

Financial Services for the Underbanked: Why Banks Aren't the Solution



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Panel Detail:

Monday, April 26, 2010 11:00 AM – 12:15 PM

Speakers:

[Roger Dean](#), Chief Financial Officer, Axxess Financial

[Mark Ernst](#), Deputy Commissioner for Operations Support, Internal Revenue Service

[Daniel Henry](#), CEO, NetSpend

[Dan Tarantin](#), President and CEO, Direct General Corp.

[Stephen Vogel](#), CEO, Grameen America

Moderator:

[Mark Bremer](#), Chief Operating Officer, Stax Inc.

General definitions of the unbanked and underbanked

Unbanked

- Do not currently have a checking or savings account.
- May have had checking or savings account in the past.

Underbanked

- Currently have a checking or savings account.
- Regularly use money orders, check-cashing services, payday loans, rent-to own, pawn shops, or refund anticipation loans.

Our discussion will focus on solutions for financially serving the unbanked and underbanked



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*Size & Scope
of the
Consumer
Segment*

*Unique Set
of Needs*

*Banks
Structurally
Disadvantaged*

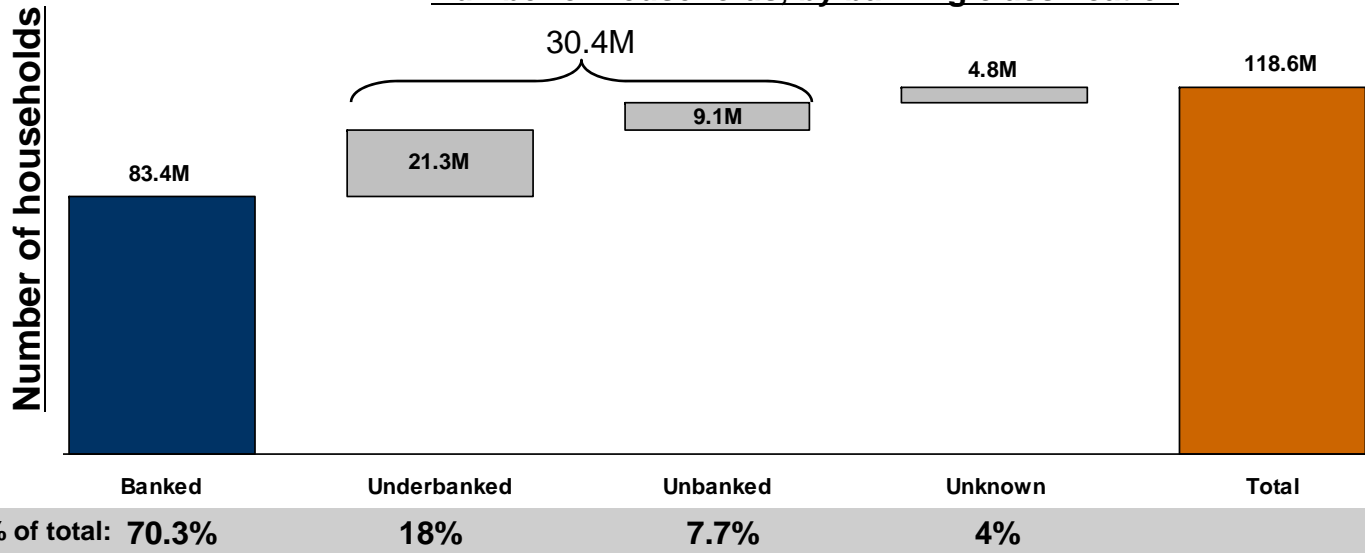
*Growth in
Alternative
Financial
Services*

What are the Best Solutions for Financially Serving the Unbanked and Underbanked?

Source: Stax Inc.

