CFSI Center for Financial Services Innovation

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One Size Does Not Fit All

A Comparison of Monthly Financial Services Spending

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Executive Summary

The Center for Financial Services Innovation (CFSI) has conducted an investigation into the amounts that prepaid cardholders spend each month to conduct essential financial transactions, and compared that to the amounts that they would spend if they remained underbanked or used checking accounts for the majority of their transactions instead. Our analysis indicates that there is no one financial strategy – whether based on using a traditional checking account, check cashing services or a prepaid card – that is right for all people. Each of these services can be used relatively cost effectively, if the individual has access to low cost providers. Instead, consumers of financial services must evaluate their own cash flow needs, behaviors and preferences in order to choose the combination of products and services that is the best fit for them in terms of both price and functionality. It is clear that consumers are making trade-offs regarding the relative merits of different options – often by choosing a combination of services offered by different providers – in order to balance cost concerns with the other features that they need, such as convenience, accessibility, liquidity, simplicity and certainty.

This analysis also indicates several ways that the financial products and services available to underbanked consumers today could be improved. These include broadening the availability and use of direct deposit; expanding the functionality of both prepaid cards and checking accounts; increasing the transparency and certainty around fees to be paid; and guiding consumers to the best choice for their particular needs. Additional functionality to facilitate budgeting is crucial. Finally, adding credit-building and savings features to the transactional products studied would strengthen their connection to long-term financial prosperity and dramatically increase their utility to the individuals who use them.

Introduction

Individuals who live in underserved markets often pay more for basic goods and services than other Americans. Many factors contribute to this phenomenon. Higher costs to do business in underserved neighborhoods and a lack of competition diminish the supply of appropriately priced goods and services. On the demand side, underserved individuals often face meaningful barriers to seeking out the lowest price option (such as lack of time or a car), or require product features for which they are charged a premium. These dynamics have been well documented as they relate to many consumer products including credit,[1] and they similarly apply to everyday financial transactions such as managing income, safeguarding cash and paying bills.

In this context, there is ongoing interest in examining the costs of the financial services used by underserved individuals. The Center for Financial Services Innovation (CFSI) has thus conducted a brief investigation into the amounts that prepaid cardholders spend each month to conduct essential financial transactions. Our analysis indicates that there is no one financial strategy – whether based on using a traditional checking account, a prepaid card or remaining unbanked – that is right for all people. Instead, consumers of financial services must evaluate their own cash flow needs, behaviors and preferences in order to choose the combination of products and services that is the best fit for them in terms of both price and functionality.

Methodology

Earlier this year, CFSI interviewed 22 prepaid cardholders in the Chicago and Seattle metro areas.[2] These individuals provided detailed information about their monthly income and expenses. The interviewees described their sources of income and how they receive income, whether via direct deposit to a checking account or prepaid card, check or cash. They also listed each financial obligation that they pay during the month and how it is paid, whether via prepaid card, check, money order, cash, or other means. CFSI applied estimates of what each transaction service generally costs in order to calculate the total monthly financial services expenditures for three underbanked individuals. There is wide variation in the fees charged to complete the same or similar services, so CFSI used a range of fees. Then CFSI calculated what the monthly financial services spending would be for each of these individuals if he or she used check cashers or a checking account instead of a prepaid card to conduct the majority of his or her financial transactions.

While it is not possible to generalize from this exercise to the entire underbanked population of 40 million households,[3] the cash flow patterns and fees paid are instructive. In combination with the explanations given for why each individual chooses the financial services that they use, these profiles of monthly cash flow and financial services spending offer many insights into the relative merits of the financial products and services available today. They also point toward important improvements that could be made to those products and services.

