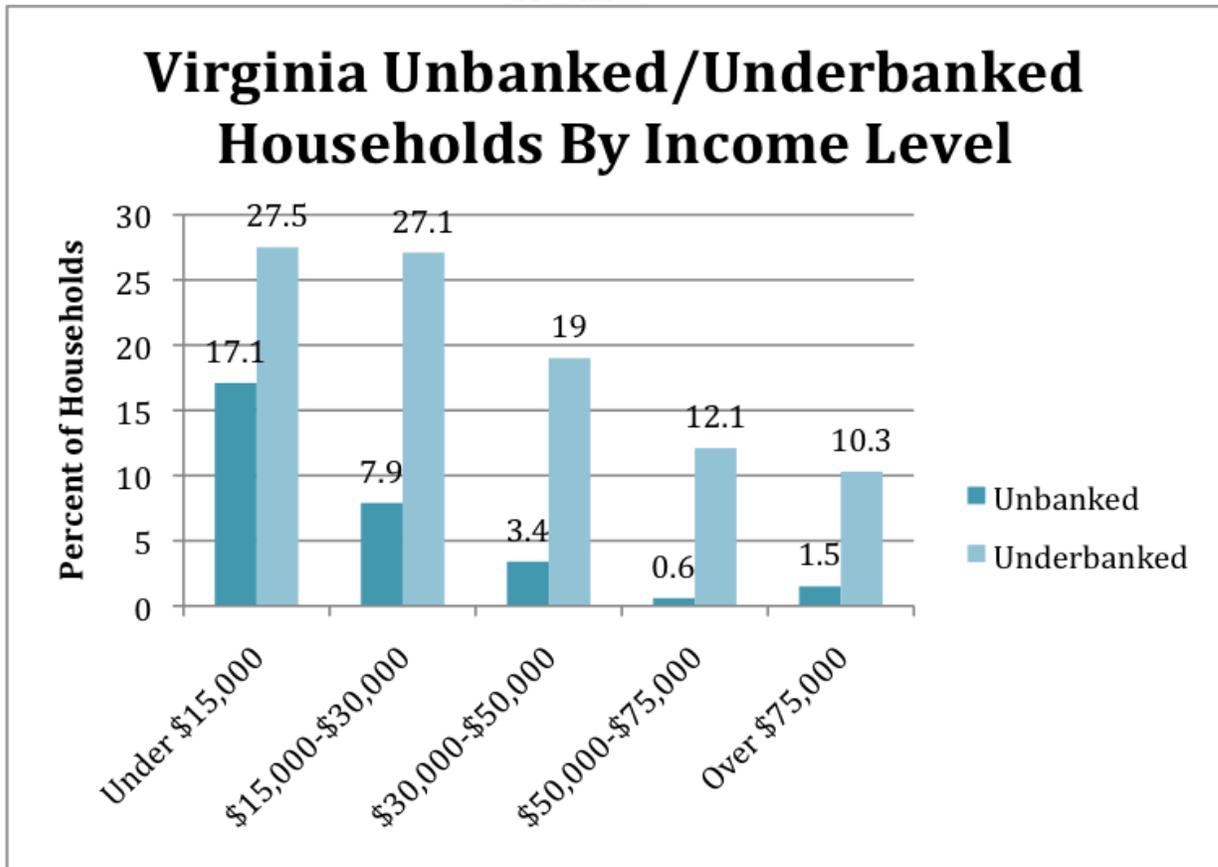
In 2009, the FDIC collected data on households classified as unbanked or underbanked. The results of their survey suggest that as income levels decrease, the probability of an individual having unbanked or underbanked status increases. The same pattern also exists for education attainment—as education levels decrease, the likelihood of being unbanked or underbanked increases (FDIC Economic Inclusion, 2011).

