Access to Electronic Payments Systems by Unbanked Consumers

By Fumiko Hayashi

In 2013, nearly 8 percent of U.S. households, or about 17 million U.S. adults, did not have a checking or savings account (Burhouse and others). Many of these consumers—who are considered "unbanked"—rely heavily on cash to meet their transaction needs. Some consumers may choose not to have a bank account solely due to personal preferences such as for privacy. Others, however, may be influenced by factors they cannot control, such as minimum requirements to open accounts and high fees. If the latter is the case, access to more affordable electronic payment products could enhance unbanked consumers' economic well-being by reducing the cost and time associated with payments and broadening their options of where to make purchases.

Increasing unbanked consumers' access to and use of electronic payment products are high priorities among policymakers around the world (Committee on Payments and Market Infrastructures and World Bank Group). Payment services are, in their own right, an important part of the overall package of financial services, but they also serve as an entry point to other financial services such as savings, investments, loans, and insurance. The Federal Reserve's mission in payments is to foster the integrity, efficiency, and accessibility of U.S. payments and settlement systems to support financial stability and economic growth. Promoting electronic payments systems with broad public access is key to achieving accessibility as well as efficiency.

Fumiko Hayashi is a senior economist at the Federal Reserve Bank of Kansas City. This article is on the bank's website at ***www.KansasCityFed.org.***

In this article, I examine the main reasons some consumers do not have a traditional bank account and identify features of electronic payment products that might attract those consumers. I find that while a small fraction of unbanked consumers prefer to use cash for privacy reasons, the majority of consumers are unbanked for other reasons, such as limited credit or banking history, low and unstable income, high fees, negative perceptions of banks, and account attributes like complexity and slow speed of funds availability. Some electronic payment products have the potential to attract unbanked consumers by addressing the issues they have with traditional checking accounts. Among such products, general purpose reloadable (GPR) prepaid cards may be able to address the issues more effectively than alternative checking accounts offered by depository institutions or transaction accounts offered by nondepository institutions.

Section I reviews previous research on the reasons why some consumers do not use banks and assesses the importance of these reasons. Section II describes electronic payment products available to unbanked consumers, discusses advantages and disadvantages of those products relative to traditional checking accounts and cash, and considers which products unbanked consumers are most likely to adopt. Section III concludes with a discussion of policy implications.

I. Reasons Consumers Do Not Have Bank Accounts

Consumers may not have a bank account for a variety of reasons. Some reasons are solely related to factors that providers control, such as credit and banking history requirements to open a bank account. Other reasons are solely related to consumers' preferences, such as the desire for privacy. And still other reasons are related to factors consumers can control and factors outside their control: for example, consumers may choose not to use a bank account if the high cost of using a bank account—due to both their low, unstable income and banks' high fees—exceeds the benefits. While individual unbanked consumers may have several reasons for not having a bank account, some reasons may be more important than others. Understanding these reasons—as well as which reasons are greater barriers to entry than others—is useful not only for payment service providers as they develop electronic payment products that attract unbanked consumers, but also for policymakers as they consider policies that encourage the use of electronic payments systems.

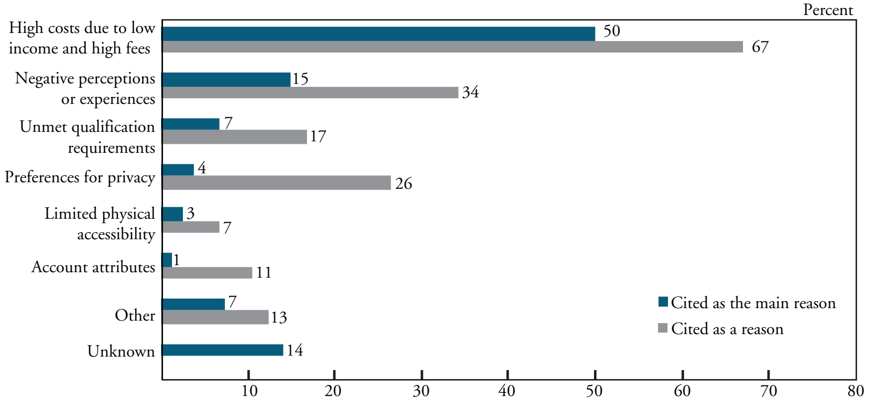
To identify the various reasons why consumers do not have bank accounts, I use two studies based on interviews with different subsets of consumers. The Federal Reserve Bank of Kansas City interviewed unbanked and underbanked individuals with low and moderate incomes to understand why they distrust banks or why they choose other institutions to meet their financial service needs.[1] Likewise, Romich, Gordon, and Waithaka interviewed prepaid card users who previously had a bank account to examine why those individuals exited from the banking system.