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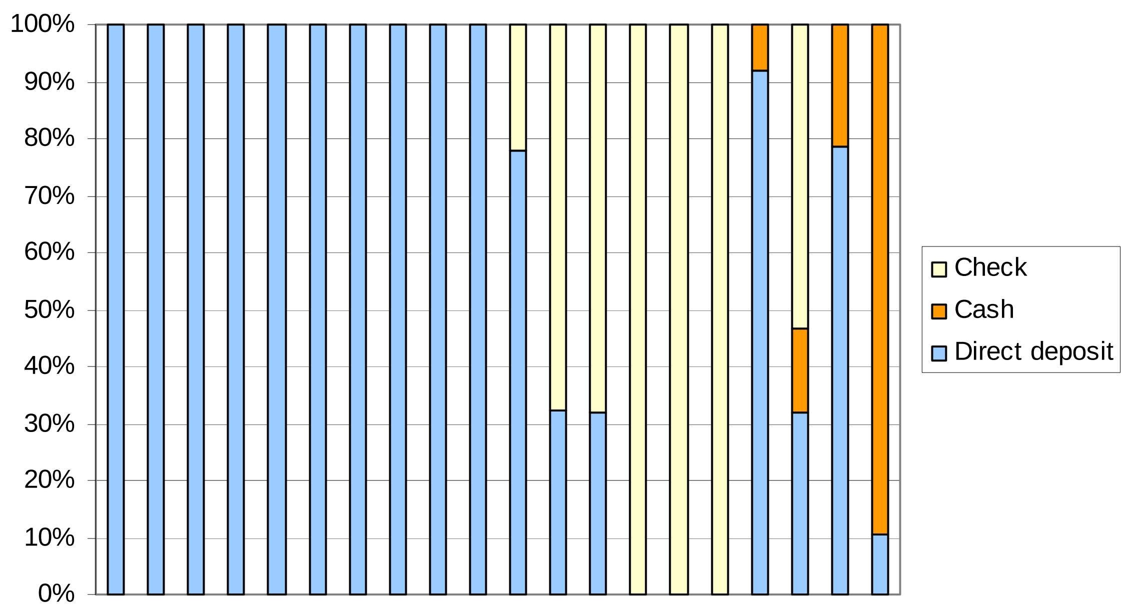
[1] See Matt Fellows, “Reducing the High Costs of Being Poor,” Testimony before the House Committee on Financial Services, Subcommittee on Housing and Community Opportunity, March 8, 2008.
[2] See Sarah Gordon, Jennifer Romich, Eric Waithaka, “A Tool for Getting by or Getting Ahead? Consumers’ Views on Prepaid Cards,” Center for Financial Services Innovation, March 2009 for a complete report of these interviews.
[3] CFSI Underbanked Consumer Study, Center for Financial Services Innovation, June 2008.

Summary Statistics

The individuals CFSI interviewed were either NetSpend or AccountNow cardholders. Because AccountNow intentionally markets the use of its prepaid cards for direct deposit of paychecks, the preponderance of direct deposit to a prepaid card among this sample is very high. Furthermore, the use of prepaid cards is not yet prevalent.[4] However, the amounts, types and timing of cash flows presented in this analysis are likely typical of underbanked individuals.

Among the individuals interviewed, income payments are generally concentrated in one primary method of receipt: 19 of 20 receive two thirds or more of their income by their primary method. Over half receive all of their income via their primary method. Only one respondent uses more than two ways of receiving income. The interviewees receive their income, on average, in four installments over the course of the month – though this varies significantly, ranging from one monthly payment to eight monthly payments. These frequent income payments are typical of underbanked consumers, who often receive income from multiple sources and are more likely to be paid weekly or biweekly than monthly.

Table 1: Income Payments by Type (%)