FIGURE 2



FDIC Economic Inclusion (2011)

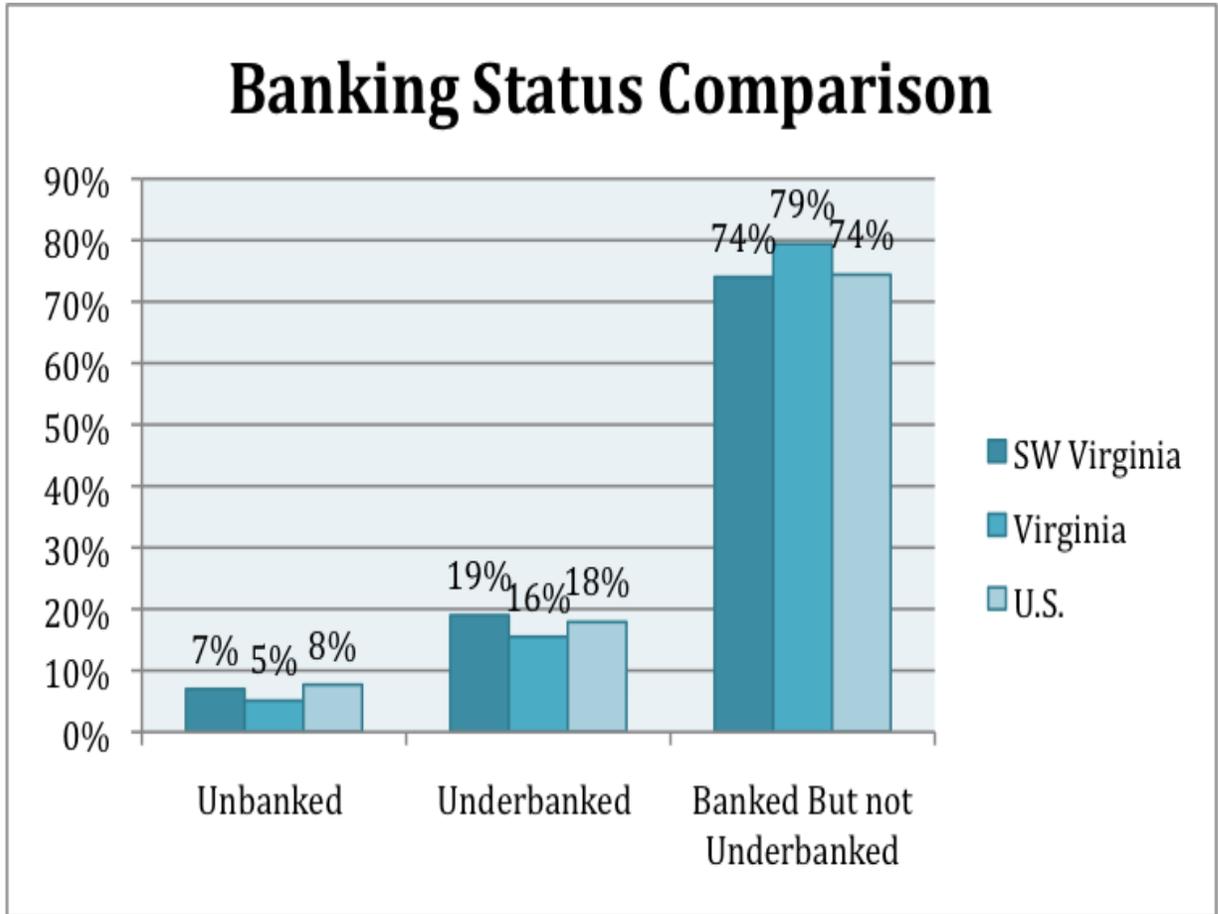
FIGURE 3.