However, these interview studies do not indicate the relative importance unbanked consumers place on these reasons. To isolate the main reasons from all possible reasons, I use two recent surveys of unbanked consumers. I primarily use a Federal Deposit Insurance Corporation (FDIC) survey, which asks unbanked households to select all reasons why they do not have a bank account and then select one main reason from the list provided in the survey, including "other." The FDIC list encompasses almost all reasons identified in the aforementioned interview studies. As a supplement, I also use a survey conducted by the Board of Governors of the Federal Reserve System. Similar to the FDIC survey, the Board of Governors survey asks unbanked consumers to select main reasons from a predetermined list; however, the Board of Governors list has two drawbacks. First, it does not include one potentially important reason—privacy. Second, it includes the reason "do not need or want a bank account," which encompasses various reasons related to consumers' preferences and may mask the fundamental reasons unbanked consumers do not need or want a bank account.

Distinguishing between common reasons consumers do not have a bank account and the "main reasons" they select is important: a given reason may be common among consumers without being an especially significant barrier to entering the banking system. For example, 26 percent of households in the FDIC survey cited privacy as among the reasons they do not have a bank account; however, only 4 percent of households cited it as the main reason (Chart 1).

The reason consumers most often selected as the "main reason" they do not use banks is the high cost of maintaining an account due

Chart 1
Reasons Households Do Not Have Bank Accounts



Source: Author's calculations based on 2013 FDIC survey.

to their low, unstable income and banks' high fees. Some bank accounts have a minimum deposit requirement to open the account, typically ranging from $25 to $100 (Bretton Woods). In addition, many banks offer conditionally free checking accounts: banks waive or reduce monthly account fees if a consumer meets a minimum balance, a minimum monthly deposit, or both (Hayashi, Hanson, and Maniff). However, consumers with low and unstable income may not meet those criteria and thus may incur a monthly fee. Their unstable income, and to some extent their limited financial literacy, may also trigger fees such as overdraft fees and non-sufficient-funds (NSF) fees, which are assessed when account holders' balances are not sufficient to cover their transactions. Many consumers perceive the level of these fees—the median fee is $30 per overdraft or NSF incident—to be too high.[2] In the FDIC survey, about 50 percent of unbanked households cited main reasons related to low income that does not meet minimum balance requirements (37 percent) or high fees (13 percent) (Chart 1).

The second main reason relates to consumers' negative perceptions or experiences with banks. In the two interview studies, unbanked interviewees often stated their past experiences with banks had been negative. Some consumers felt that banks cleared checks and other transactions in a way that intentionally created a greater number of overdraft or NSF charges. These unexpected fees caused some consumers to close their bank accounts and distrust banks. Other unbanked consumers felt they would not be welcomed at banks or treated with respect. And some consumers, especially immigrants, felt they could not easily communicate with bank staff due to language barriers. About 15 percent of households in the FDIC survey cited negative perceptions or experiences with banks as the main reason they do not use banks.

The third main reason is that consumers do not meet banks' qualification requirements. Unmet qualification requirements include no credit score or credit scores too low to open bank accounts, lack of proper identification or Social Security number, involuntary account closures by banks, and applications denied by banks due to past financial mistakes.[3] Consumers who do not meet the criteria set out by depository institutions cannot have a bank account, even if they want one. Thus, they have been involuntarily excluded from the banking system. Seven percent of households in the FDIC survey cited banks' qualification requirements as the main reason they do not have a bank account.

The fourth main reason, privacy, relates solely to consumers' preferences. Consumers for whom privacy is critical may choose not to have a bank account and instead exclusively rely on cash. Some of these consumers may simply prefer the anonymity of cash (Kahn, McAndrews, and Roberds). Others may want to avoid paying taxes or hide their income from debt collectors. Consumers who do not have a bank account for these reasons have voluntarily excluded themselves from the banking system. In the FDIC survey, 4 percent of households cited privacy as the main reason they do not use banks.

The fifth main reason concerns the physical accessibility of banks, such as locations and hours. If banks do not have branches where unbanked consumers reside or work, the indirect costs to these consumers—such as transportation costs or the time spent accessing the closest branch—may be too high. Few or inconveniently located branches can also raise direct costs: ATM fees, for example, can add up significantly if consumers use ATMs not owned by their banks. In these cases, consumers are likely to be assessed two separate fees: a so-called "foreign" fee by their bank and a surcharge by the ATM owner.[4] Due to these indirect and direct costs, unbanked consumers often consider retailers more convenient to use than banks for basic transaction services such as cashing checks and buying money orders. Their billers, such as landlords, often accept money orders but not checks, ACH, or credit and debit cards. Furthermore, retailers are typically open more hours than banks and allow their customers to complete other tasks concurrently such as paying bills and shopping at the store. In the FDIC survey, 3 percent of households cited limited physical accessibility of banks as the main reason they do not have a bank account.

The sixth and final main reason relates to attributes of bank accounts and associated payment services that do not meet the needs of certain groups of unbanked consumers. Consumers with limited financial literacy, for example, may find opening or managing a bank account complex and the fees confusing. Consumers who wish to access their funds immediately or make payments that reach the recipients as quickly as possible may find checks and other payment services banks offer too slow. To meet their need for faster payments, these consumers often turn to retailers or payment service providers outside the banking system, such as check cashers and money transmitters. In addition, some unbanked consumers perceive bank accounts as unsafe relative to cash even though consumer protection laws limit consumer liability for unauthorized transactions. Other unbanked consumers prefer cash because it offers greater control, enabling them to easily manage and immediately access to their money. In the FDIC survey, only 1 percent of households cited account attributes as the main reason they do not use banks.