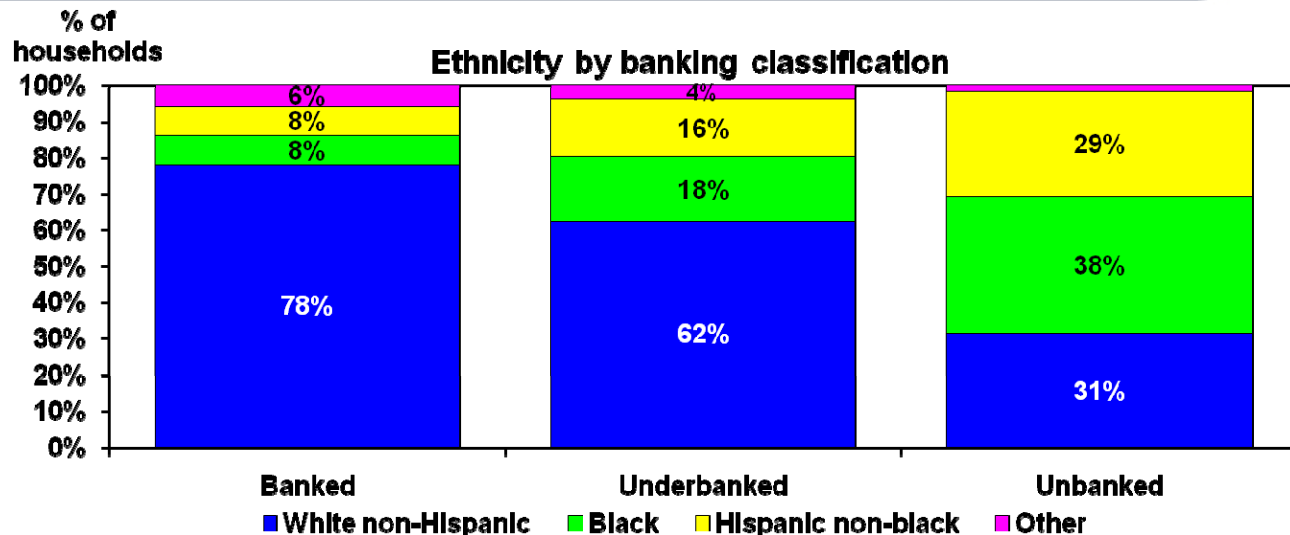
FDIC estimated the unbanked & underbanked at over 30 million households in 2009, more than 25% of U.S. households

Number of households, by banking classification



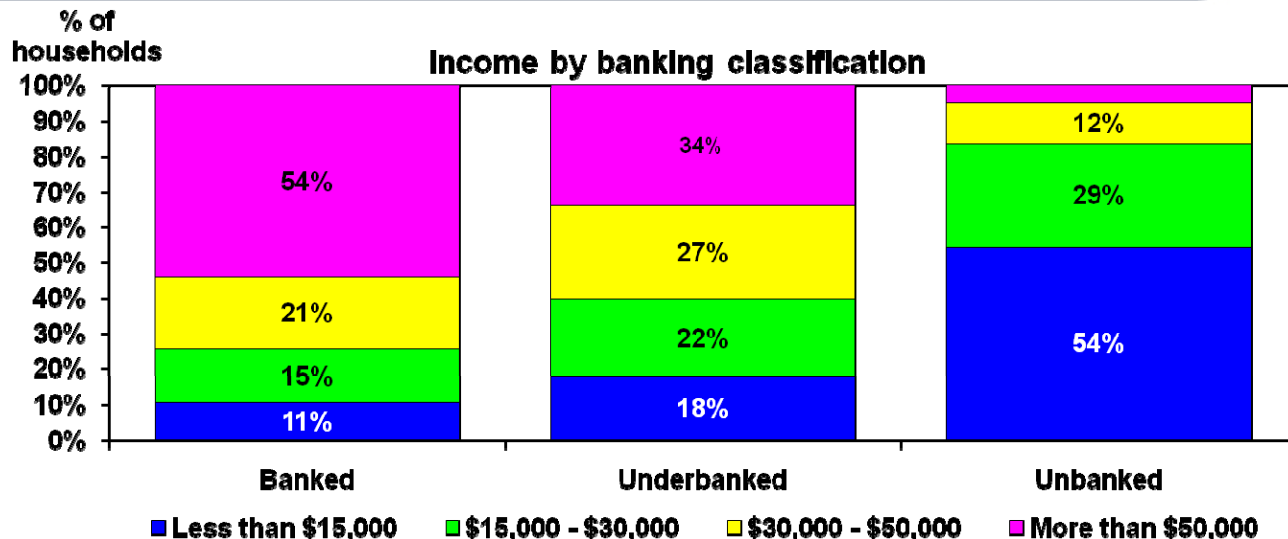
Source: FDIC, National Survey of Unbanked and Underbanked Households, www.fdic.gov, December 2009.

The unbanked and underbanked are disproportionately but not exclusively lower income and non-white