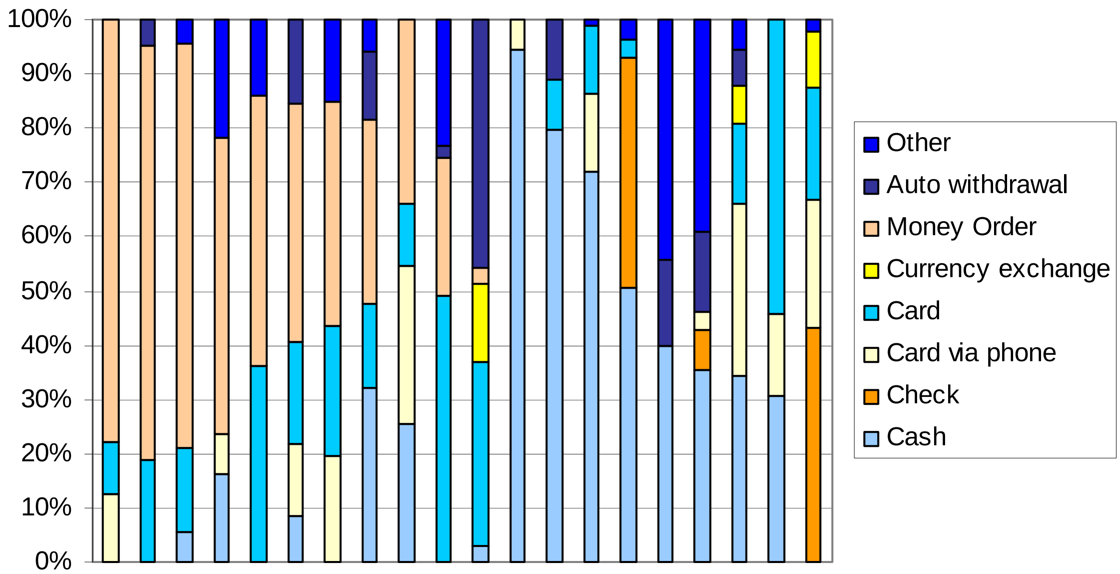


Expense payments vary more. This reflects the greater variation in both the available ways to pay bills and the ways that payees require being paid: some payees accept only checks or electronic payments, while others require cash or a money order. Thus, the primary method of paying bills represents a smaller proportion of total payments for each individual and there is a wider range of behavior. No one in this sample uses only one payment method, and only one

[4] CFSI Underbanked Consumer Study.

person each uses either two or six payment methods. The others are fairly evenly split among using three, four or five payment methods. On average, the individuals interviewed reported nine monthly payment events. However, a few of these payments likely represent more than one actual transaction because purchases such as groceries were reported once but likely happen several times over the course of the month. The most common methods of paying bills were by using money orders or prepaid cards.

Table 2: Expense Payments by Type (%)



Individual Cash Flows and Monthly Financial Services Spending

From among the individuals interviewed, CFSI identified three to analyze further. These individuals' cash flow patterns and use of financial services represent typical behaviors and attitudes that were reported by other interviewees as well. We applied the fees in the following schedule to the reported cash flows in order to estimate each individual's monthly financial services spending.

Table 3: Financial Services Cost Assumptions

Prepaid Card Fees[5]	**Low**	**High**
Monthly service fee	$3.00	$9.95
Cash load	$0.00	$4.95
Cash withdrawal**	$0.00	$4.50
Signature POS	$0.00	$1.00
PIN POS	$0.00	$2.00
Bill payment	$0.00	$1.00
Activation fee	$0.00	$9.95
Check Cashing Fees[6]	**Low**	**High**
Government/payroll checks	$3/1.5%	4%
Personal checks	$3/1.5%	10%
Bill payment	$1.00	$2.00
Expedited bill payment		$9.95
Money Order Fees	**Low**	**High**
Under $500	$1.10	$4.00
$501-$1,000	$1.50	$4.00
Checking Account[7]	**Low**	**High**
Minimum balance to open	$82.71	
Minimum balance to avoid fees	$109.26	
Monthly service fee	$1.93	$15.00
ATM surcharge + fee	$3.43	$3.43
Insufficient funds fee (NSF)	$28.95	

[5] Pricing plans vary, with some companies offering plans that allow unlimited transactions for a flat fee as well as pay-per-transaction structures. This analysis does not include card acquisition fees because they are not ongoing fees. They range from $0.00 - $19.95, with most at $9.95. The low and high scenarios are extreme cases, with most pricing plans falling somewhere in the middle.

[6] These estimated check cashing fees are based on the limits established by state regulatory authorities. Financial Service Centers of America, "Summary of State Check Cashing Laws," September 2008 Update.