However, the importance of account attributes in consumers' banking decisions may be understated in the FDIC survey. The FDIC survey includes only one reason related to account attributes—"banks do not offer needed products or services." In contrast, the Board of Governors survey allows unbanked consumers to cite one of three reasons related to account attributes as the main reason. Those reasons include "would not use an account enough" (cited by 8 percent of the survey respondents), "cannot manage or balance an account" (2 percent), and "needed products or services are not offered" (1 percent). As the FDIC survey does not include the first two reasons in its list of options, consumers who would have selected them may have selected "other" instead.

The survey results suggest providers at least partially control the main reasons consumers report they do not use the banking system. This may imply that consumers who rely solely on cash to meet their transaction needs do so not out of a preference for cash but because they lack bank accounts. Unlike most banked consumers, who access electronic payment products such as debit cards and ACH through their bank accounts, unbanked consumers cannot access many electronic payment products. However, more recently, electronic payment products have become increasingly available through accounts other than traditional bank accounts. Thus, unbanked consumers may be able to adopt those electronic payment products if such products address the issues unbanked consumers have with traditional bank accounts.

II. Which Electronic Payment Products Would Attract Unbanked Consumers?

Both depository institutions and nondepository institutions offer electronic payment products that may attract unbanked consumers. Both types of institutions offer general purpose reloadable (GPR) prepaid card accounts which enable consumers to use GPR prepaid cards. Some depository institutions offer alternative checking accounts that provide debit cards and access to ACH to meet the needs of otherwise unbanked consumers. In addition, some nondepository institutions offer transaction accounts associated with mobile or online payment products.

I assess whether GPR prepaid cards, alternative checking accounts, or transaction accounts are best equipped to address the reasons some consumers do not use the banking system by examining the advantages and disadvantage of each type of account relative to traditional checking accounts. Unbanked consumers may be more likely to adopt electronic payment products if they are associated with accounts that meet their needs.

GPR prepaid card accounts

Currently, GPR prepaid cards, which are directly tied to GPR prepaid card accounts, may be the most prominent electronic payment product for unbanked consumers. GPR prepaid cards can be used as a substitute for a checking account. Before cardholders use a GPR prepaid card for purchases, cash withdrawals or bill payments, they must load funds on to the card. They can load and reload funds through electronic funds transfers, direct deposits, or at a retailer that participates in a reload network.

Current state. In the past several years, unbanked consumers have increasingly turned to GPR prepaid cards to meet their transaction needs. According to Burhouse and others, the share of unbanked households that had ever used a GPR prepaid card increased from 18 percent in 2011 to 27 percent in 2013. More than 22 percent of unbanked households reported they used these cards in the 12 months prior to the survey, and nearly 58 percent of these households reloaded funds on their cards at least once.

GPR prepaid cards serve three functions. First, they can be used like debit cards. Cardholders can make purchases at any brick-and-mortar or online merchant that accepts the brand(s) on their card (such as Visa or MasterCard), and they can withdraw cash at ATMs or at retailers using the cash-back function.[5] Second, GPR prepaid cards can be used to send and receive ACH payments. In addition to a 16-digit card number, GPR prepaid cards typically have a separate 10–14 digit account number that consumers can use to receive direct deposits or pay bills through ACH. Third, some GPR prepaid cards can be used for person-to-person transfers. Consumers have traditionally relied on checks and money transmitter services to send funds to and receive funds from other consumers.

Both depository institutions and nondepository institutions offer GPR prepaid cards. Hayashi, Hanson, and Maniff identify 24 major providers—10 banks and 14 nondepository institutions. The nondepository institution providers typically act as a program manager—in other words, while a depository institution may issue the cards, the nondepository institution runs the card program on the issuer's behalf. Some nondepository institutions, such as NetSpend, also maintain the cardholder database, approve or decline transactions, and provide customer services. American Express, a nondepository institution, which issues its GPR prepaid cards by itself and runs its own card programs, is a notable exception.[6]

Advantages and disadvantages. GPR prepaid cards have clear advantages over traditional checking accounts in addressing qualification requirements, negative perceptions and experiences with banks, and physical accessibility. GPR cards have some advantages over traditional checking accounts in addressing high costs due to consumers' low, unstable income and bank accounts' high fees and issues related to account attributes. And GPR cards have neither an advantage nor a disadvantage over traditional checking accounts in addressing privacy concerns.

GPR prepaid cards can mitigate some qualification requirements to open an account. For example, GPR card providers do not typically check prospective customers' credit and banking histories; as a result, unbanked consumers with credit or past banking problems can more easily access GPR cards than traditional bank accounts. However, some obstacles remain: as with bank accounts, prospective GPR cardholders must provide proper identification in compliance with anti-money laundering regulatory requirements.