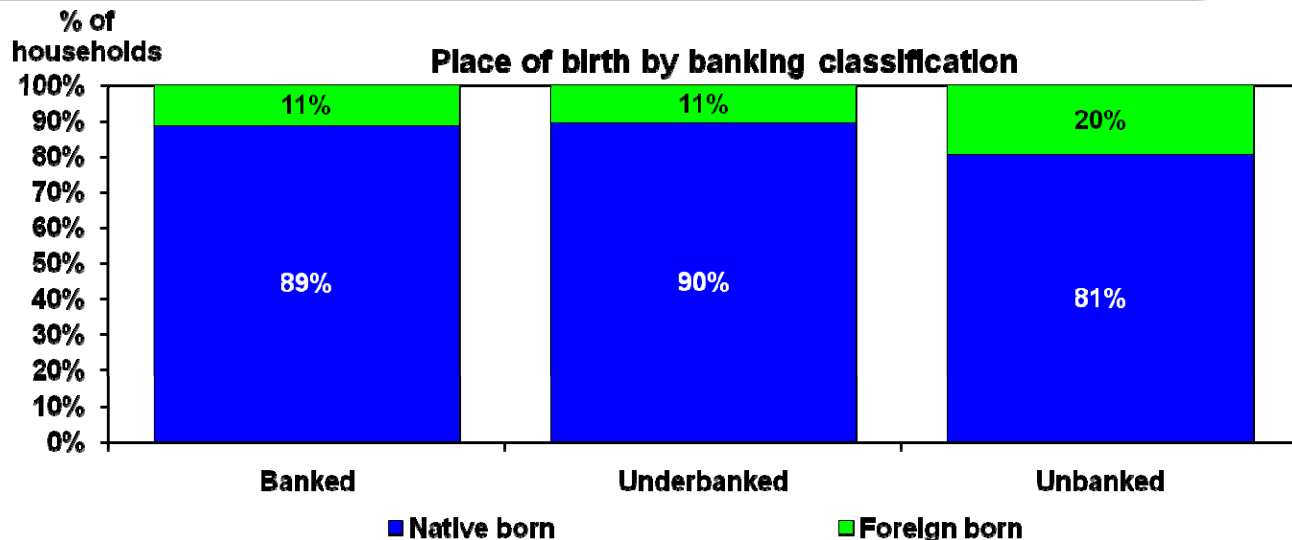
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The unbanked and underbanked are disproportionately but not exclusively lower income and non-white



Source: FDIC, National Survey of Unbanked and Underbanked Households, www.fdic.gov, December 2009.

The unbanked are disproportionately but not exclusively immigrants



Source: FDIC, National Survey of Unbanked and Underbanked Households, www.fdic.gov, December 2009.

Consumers are unbanked by both necessity & choice; a 2007 Federal Reserve study suggests many are unbanked by choice



Unbanked

Choice

- * 65.1% of households are unbanked due to the following reasons (up 0.9% from 1998):
 - Do not like dealing with banks
 - Do not write enough checks to make it worthwhile
 - Service charges are too high
 - Do not need or want an account
 - Over last decade, an increasing % of the unbanked fall into the choice category

Necessity

- * 29.3% of households are unbanked due to the following reasons (down 3.3% from 1998):
 - Do not have enough money
 - Minimum balance is too high
 - Credit problem
 - Cannot manage or balance a checking account
 - No bank has convenient hours or locations

Source: Federal Reserve Board, "2007 Survey of Consumer Finances," and earlier studies.

*5.6% of unbanked survey respondents did not give a reason for why they had no checking or savings account.

Retail banks are not serving this customer group well, largely due to high fees, which have become an issue with regulators



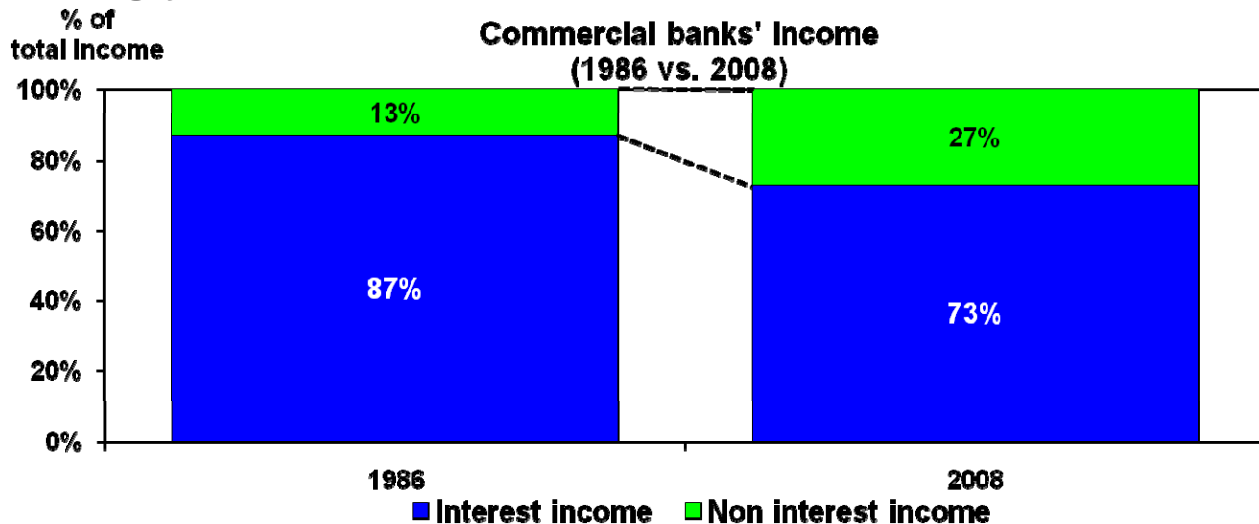
Traditional financial institutions' structure has not met unbanked and underbanked customer needs:

- Minimum initial investment restrictions and credit-scoring tools
- Millions of consumers prevented from opening checking accounts due to past overdrafts and unpaid fees
- Fees higher for lower-balance accounts
- Overdraft fees particularly high for lower-balance accounts
- Fewer physical locations in low income communities
- Relatively little marketing and sales efforts targeted toward lower-mass market
- Banks implicitly refine mandates to serve more affluent customers

Source: Stax Research; "U.S. Check Cashing, Money Transfer, Payday Loan Services, and Pawnshops," Marketdata Enterprises, Inc.

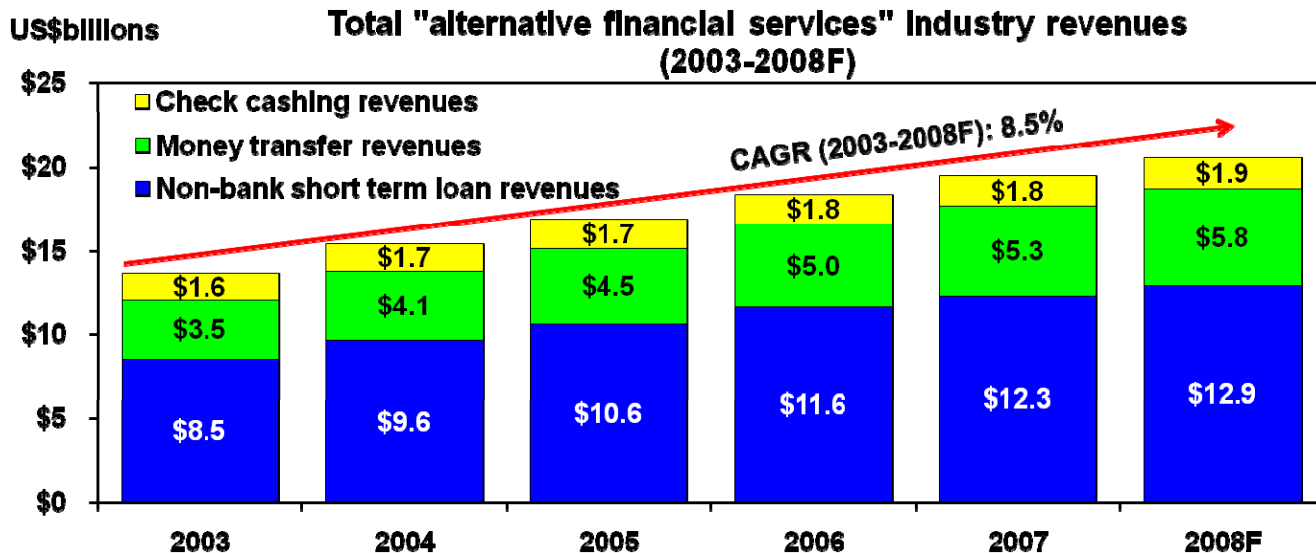
Note: Credit consultancies NewCheckingAccount and Chexsystems Relief conservatively estimate the size of ChexSystem's database, respectively, at 7 million and 10 million Americans.

The same overdraft fees that drive some consumers from banks have become increasingly important to the banks themselves



Retail banks' fee-based income grew at 8% annually between 1986 and 2008.

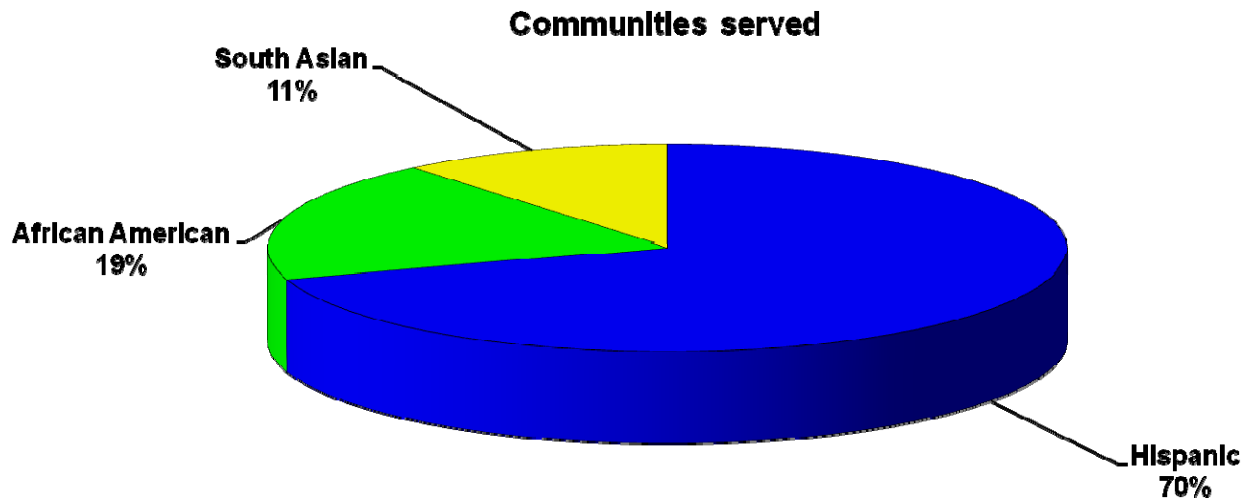
The “alternative financial services” (AFS) market has grown into an \$18 billion industry