[7] Bankrate.com. The low scenario represents average fees. To create the high scenario, CFSI applied the high monthly service fee from Chicago and Seattle (the markets in which the individuals interviewed live) and varied the estimate for the number of times that accountholders use fee-based services such as ATMs.

Ms. January

Ms. January is a single mother who works part-time for her father and receives disability and survivor benefits. She prepares a monthly budget every month, paying her bills when she receives her benefits rather than waiting until they are due. She uses a prepaid card because it is convenient, allows her to avoid check cashing fees and makes it easier to control her spending. She does not like that when she had a bank account, she was charged fees that she did not expect. She is not currently in debt and avoids credit, because in the past she got behind on student loan and credit card payments. When she has saved money previously – to buy her van for example – she gave cash to her father to keep in his store safe. If she were to save now, she would save money for her children's education or to buy her 15 year old son a car when he turns 16. However, Ms. January reports that if she has some money left after paying her budgeted expenses, "the kids, the car or something else comes up" requiring her to spend her full income. Ms. January has recommended prepaid cards to friends and plans to use her card for the foreseeable future.

Table 4: Ms. January Monthly Cash Flow and Estimated Financial Services Spending

Payments	Method	Amount	Est. Fees
Prepaid card and Check cashing fees:			
Disability	Direct deposit to card	$728	$0.00
Survivor	Direct deposit to card	$602	$0.00
Work	4 weekly checks	$95	$1.43 - $9.50 each
Income	**6 payments**	**$1,710**	**$5.70 - $38.00**
Rent	Cash	$450	$0.00 - $9.00
Phone	Card via phone	$70	$0.00 - $1.00
Cable	Card via phone	$75	$0.00 - $1.00
Car insurance	Card via phone	$80	$0.00 - $1.00
Eating out	Card	$100	$0.00 - $1.00
Groceries	4 card transactions	$700	$0.00 - $4.00
Prepaid card			$3.00 – $9.95
Expenses	**6 payments[8]**	**$1,475**	**$0.00 - $6.50**
Total Fees	**Prepaid card, Cash**		**$8.70 - $64.95**
			Average = $36.83

If Ms. January were to use a check casher or a checking account for her financial transactions rather than a prepaid card, her monthly financial services spend would change as follows:

[8] Number of payments excludes the prepaid card fee.

Table 5: Ms. January Monthly Financial Services Spending Alternatives

Payments	Method	Amount	Est. Fees
Check Cashing Fees:			
Income	6 checks rec'd and cashed	$1,710	$11.70 - $91.20
Expenses	3 cash payments, 3 money orders	$1,475	$3.00 - $6.00
Total Fees	**Check cash, Cash, Money orders**		**$14.70 - $97.20**
			Average = $55.95
Checking Account Fees:			
Income	6 checks deposited in account	$1,710	$0.00
Expense	Low = 3 ATM fees, 3 checks	$1,475	$12.22 - $35.58
	High = 6 ATM fees		
Total Fees	**Checking, Cash**		**$12.22 - $35.58**
			Average = $23.90
If one expedited bill payment fee:			**$33.85**
If one insufficient funds fee:			**$52.85**

According to these estimates, it is possible that Ms. January could spend less on financial services each month by using a checking account, but only if she:

1. can have her income payments direct deposited into her account or maintain a minimum balance sufficient to avoid monthly service fees,
2. has sufficient liquidity to wait for deposited checks to clear before accessing the funds and to pay her bills in advance by check;
3. can conduct necessary transactions at the branch during the hours it is open;
4. is not barred from having a checking account through Chex Systems; and
5. never overdrafts.

In addition, Ms. January would have to forgo several important advantages of prepaid cards versus checking accounts. Ms. January prioritizes immediate liquidity and the ability to manage the exact timing of cash flows. She appreciates that she is able to access her funds immediately on the day that her checks are paid and checks her balance regularly. To achieve this same strategic cash management, many underbanked individuals pay their bills in person, which is time consuming, or pay fees of as much as $9.95 per bill to expedite payment. Direct debit of payments from her prepaid card allows Ms. January to achieve this goal more cost-effectively and saves her valuable time. Using a checking account to pay bills introduces uncertainty about how long a check will take to arrive and clear. Ms. January also did not like going to banks: she felt that banks tried to sign her up for services she did not want or need and that they had surprise fees even when she thought she had a free checking account.