FDIC Economic Inclusion (2011)

The FDIC report also shows an estimated 7% of Southwest Virginia households (approximately 18,800) are unbanked. These households do not have a checking or savings account. The FDIC also found an estimated 19% of Southwest Virginia households (roughly 46,700) are underbanked (Bank On, 2011). These households have a checking or savings account, but rely on low quality AFS. Specifically, underbanked households have used “non-bank money orders, non-bank check-cashing services, payday loans, rent-to-own agreements, or pawnshops at least once or twice a year or refund anticipation loans at least once in the past five years” (FDIC, 2012). The same FDIC data shows Southwest Virginia has a higher percentage of unbanked households than the rest of Virginia and a higher percent of underbanked households than the rest of Virginia and the United States.

FIGURE 4.



The Unbanked/Underbanked and Low Quality Alternative Financial Services

The FDIC's research shows 100% of underbanked Virginia households have used low quality alternative financial services (AFS) and 61.8% of unbanked households have used low quality AFS. The FDIC also found 44.3% of AFS users do not have a high school degree, 34.2% have only a high school degree, and 32.5% of ASF users have only some college education. Also, the majority of AFS users are White non-Black non-Hispanic. It should be noted, however, as a percentage of race/ethnicity, Blacks have the highest percentage of AFS use (46.1%), followed by Hispanic non-Blacks (45.6%). According to the FDIC's research, 48% of households that earn \$30,000 or less use AFS and 30.7% of households that earn between \$30,000 and \$50,000 use AFS.

TABLE 2.

VA Household Characteristics	All VA Households		Used AFS		
	Number (1000)	% of row total	Number (1000)	% of row total	% of All Households
All Households	2,996	100.0%	NA	NA	NA
Banking Status					
Underbanked	464	15.5%	464	100.0%	15.49%
Unbanked	153	5.1%	95	61.8%	3.17%
Not Unbanked	2,252	75.2%	368	16.4%	12.28%
Education					
No high school degree	344	11.5%	152	44.3%	5.07%
High school degree	840	28.0%	287	34.2%	9.58%
Some college	686	22.9%	223	32.5%	7.44%
College degree	1,126	37.6%	275	24.4%	9.18%
Race/Ethnicity					
Black	577	19.3%	266	46.1%	8.88%
Hispanic non-Black	139	4.6%	63	45.6%	2.10%
White non-Black non-Hispanic	2,252	75.2%	593	28.0%	19.79%
Other non-Black non-Hispanic	159	5.3%	15	9.1%	0.50%
Household Income					
Less than \$30,000	571	19.1%	274	48.0%	9.15%
Between \$30,000 and \$50,000	451	15.1%	138	30.7%	4.61%

In a similar study, the Center for Financial Services Innovation found an estimated 15 million consumers in the U.S. used at least one AFS product in the past year. In a 2010 article, the CFIS found that “almost one third of the 30 million U.S households who are unbanked or underbanked borrow to meet their short term needs.” Also, “Almost 40% of unbanked and underbanked borrowing is used to pay for basic living expenses” (Schneider & Koide, 2010). The CFSI also found that among AFS users only 10% have a bachelor’s degree or higher. Half of all AFS users live in the south, 46% are white/non-Hispanic, and the average household size is larger (3.2) compared to non-AFS users (2.8) (Levy & Sledge, 2012).

TABLE 3.

	AFS Customers	Non-AFS Customers	Overall Population
Education			
% With bachelor’s degree or higher	10%	23%	18%
Region			
Northeast	8%	18%	17%
Midwest	21%	24%	22%
South	50%	35%	39%
West	21%	24%	22%
Household Size (Mean)	3.2	2.8	NA
Race/Ethnicity			
White	46%	64%	63%
African-American, Non-Hispanic	29%	11%	14%
Other, Non-Hispanic	6%	7%	6%
Hispanic	20%	18%	17%

Center for Financial Services Innovation (2012)

The Unbanked and Underbanked of Southwest Virginia

By applying the research conducted by the FDIC and the CFSI to the demographics of Southwest Virginia, we find a high probability that many individuals in Southwest Virginia are unbanked, underbanked, and relying on alternative financial services.