Source: "U.S. Check Cashing, Money Transfer, Payday Loan Services, and Pawnshops," Marketdata Enterprises, Inc., June 2005.

Note: other types of AFS service include pre-paid debit, rent-to-own, insurance, subprime mortgages, and pre-paid wireless products.

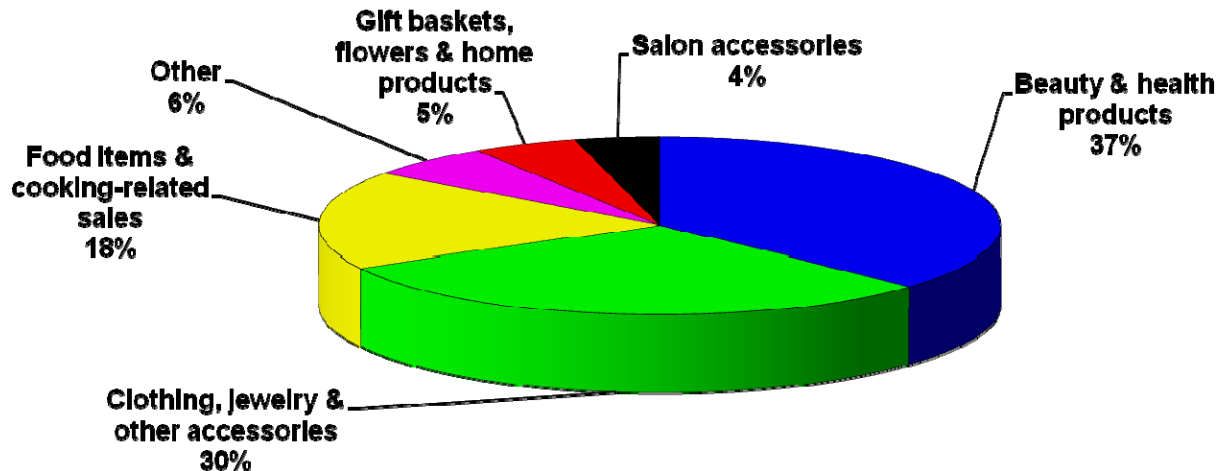
Customer base: the poorest of the poor



Source: Grameen America.

Customer base: the poorest of the poor

Businesses funded with microloans



Source: Grameen America.

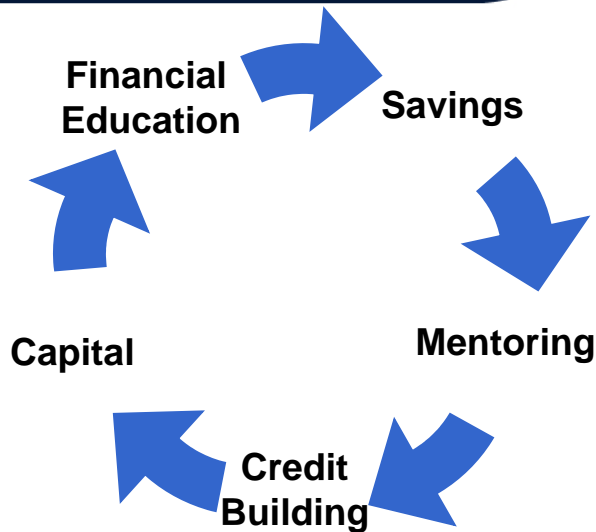
Grameen America borrower businesses



Source: Grameen America.

Financial services needed by the unbanked

- **Microloan:** Investment Capital
- **Credit Score:** Establishment or Improvement
- **Savings Account:** No fee, No Minimum Balance
- **ATM Card:** Accessing Mainstream Financial Institutions
- **Financial Education:** Mentoring and Support



Source: Grameen America.