GPR prepaid cards can also benefit unbanked consumers with negative perceptions of banks. GPR cards have a clear advantage over traditional checking accounts for these consumers, as they are available at nondepository institutions as well as banks. Although banks do issue many nondepository institutions' GPR cards, cardholders do not interact directly with the issuing bank. Instead, the nondepository institution interacts with consumers as a program manager. Moreover, some GPR cards are co-branded with a retailer, check casher, or money transmitter with which unbanked consumers are familiar, helping increase consumer trust in those cards.[7]

GPR prepaid cards also have a clear advantage for unbanked consumers who consider retailers more convenient than banks for their transaction needs. Many GPR cards offered by nondepository institutions can be obtained at a retail store and registered and activated online. At retail stores, consumers can also reload funds on the card using cash, in addition to making purchases and obtaining cash with the card.

Furthermore, GPR prepaid cards have a slight advantage in addressing high costs due to unbanked consumers' low, unstable income and bank accounts' high fees. GPR prepaid cards typically do not have minimum balance requirements to open the account or to waive or reduce monthly account fees. In addition, fees for overdraft transactions on GPR cards are much less than for checking accounts (Hayashi, Hanson, and Maniff). Consumers can also avoid unexpected overdraft and NSF fees entirely by choosing a GPR card that does not offer overdraft capability. However, excluding overdraft or NSF transaction fees, GPR cards could be more costly than traditional checking accounts. Cardholders who do not receive periodic direct deposits may incur a monthly fee or per-purchase fee. Cardholders may also incur some fees unique to GPR cards: some providers charge balance inquiry fees, and some retailers charge reload fees when cardholders reload their card with cash.

GPR prepaid cards also have a slight advantage in expanding or addressing bank account attributes that do not meet the needs of certain unbanked consumers. Many providers of GPR cards offer tools such as online access, mobile applications ("apps"), and text alerts so their cardholders can easily monitor and manage the balance of their card anytime anywhere. Although large banks offer similar tools to their customers, smaller banks lag their larger counterparts especially in mobile banking service offerings.[8] Other account attributes, such as safety and the speed of funds availability, are similar for both GPR cards and traditional checking accounts. Like traditional checking accounts, a majority of GPR cards are FDIC-insured, meaning funds on the cards will be returned to the cardholder if the card issuer fails. Also like debit cards, most GPR providers limit consumer liability for unauthorized transactions.[9] Speed of funds availability is also similar for both GPR cards and traditional accounts, since GPR cards use either debit card networks or ACH to process transactions. Some GPR cards do, however, have faster person-to-person transfers between cardholders who use the same GPR card product. Since both the sender and recipient of the funds are on the same provider's account book, transfers between cardholders can be immediate.

Finally, GPR prepaid cards have no advantage over traditional bank accounts in addressing consumer privacy concerns. Like traditional bank accounts, GPR card providers require prospective cardholders to present identification which is then linked to the card number. Accordingly, the card is traceable to an individual consumer. As a result, a creditor could garnish the balance on the GPR card. Moreover, the traceable nature of the card means payments made with GPR cards are not anonymous, just like debit card and ACH payments.

Alternative checking accounts

Alternative checking accounts offer another option for previously unbanked consumers to access electronic payment products such as debit cards and ACH. Banks and credit unions offer alternative checking accounts to consumers who are not qualified for, or cannot afford, traditional checking accounts. These accounts include second-chance checking accounts and checking accounts accompanied by low-fee, short-term, small-dollar loans.[10]

Current state. Unbanked consumers by definition do not have any bank account, including an alternative checking account. However, some unbanked consumers may consider opening a bank account in the future, and alternative checking accounts may be easier for them to open than traditional checking accounts. According to Burhouse and others, 14 percent of unbanked households reported they were very likely to open a bank account in the 12 months following the survey; 22 percent reported they were somewhat likely to open a bank account in the 12 months following the survey.

At least a few hundred banks and credit unions offer second-chance checking accounts for consumers with credit and banking history problems.[11] Some of these accounts also carry lower fees than traditional checking accounts. Depository institutions, especially credit unions, are also increasingly offering short-term, small-dollar loans to consumers with little or no credit history. According to the National Credit Union Administration, the number of credit unions offering such loans increased more than five times from 2010 to 2013 (Peters). These loans carry a lower interest rate than alternative short-term loans such as payday and car-title loans.[12] However, to be eligible for such loans at a credit union, consumers need to open an account with the credit union. Many credit unions that offer low-fee, short-term, small-dollar loans also offer checking accounts that carry relatively lower fees than traditional checking accounts.

Advantages and disadvantages. Alternative checking accounts have a clear advantage over traditional checking accounts in mitigating qualification requirements for consumers to open an account and some advantages in addressing high costs due to both consumers' low, unstable income and high fees of traditional checking accounts; negative perceptions and experiences with banks; and account attributes. As with GPR prepaid cards, alternative checking accounts have no advantage over traditional bank accounts in addressing consumer privacy concerns. In addition, alternative checking accounts have a disadvantage relative to traditional checking accounts in addressing issues related to physical accessibility.