Conducting her financial transactions via check cashing outlets would be more expensive for Ms. January than her current practice. Because she has direct deposit, many prepaid card companies would waive or lower some of her fees, allowing her financial services spending to stay near the bottom of the estimated range.

Mr. November

Mr. November lives with his girlfriend and their child. They coordinate their work schedules so that they do not have childcare expenses, and get some financial help from relatives. He and his girlfriend each have prepaid cards, though from different companies. Mr. November used to have his paycheck direct deposited to his card, but now he cashes his check at his employer's bank, loads the money that he wants to have on the card and keeps some funds in cash. Mr. November likes using a prepaid card because it is convenient and private. He also appreciates that there is no "fine print (that he didn't read) that cost him money." When he had a bank account in the past, he did not like that he had to go to a branch or wait in a line. He also prefers checking his balance online versus waiting for his statement to find out what his account activity and balance are. He has recommended prepaid cards to friends, but some do not trust the product. When he and his girlfriend save money, it is generally for a specific purpose, such as if the holidays are coming up or if they need to travel. He previously had a credit card, but paid it off about two years ago. He has substantial personal debt, including medical debt. He has a 401(k) plan, but no life insurance. He does not know his credit score, though he assumes it is not good.

Table 6: Mr. November Monthly Cash Flow and Estimated Financial Services Spending

Payments	Method	Amount	Est. Fees
Prepaid card and Check cashing fees:			
Work	Cash at employer's bank, load to prepaid card	$1,680	$16.00
Income	**6 payments**	**$1,680**	**$16.00**
Rent	Money order	$450	$0.50 - $1.00
Cable/internet	Money order	$100	$0.50 - $1.00
Car insurance	Money order	$125	$0.50 - $1.00
Church	Card	$75	$0.00 - $1.00
Child support	Money order	$163	$0.50 - $1.00
Grooming	Cash	$80	$0.00
Entertainment	Card	$100	$0.00 - $1.00
Diapers/toiletries	Card	$60	$0.00 - $1.00
Gas/car	Card	$100	$0.00 - $1.00
Groceries	Card	$300	$0.00 - $1.00
Prepaid card			$3.00 - $9.95
Expenses	**10 payments[9]**	**$1,553**	**$3.00 - $18.95**
Total Fees	**Prepaid card, Cash**		**$19.00 - $34.95**
			Average = $26.98

If Mr. November were to use a check casher or a checking account for his financial transactions rather than a prepaid card, his monthly financial services spending would change as follows:

[9] Number of payments excludes the prepaid card fee.

Table 7: Mr. November Monthly Financial Services Spending Alternatives

Payments	Method	Amount	Est. Fees
Check Cashing Fees:			
Income	4 checks rec'd and cashed	$1,680	$12.00 - $67.20
Expenses	4 money orders	$1,553	$4.00 - $8.00
Total Fees	**Check cash, Cash, Money orders**		**$16.00 - $75.20**
			Average = $45.60
Checking Account Fees:			
Income	4 checks deposited in account	$1,680	$0.00
Expense	Low = 4 ATM fees, 2 checks High = 6 ATM fees, 2 checks, 2 money orders	$1,553	$17.85 - $47.01
Total Fees	**Checking, Cash**		**$17.85 - $47.01**
			Average = $32.43
If one expedited bill fee:			**$42.38**
If one insufficient funds fee:			**$61.38**

As with Ms. January, Mr. November could theoretically spend less on financial services each month by using a checking account, but he is unlikely to actually pay fees at the bottom of the indicated range. Because he needs to manage the timing of his cash flows closely, he cannot rely exclusively on checks. Some payees may require him to pay with cash or a money order. In addition, Mr. November values the customer service and convenience of prepaid cards versus checking accounts.