Introducing the poor to mainstream financial services



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Weekly Repayment and Savings Deposits

- Change in Behavior

Continuous Financial Education

- How to Navigate the System

Full Transparency

- No Hidden Fees or Charges

Support Network

- Business Advice and Referrals

Asset Building

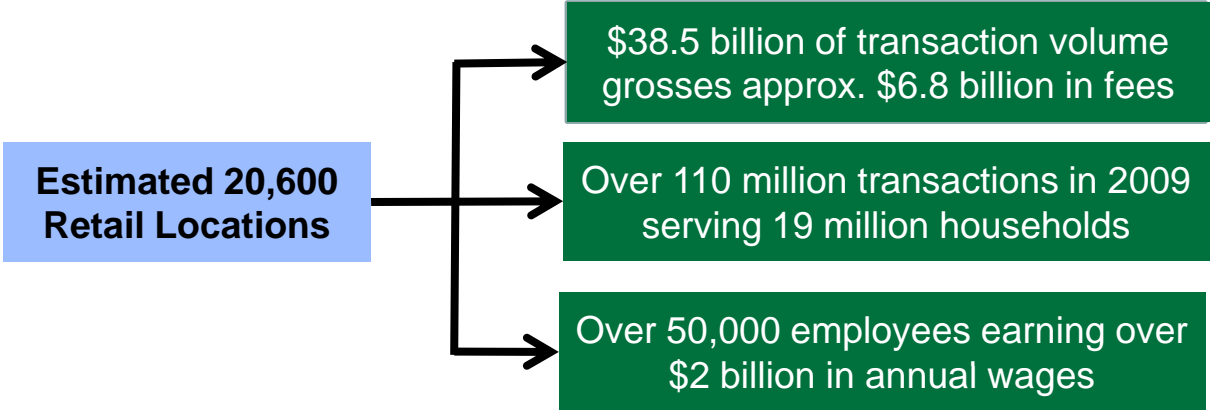
- Access to Additional Investment Capital

Source: Grameen America.

“A *social business* is a non-loss, non-dividend business. The surplus generated by the social business is reinvested in the business. Ultimately, it is passed on to the target group of beneficiaries in the form of lower prices, better service, and greater accessibility.”

-Muhammad Yunus, *Creating a World Without Poverty*

U.S. Payday Loan Industry

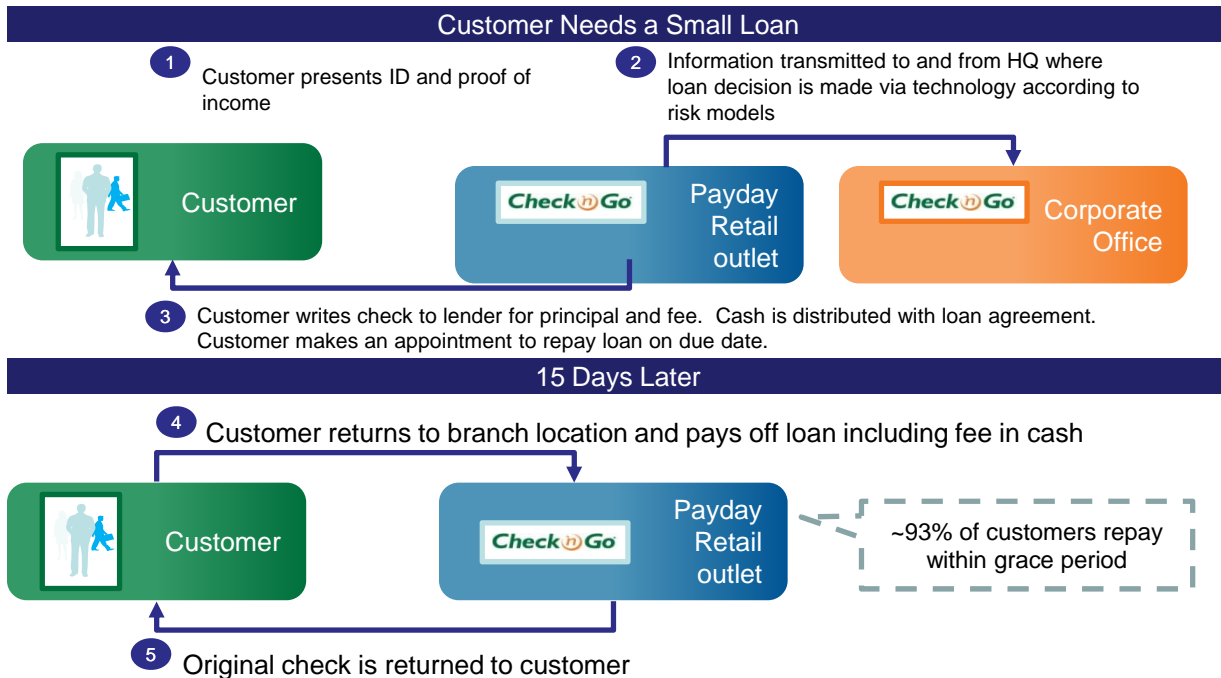


Source: Stephens, Inc.