The FDIC's research shows approximately 26% of Southwest Virginia households are unbanked or underbanked—that is approximately 65,400 households without a bank account or adequate access to high quality financial services. The FDIC's and CFSI's research also shows low levels of income positively correlate with high levels of unbanked and underbanked status. Southwest Virginia's high level of poverty supports the conclusion that a large segment of households are currently unbanked or underbanked.

By using the FDIC's research, namely that among households with annual earnings below \$30,000, around 48% have used an AFS, we can conjecture that at least 48% of the 84,000 Southwest Virginian households that earn less than \$25,000 per year have used or are using alternative financial services. That is an estimated 43,000 households currently using low quality AFS in Southwest Virginia. If we apply the FDIC statistic, which shows 100% of underbanked Virginia households have used low quality alternative financial services (AFS) and 61.8% of unbanked households have used low quality AFS, we find **47,700 (73%) of unbanked and underbanked Southwest Virginia households use AFS.**

Southwest Virginia's low level of academic achievement is another factor that correlates with the CFSI's and FDIC's data, namely that only 10% of AFS users had a bachelor's degree or higher and that low levels of academic achievement are correlated with high levels of unbanked and underbanked status. Due to high unemployment rates resulting from the economic downturn, unemployment among non-college educated workers is about twice as high as unemployment rates for individuals holding a bachelor's degree (University of Washington, 2010).

The unemployment rate in Southwest Virginia was 7.3% in February 2012, higher than Virginia's unemployment rate (6.1%), but lower than the national average (8.7%). 32% of Southwest Virginia adults, ages 25-64, are out of the labor force. This is much higher than statewide (20%) and national (22%) levels of out-of-labor force adults (Virginia Employment Commission, 2012). If workers are unable to find jobs, they are more likely to rely on low quality AFS for income smoothing and emergencies.

These factors, combined with Southwest Virginia's geographical location (50% of AFS users are located in the southern portion of the United States) and its 93% white/non-Hispanic population (46% of AFS users in the U.S. and the majority of AFS users in Virginia are white-non-Hispanics), make it very likely that there is a large market for high quality alternative financial services in Southwest Virginia.

The Need For High Quality Alternative Financial Services

The most common forms of AFS used by the unbanked and underbanked are non-bank money orders, non-bank check-cashing services, payday loans, title loans, rent-to-own agreements, or pawnshops. Despite having a relatively low population density, Southwest Virginia has about 421 households per payday-lending establishment (Griffith & Varnier, 2009).

Low quality AFS are characterized by interest rates as high as 400% APR, expensive fees, minimal underwriting requirements and challenging repayment terms (such as two week balloon payments) that make it very difficult to repay loans (Center For Responsible Lending, 2009; Levy, & Schneider, 2012). The use of alternative financial services often leads to unsustainable patterns of borrowing. According to the CFSI, “nearly 40% of payday and pawn borrowers report not paying back their original loan when it first came due; of those who did rollover or extend their loan, payday users averaged 5.1 rollovers and pawn users averaged 2.4 loan extensions.... The average payday consumer takes 11 loans or extensions per year and is in debt for approximately 150 days.”

The CFSI report also found dissatisfaction among many AFS users. Loans took longer to repay and were more expensive than expected. “Of all AFS products, only deposit advance had a slight majority of consumers (53%) reporting they would use the product again without hesitation. 22% of payday and auto title loan users said they would not use the product again.” Also, many customers considered the AFS products to be “unfair” and difficult to repay (Levy & Sledge, 2012).

Most importantly, low quality AFS do not offer any avenues for developing credit or savings. Very often, instead of helping low-income individuals smooth income gaps, make investments and manage risk, low quality AFS often exacerbate the problems associated with poverty.

Currently, the primary alternative to low quality AFS are traditional financial establishments such as banks and credit unions. Although these institutions offer valuable services, they are in many ways ill suited for small dollar credit customers. If the needs of the unbanked and underbanked are to be met, a third option should exist that addresses the unique requirements posed by small dollar credit clientele.