Alternative checking accounts have a clear advantage in addressing qualification requirements to open an account. Since alternative checking accounts are aimed at consumers with poor credit or banking histories, such consumers can more easily access these accounts than traditional checking accounts. However, consumers without proper identification are still unable to open these alternative accounts, as banks are required to obtain proper identification from their prospective customers.

Alternative checking accounts have some advantage over traditional checking accounts in addressing high costs due to consumers' low, unstable income and high fees of traditional checking accounts. Some depository institutions offer second-chance checking accounts with lower fees than traditional checking accounts or without overdraft capability, preventing account holders from making accidental overdrafts and incurring high fees. Checking accounts accompanied with low-fee, short-term, small-dollar loans may also reduce the cost for consumers as the loans can eliminate, or at least reduce, overdraft incidents. Other depository institutions, however, set almost identical fees for both second-chance checking accounts and traditional checking accounts.

Alternative checking accounts also have some advantage in addressing consumers' negative perceptions or experiences with banks. Some depository institutions that offer alternative checking accounts are certified as Community Development Financial Institutions (CDFIs) by the CDFI Fund, a branch of the U.S. Treasury Department, and obtain funding from the CDFI Fund. Since CDFI certification is granted for depository institutions with a mission of serving low- and moderate-income people and communities, the targeted consumers may perceive alternative checking accounts offered by CDFIs more positively than those offered by other depository institutions.

In addition, alternative checking accounts have some advantage in addressing consumers' concerns about account attributes. Alternative checking accounts may be easier for consumers with limited financial literacy to manage than traditional checking accounts, because some depository institutions—especially CDFIs—provide a range of financial education for these account holders. Non-CDFIs may still offer tips to alternative checking account holders on how to manage the account or require them to take a financial literacy or money management class.

However, as with GPR prepaid cards, alternative accounts have no advantage over traditional accounts in addressing consumer privacy concerns. Similar to traditional checking accounts, alternative accounts are traceable to an individual consumer. Electronic payment products available through alternative checking accounts—debit cards and ACH—are the same as those available through traditional checking accounts, and payments made with those products are not anonymous. As a result, like traditional checking accounts, alternative checking accounts cannot address privacy concerns.

Furthermore, alternative checking accounts may actually have a disadvantage relative to traditional checking accounts in addressing concerns about physical accessibility. Since not all depository institutions offer alternative checking accounts, finding and visiting a branch of an institution that offers alternative checking accounts may be more burdensome for consumers.

Transaction accounts

Besides GPR prepaid cards and alternative checking accounts, transaction accounts may also address unbanked consumers' needs. Nondepository institutions offer transaction accounts which can be funded with cash and do not need to be linked with a bank account or payment card account. These transaction accounts are typically either mobile accounts or online accounts.

Current state. Outside the United States, especially in emerging and developing countries, mobile accounts—generally referred to as "mobile money"—have been playing a key role in promoting financial inclusion. Mobile accounts in these countries are usually pre-funded: consumers use cash to fund accounts held at their mobile carrier. Almost 90 percent of transactions made with mobile money are purchases of mobile phone airtime and money transfers to another individual (Groupe Spéciale Mobile Association).

In the United States, mobile wallets linked with mobile carrier billing are emerging—in other words, payments made with the mobile wallet are added to the consumer's mobile phone bill. Until recently, the purchases consumers could add to their mobile carrier bill were limited to digital goods like mobile apps and games. More recently, however, LevelUp, a mobile wallet mainly used for purchases at merchants such as fast food restaurants, has added carrier billing as an option for its users (Hernandez).

PayPal is the major provider of online accounts in the United States. PayPal accounts can be used to make purchases online, transfer money to and from another individual, and make purchases at a brick-and-mortar store through a mobile app. Although account holders typically load funds onto the account by linking it to their bank accounts or payment card accounts, they can also load the account with cash.[13]

Advantages and disadvantages. Transaction accounts offered by nondepository institutions have clear advantages over traditional checking accounts in addressing issues related to qualification requirements to open an account; high costs due to low, unstable income and high fees; negative perceptions and experiences with banks; and physical accessibility. Transaction accounts have no advantage over traditional checking accounts in addressing privacy issues. And transaction accounts have a disadvantage relative to traditional checking accounts in addressing issues related to account attributes.

Transaction accounts can significantly mitigate qualification requirements to open an account. For unbanked consumers who have identification, credit, or banking history problems, transaction accounts offered by nondepository institutions are more accessible than traditional bank accounts. Some mobile carriers neither require prospective customers to show proper identification nor check credit history when the customers select a prepaid plan. Similarly, PayPal does not check credit history and does not require proper identification when a consumer opens an account.[14]

Transaction accounts also have a clear advantage over traditional accounts in addressing high costs due to banks' high fees and consumers' low, unstable income. In particular, cash-load, pre-funded transaction accounts cost much less than traditional checking accounts. These accounts have no minimum deposit requirement and no monthly fees.