Typical Loan Transaction



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Payday Loan Customer Profile

Middle Income

- 52% have incomes of \$25,000 to \$50,000
- 23% have incomes less than \$25,000
- 25% have incomes over \$50,000

Young Families

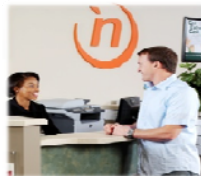
- 68% are under 45 years old (only 3.5% are 60 or older)
- Majority are married
- 64% have children in household

Middle Educated

- 94% have high school diplomas or better
- 56% have some college education
- 19% have a college degree

Stable Working Class

- 42% own homes
- 100% have steady incomes
- 100% have checking accounts
- 49% are credit union members
- 57% have major credit cards



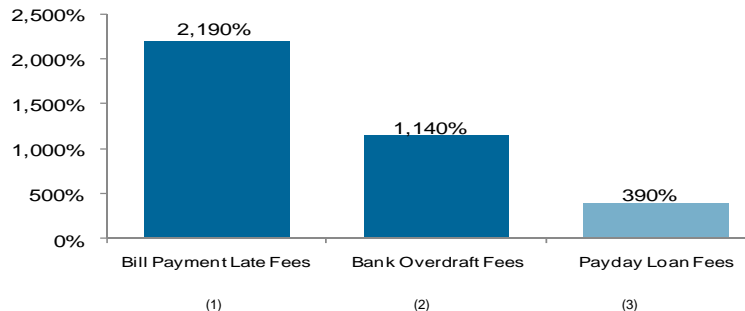
Simple, Low Cost Alternative



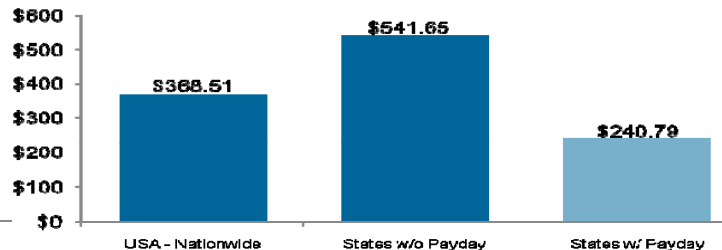
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- Superior economics compared to bank and credit card fees
- Customers with PDL options incur less overdraft fees
- States that have banned PDL generally experience increased:
 - Bounced checks
 - Chapter 13 bankruptcy filings
 - Complaints to the Federal Trade Commission about lenders and debt collections

Average APR



Average NSF/ODP Fees per Banked Household in 2008



Source: BAI Banking Strategies Magazine and Moebs Economic Research Services.

(1) Based on NSF fees of \$28.95, late fees of \$26.64 and average check size of \$66.00.

(2) Based on overdraft fees of \$28.95 and average check size of \$66.00.

(3) Based on fees of \$15.00 per \$100.00 loaned and average loan duration of two weeks.

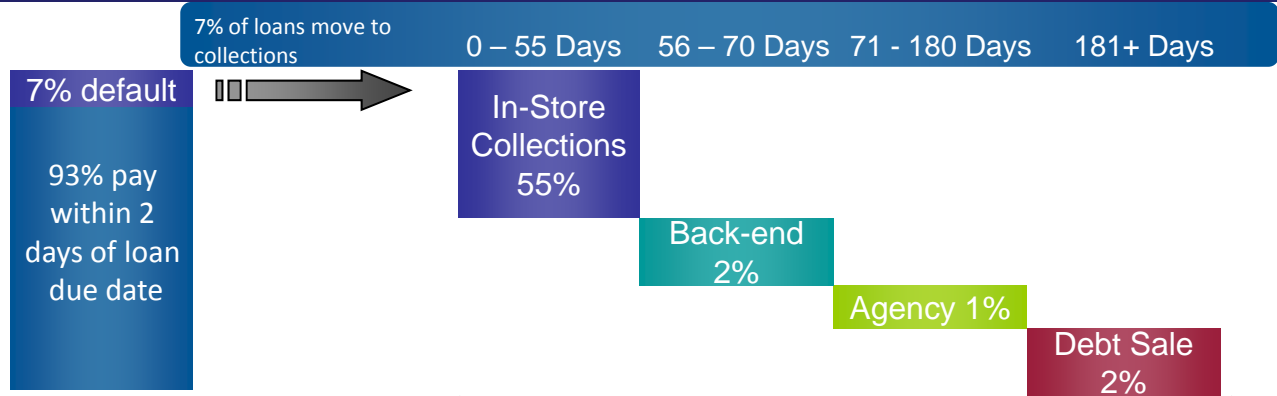
Customers are NOT high credit risk



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- Most are below “Subprime” by traditional measures
- Approximately 93% of loans paid at maturity
- Approximately half of initial defaults are subsequently collected, resulting in net charge-offs of approximately 3%

U.S. Store Payday Loan Collection Process (% based on dollars originated)



Approximately 60% of defaulted loans are eventually recovered – leaving approximately 3% net debt write - off

Fair Returns...