Recommendation

With approximately 65,400 unbanked and underbanked households and 47,700 households likely using alternative financial services in Southwest Virginia, a large market exists for high quality alternatives to such institutions as payday lending and title loans. Unbanked and Underbanked households represent a valuable opportunity for banks and credit unions to increase their market share. According to the CFSI, “**fees paid to access these small dollar credit products in 2011 amounted to \$17 billion**. This is revenue that should be shifted toward products and services that meet the need for credit in a way that aligns provider and customer success and builds economic opportunity for customers—rather than seeing those opportunities stripped away” (Levy & Schneider 2012).

Several banks and credit unions are already profiting from serving underbanked and unbanked customers. Self Help, a credit union located in California, offers several financial services specifically designed for unbanked and underbanked immigrants. Their services include check cashing, money transfers, check free bill payment, and other services including prepaid phone cards. Self Help charges reasonable fees for their check cashing services and incentivizes credit union membership by offering a discount for members. Transactional services like check cashing can be used as an effective tool for cross-selling traditional bank products.

Self Help credit union is a good example of how a traditional financial institution can meet the needs of small dollar credit customers by customizing their services. Since the needs of unbanked and underbanked customers are different from traditional bank customers, it is essential that banks tailor their services to their specific target market.

Outlined below are four recommendations for better serving unbanked and underbanked customers.

- **Location:** Low-income individuals are less likely to have access to reliable long distance transportation; therefore, small dollar credit financial firms should be located adjacent to other retailers where their customers are already shopping. This would also be considerably less expensive than building a traditional bank branch. Alternative financial service locations should be ubiquitous, stay open later than traditional bank branches, and provide a welcoming and accepting atmosphere.
- **Access and Speed:** Participants in the CFSI study indicated the two most salient features of AFS were access and speed. This would be especially pertinent in an emergency situation, considering most AFS users do not have any savings and would be solely relying on AFS to quickly meet their credit needs. For these reasons many AFS products with lower interest and longer approval periods would not meet the needs of customers. Access, speed, and convenience should be balanced, however, with sound underwriting and affordability.
- **Transactional Services:** As described above with Self Help FCU, providing transactional services can be a profitable way to meet customer demand and also

establish customer loyalty. Prepaid cards are another valuable transactional service. A Visa or MasterCard prepaid card could provide a record from which a credit history could be developed. Also, prepaid cards would allow underbanked customers to make transactions online or over the phone.

- Education: Most AFS are used due to a chronic lack of income. Many individuals simply do not make enough money to cover their basic living expenses. For individuals that fall into this category, credit is not the best long-term solution. Although this is a very difficult problem, a possible solution could be offering basic budgeting counseling. A financial firm could put individuals in contact with organizations that specialize in financial education or individual development accounts.

High quality AFS should seek to meet the needs of underbanked and unbanked customers of Southwest Virginia by offering quick, competitively priced services that are able to cover the cost of accepting high-risk customers, but also enable individuals to develop credit. High quality small dollar credit services should be accessible, regulated to ensure that individuals do not accept loans that they are unable to repay, have high enough interest rates to ensure profitability, have clear and easily understood terms, and offer credit repair/building services that would eventually lead to lower interest rates and traditional forms of credit.

High quality AFS should also provide a sustainable way for individuals to purchase investments, such as vehicles, childcare and education, that lead to greater income. If banks and credit unions were to offer small dollar credit services, they would be able to establish a connection with unbanked individuals and offer other services, such as savings accounts and debit cards that they ordinarily would not use. It is important to note, however, that even if high quality alternative financial services are offered, many challenges to overcoming poverty will remain in Southwest Virginia. Regardless, there is a market in Southwest Virginia for high quality small dollar financial services. These financial services will help individuals keep more of the money they earn and escape destructive borrowing patterns.

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