Moreover, these accounts incur no overdraft fees because any transaction that exceeds the account balance will be declined (as long as the account is not linked to a bank account, payment card account, or post-payment mobile carrier bill).

Mobile accounts linked with mobile carrier billing also have a clear advantage over bank accounts in addressing consumers' negative perceptions of banks. About 70 percent of unbanked households had mobile phones in 2013, suggesting a majority of unbanked consumers already have a relationship with a mobile carrier (FDIC 2014). Whether providers such as PayPal are more trusted than banks is unclear; however, since PayPal's cash load is available at retailers or money transmitters with which unbanked consumers are familiar, those consumers might feel more comfortable dealing with PayPal than with banks.

Finally, transaction accounts have a clear advantage over traditional accounts in terms of physical accessibility. Transaction accounts, which can be accessed online, do not require consumers to visit a physical location except when they load funds with cash onto their accounts. When they do need to load cash onto their accounts, consumers have more convenient options to choose from: mobile wallet users can add funds to many mobile carriers' prepaid plans at retailers and the carriers' service locations, and PayPal account holders can load cash at retailers and certain money transmitters.

As with both GPR prepaid cards and alternative checking accounts, transaction accounts offer no privacy advantage over traditional checking accounts. Although transaction accounts have less stringent identification requirements, they do not necessarily offer more privacy. Payments made with PayPal accounts or mobile wallets linked to mobile carrier bills are not anonymous. Both mobile and online accounts are traceable to an individual consumer.

In addition, transaction accounts have attributes that are less attractive than bank accounts. The current limited use of mobile wallets linked to mobile carrier bills limits their functionality. Mobile wallets can, however, offer their users the ability to monitor and manage their account balance anytime anywhere. PayPal offers account features similar to GPR prepaid cards, such as real-time online account monitoring and immediate money transfer between PayPal account holders. However, while PayPal accounts are frequently used for online transactions and person-to-person funds transfers, their use at brick-and-mortar merchants is still limited.

Arguably, a more critical disadvantage of these transaction accounts is safety. PayPal accounts, for example, are not FDIC-insured (Woodruff).[15] Thus, if PayPal fails, funds on PayPal accounts may not be returned to the account holders. With respect to unauthorized transactions, PayPal and mobile wallet providers voluntarily limit consumer liability. While PayPal provides similar consumer protections to those debit and GPR prepaid card issuers are required to provide, some mobile wallet providers may not clearly disclose whether they have dispute resolution or liability limiting policies (Federal Trade Commission).

Prospects for adoption

Although each of the three account types has some advantages over traditional checking accounts, it is not clear which account and associated electronic payment product unbanked consumers would be most likely to adopt. To compare the three types of accounts, Table 1 summarizes the advantages and disadvantages of each account type in addressing the six main reasons consumers do not use bank accounts. The reasons are ordered from most to least cited as the main reason in the FDIC survey.

Transaction accounts have a clear advantage in addressing the number one reason in the FDIC survey: high costs due to consumers' low, unstable income and the high fees of traditional checking accounts. However, GPR prepaid cards and alternative checking accounts have at least some advantage over traditional checking accounts as well (Table 1). The costs consumers incur can vary significantly according to their behavior; however, any individual consumer with low, unstable income may find at least one of the three accounts less costly than traditional checking accounts. Therefore, the three types of accounts can collectively lower costs, positively influencing unbanked consumers' adoption of the three types as a whole.

Both GPR prepaid cards and transaction accounts have a clear advantage in addressing the second most cited main reason: negative perceptions and experiences with banks. However, alternative checking accounts also have some advantage, because unbanked consumers may trust providers of alternative checking accounts such as CDFIs more

Table 1

Advantages and Disadvantages of Alternative Accounts Relative to Traditional Checking Accounts

Main reason ranking	Reason	GPR prepaid card accounts	Alternative checking accounts	Transaction accounts
1	High costs due to low income and high fees	+	+	++
2	Negative perceptions or experiences	++	+	++
3	Unmet qualification requirements	++	++	++
4	Preferences for privacy	~	~	~
5	Limited physical accessibility	++	—	++
6	Account attributes	+	+	—

++ : Clear advantages ~ : Indifferent
\+ : Some advantages — : Disadvantages

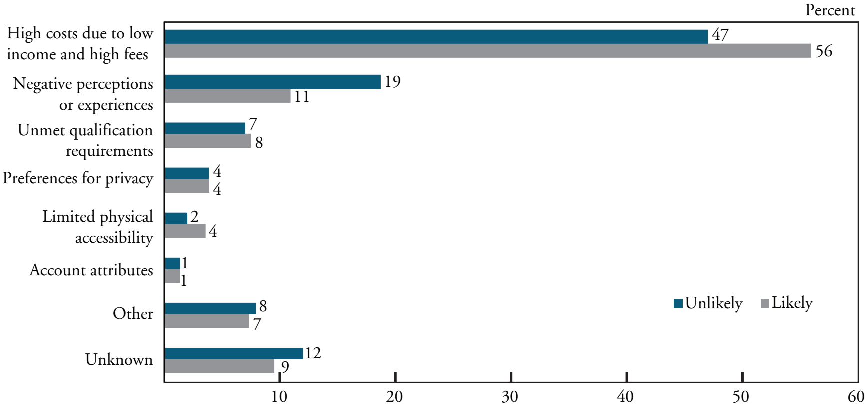
than other depository institutions. Trust is a key factor for unbanked consumers in determining whether to adopt an electronic payment product. According to the 2013 FDIC survey, 19 percent of unbanked households who said they were not too likely or not likely at all to open a bank account in the 12 months following the survey cited "distrust or dislike dealing with banks" as the main reason they do not have a bank account (Chart 2).