- Average:
- Loan Amount - <\$400
- Fee - \$16 per \$100
- Duration - 2 weeks
- Unsecured

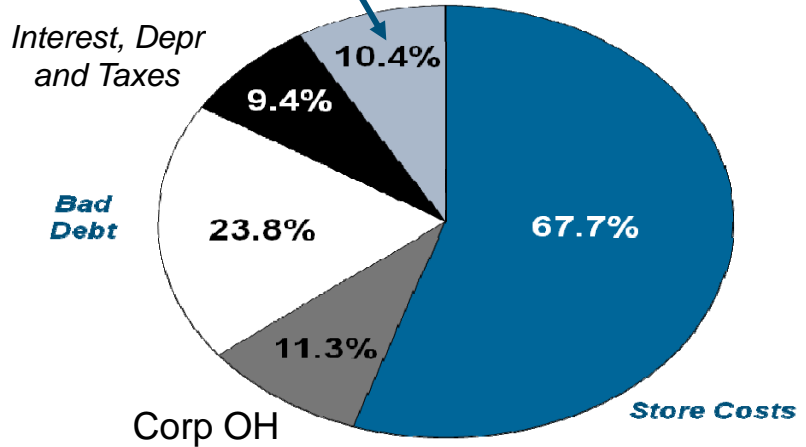


Traditional APR measures don't work – e.g., at 28% “APR”, loan generates only \$4 of interest revenue...

After-tax Profit Margin



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Illustrative Profit Margin - AEA

NetSpend premier product features



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FREE Direct
Deposit



90,000
Reload
Locations



FDIC-
Insured



FREE
Person-to-
Person
Transfer



FREE Anytime
Alerts™



iAdvance
Line of
Credit

Flexible
Options



Life Benefits



Phone and Online
Bill Pay

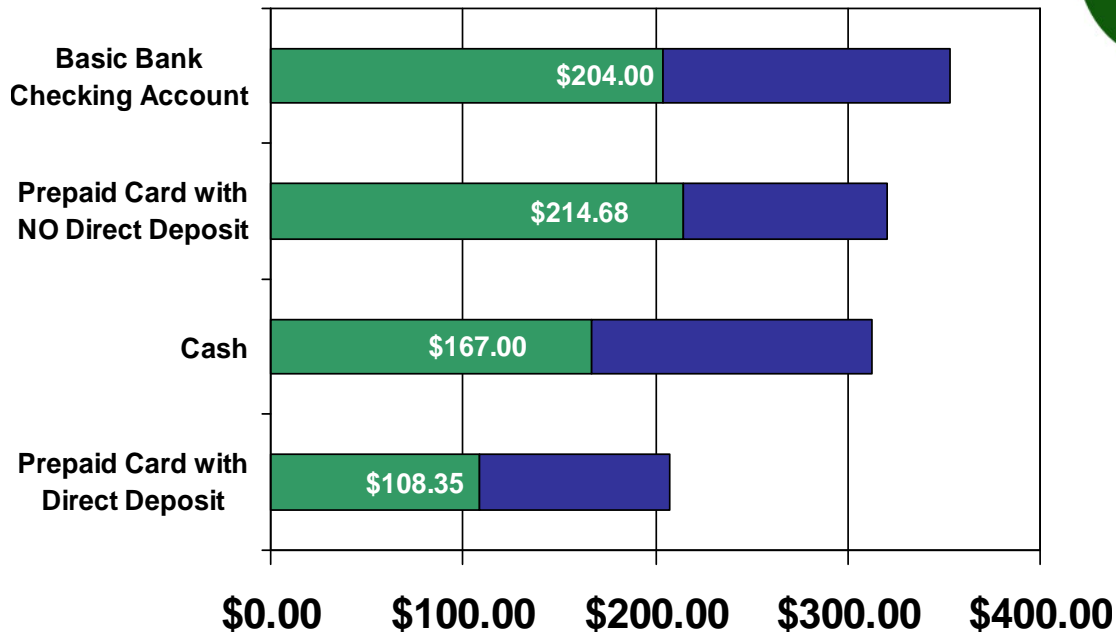


NetSpend
National Savings
Program (SM)

Prepaid vs. banks & cash



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Source: Payment Systems Evolution and Branded Prepaid Card Analysis; Bretton Woods, 10/09

■ Low ■ High

Bank employees use us



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Company	Number of Employees who are NetSpend Customers	Number of Transactions
Bank of America 	833	9,631
	724	8,868
CHASE 	478	4,411
 WACHOVIA	288	2,981