All three types of accounts have a clear advantage in addressing qualification requirements to meet to open an account (Table 1). All three types have less stringent requirements for consumers' credit and banking histories than traditional checking accounts, which may increase the likelihood of consumers adopting these accounts and associated electronic payment products. Although transaction accounts have less strict identification requirements than the other two, this looser requirement may also sacrifice product safety. As a result, it is unclear whether transaction accounts will be more attractive to unbanked consumers than the other two types.

None of the accounts have an advantage over traditional checking accounts in addressing the fourth main reason: privacy. Thus, consumers who avoid bank accounts solely for privacy reasons are unlikely to adopt any of the three products. Such consumers, however, account for a relatively small share of unbanked consumers (4 percent).

Chart 2

Main Reasons Households Do Not Have Bank Accounts: Likely versus Unlikely To Have a Future Account



Source: Author's calculations based on 2013 FDIC survey.

In addressing the fifth main reason, physical accessibility, GPR prepaid cards and transaction accounts have an advantage over traditional checking accounts, while alternative checking accounts have a disadvantage. As a result, this factor may positively affect adoption of GPR prepaid cards and transaction accounts but negatively affect adoption of alternative checking accounts.

Finally, GPR prepaid cards and alternative checking accounts have some advantages in addressing the sixth main reason: attributes of traditional checking accounts that do not meet unbanked consumers' needs. Transaction accounts, in contrast, have disadvantages relative to traditional accounts in terms of safety and functionality. All three types of accounts allow users to easily monitor and manage their accounts thanks to technologies like online access, mobile apps, and text alerts. Such abilities will likely encourage unbanked consumers to adopt an electronic payment product. According to the Board of Governors survey, about 67 percent of unbanked consumers of all ages have access to a mobile phone; access among unbanked consumers age 34 or younger reached 75 percent in 2015.[16] Among mobile phone users, unbanked consumers are more likely to make mobile payments than fully banked consumers (23 percent versus 17 percent). Furthermore, adoption of GPR prepaid cards is highly correlated with access to a mobile phone, especially a smart phone (FDIC 2014). More than 40 percent of unbanked households with access to a smart phone have adopted GPR prepaid cards, while only 21 percent of unbanked households without access to a smartphone have adopted them. These statistics suggest that as more unbanked consumers gain access to a mobile phone or smartphone, adoption of mobile accounts or GPR prepaid cards will increase.

In contrast, all three account types have little or no advantage over traditional accounts in addressing another account attribute: speed. While some GPR prepaid cards and transaction accounts enable users to make immediate money transfers between users of the same product, none of the three accounts really meet the unbanked consumers' demand for speed, such as immediate access to their funds and payments that reach the recipients immediately.[17] This may prevent some unbanked consumers from adopting products available through these accounts over cash. However, immediate payments and funds availability may soon become available through these products as the United States implements faster payments capabilities (see Box). Whether a given product offers faster payments may significantly influence unbanked consumers' adoption of that product.

Transaction accounts have a disadvantage relative to traditional checking accounts as well as the other two types of accounts with respect to another account attribute: safety. Consumers concerned about the safety of their funds stored in an account may be less likely to adopt transaction accounts. Transaction account providers voluntarily protect consumers from unauthorized transactions, but some do not clearly disclose their liability limit policies to their customers.

In sum, GPR prepaid cards may be able to address issues unbanked consumers have with traditional checking accounts more effectively than alternative checking accounts or transaction accounts. GPR prepaid cards have advantages in addressing nearly all reasons consumers do not have bank accounts and do not have a clear disadvantage. Transaction accounts have clear advantages in addressing four of the six reasons but have disadvantages in account attributes such as safety and functionality. Alternative checking accounts have at least some advantages in addressing issues related to four reasons but have a disadvantage in physical accessibility.

Box

Faster Payments in the United States

Faster payments require providers to immediately confirm payment execution, notify the payer and payee, deduct the payment from the payer's account, and make funds available to the payee's account in near real time. Consumers with low, unstable income in particular may benefit from near-real-time funds availability, because it allows them to better control their cash flow and make and receive last-minute payments of all types. Faster funds availability also helps consumers reduce the costs of overdrafts or declined payments due to insufficient funds (Hayashi).

More than 20 countries have already developed or are developing faster payments systems to better meet the needs of their citizens and businesses. In the United States, the Federal Reserve has established and led a Faster Payments Task Force that consists of a diverse array of stakeholder members to identify and assess alternative approaches for implementing safe, ubiquitous, and faster payments capabilities. The Task Force will assess faster payments solution proposals from various providers using the effectiveness criteria it has identified and then publish the proposals, assessments, and strategic issues deemed important to the successful development of faster payments as a final report in 2017.

III. Conclusion

About 8 percent of U.S. households do not have a checking or savings account and rely heavily on cash. Access to affordable electronic payment products could enhance many unbanked consumers' welfare. Electronic payment products reduce the cost and time associated with transactions and enable consumers to make purchases not only at brick-and-mortar merchants but also over the internet or a mobile phone. As retail payments have shifted from paper-based to electronic over the years, including unbanked consumers in the electronic payments system is key to fulfilling the Federal Reserve's mission of achieving accessibility and efficiency in payments.

I find that three types of accounts through which electronic payment products are available—GPR prepaid cards in particular, and, to a lesser extent, alternative checking accounts and transaction accounts—have the potential to attract unbanked consumers through their advantages over traditional bank accounts. These accounts and associated electronic payment products can address issues unbanked consumers have with traditional bank accounts such as credit and banking history problems; high costs due to consumers' low, unstable income and banks' high fees; negative perceptions of or experiences with banks; and the complexity and security of certain account features. However, all three account types could make improvements to facilitate further adoption. In particular, by offering faster payments as soon as is feasible, providers of electronic payment products associated with the three account types can meet unbanked consumers' demand for immediate access to their funds and payments that immediately reach the recipients.

These findings have some implications for policymakers. Although GPR prepaid cards appear to be more effective than the other two types of accounts in addressing issues unbanked consumers have with traditional checking accounts, no single electronic payment product can address all of these issues; instead, individual consumers can choose the product that aligns with their behavior as well as their reasons for being unbanked. Currently, both depository and nondepository institutions provide electronic payment products to meet the needs of unbanked consumers. Thus, policymakers may want to ensure a competitive environment for these institutions to fairly and safely provide payment services to this segment of population.

As a first step, policymakers could review the regulatory framework for bank and nondepository institution payment service providers and improve the framework if needed. In addition, policymakers could explore ways to encourage the accessibility of faster payments not only through bank accounts but also through other alternatives such as GPR prepaid cards and transaction accounts.

Endnotes

[1]Underbanked consumers are defined as consumers who have a bank account but also use alternative financial services outside the banking system such as check cashing, money remittances, payday loans, and auto title loans.

[2]The median overdraft and NSF fee varies by the size of financial institutions, ranging from $25 among institutions with less than $100 million in assets to $35 among institutions with more than $50 billion in assets (Moebs Services).

[3]Many U.S. banks use ChexSystems' data to screen a bank account applicant's banking history. ChexSystems tracks checking and savings account activities and reports information such as involuntary account closure, bounced checks and overdrafts, unpaid negative balances, and risky or dishonest behavior.

[4]The foreign fee typically ranges from 50 cents to $3, and the median surcharge is about $2.50.

[5]Using their card and personal identification number, cardholders can obtain cash at the checkout counter by adding their cash withdrawal amount to their purchase amount.

[6]The funds of American Express's GPR prepaid cards are held by Wells Fargo.

[7]Co-branded cards are designed with a retailer, check casher, or money transmitter's brand as the dominant brand on the card but also contain the GPR prepaid card provider's logo and the card network's logo.

[8]Banks and credit unions with larger assets are more likely to offer mobile banking services than those with smaller assets, according to a survey conducted in 2014 in five Federal Reserve Districts: Atlanta, Boston, Dallas, Minneapolis, and Richmond. The survey results are presented in Crowe, Tavilla, and McGuire.

[9]Although the Consumer Financial Protection Bureau has not finalized rules governing GPR prepaid cards, card networks such as Visa and MasterCard require GPR card providers using the network to limit consumer liability.

[10]Products and services financial institutions offer to unbanked and underbanked consumers are reported in Rengert and Rhine.

[11]About 300 banks and credit unions that offer second-chance checking accounts are listed at *www.nerdwallet.com/blog/checking/second-chance-checking/*. Alternative credit scores (for example, the FICO Score XD) allow depository institutions to assess otherwise unscoreable consumers (*www.fico.com/en/products/fico-score-xd#marketecture*).

[12]To get a payday loan, consumers are typically required to have a bank account in relatively good standing.

[13]Account holders can purchase a PayPal My Cash Card and load funds on the card at a retailer with cash. Then, the account holders apply those funds to their PayPal account through PayPal's website.

[14]PayPal may later request its account holders to provide their date of birth and the last four digits of their Social Security number to verify the account holders and allow them to add funds to their PayPal account.

[15]PayPal accounts had been FDIC-insured until 2012, when new oversight laws passed in California.

[16]Access to smartphones among unbanked consumers age 34 years or younger reached 61 percent in 2015.

[17]Unbanked and underbanked consumers' desires for faster funds availability, faster payment speed, and faster deposits are reported in Burhouse, Navarro, and Osaki.

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