Mr. November could also lower his monthly financial services spending by direct depositing his income to his prepaid card. Cashing checks and then loading the funds onto a prepaid card maximizes the total fees paid because the cardholder may then pay a check cashing fee, a reload fee and monthly fees for the prepaid card. In this case, Mr. November is cashing his check for free at the bank on which it is issued, so his total monthly financial services spending is still lower than it would be if he exclusively used a check casher. And, if he had a checking account and overdrafted once per month, his spending would be higher than it is currently.

Ms. Cancer

Ms. Cancer is single, 25 and never married. She works at a gas station, but expects to start a second job soon because she normally works two jobs. She lives with a friend, her friend's son and her boyfriend. She has had bad experiences with bank accounts in the past. She had a checking account at a bank that she closed because of overdraft fees. She didn't realize that she would be charged a fee for every transaction. Those fees added up and caused her to overdraft. She then had a checking account at a credit union. Her credit card with that credit union was stolen and someone charged over $2,000. Because she didn't report the theft quickly enough, she still owes $500 on that account. After those experiences, she decided to rely entirely on a check cashing chain that she has used consistently and is happy with. She perceives her prepaid card to be a banking product offered by that check cashing chain. She has two prepaid cards from the same company. She deposits her paycheck in one and uses it to pay for most of her expenses. She refers to the other card as her "emergency card," and uses it to receive her tax refund. She has $16,000 in medical debt and $600 owed for a cell phone that she cosigned for a friend. She is actively saving $50 – 75 of each paycheck on her prepaid card. She'd like to go back to school without taking out student loans, or to own her own business someday, but she perceives her delinquent bills to be a major barrier to achieving those goals.

Table 8: Ms. Cancer Monthly Cash Flow and Estimated Financial Services Spending

Payments	Method	Amount	Est. Fees
Prepaid card and Check cashing fees:			
Work	Direct deposit to card, biweekly	$1,040	$0.00
Income	**2 payments**	**$1,040**	**$0.00**
Rent	Money order	$350	$0.00 – $1.00
Prepaid phone	Card	$60	$0.00
Groceries	Card	$160	$0.00
Roommate	Cash	$80	$0.00 – $1.00
Storage	Auto withdrawal	$130	$0.00
Entertainment	Cash	$50	$0.00 – $1.00
Friend's car	Cash	$100	$0.00 – $1.00
Prepaid card		NA	$6.00 - $19.90
Expenses	**7 payments**[10]	**$930**	**$6.00 - $23.90**
Total Fees	**Prepaid card, Cash**		**$6.00 - $23.90** **Average = $14.95**

If Ms. Cancer were to use a check casher or a checking account for her financial transactions rather than a prepaid card, her monthly financial services spending would change as follows:

[10] Number of payments excludes the prepaid card fee.

Table 9: Ms. Cancer Monthly Financial Services Spend Alternatives

Payments	Method	Amount	Est. Fees
Check Cashing Fees:			
Income	2 checks rec'd and cashed	$1,040	$6.00 - $41.60
Expenses	4 money orders	$930	$4.00 - $8.00
Total Fees	**Check cash, Cash, Money orders**		**$10.00 - $49.60**
			Average = $29.80
Checking Account Fees:			
Income	2 checks deposited in account	$1,040	$0.00
Expense	Low = 2 ATM fees, 1 money order High = 4 ATM fees, 1 money order	$930	$9.89 - $32.72
Total Fees	**Checking, Cash**		**$9.89 - $32.72**
			Average = $21.31
If one expedited bill payment fee:			**$31.26**
If one insufficient funds fee:			**$50.26**

In theory, in this case, Ms. Cancer could lower her monthly financial services spending by using either a check casher or a checking account instead of a prepaid card. However, these estimated checking account fees don't reflect Ms. Cancer's prior experience with checking accounts. She paid large amounts of money in the past because she had insufficient funds or because she was the victim of fraud. She also paid substantially more to use an ATM than she pays now.

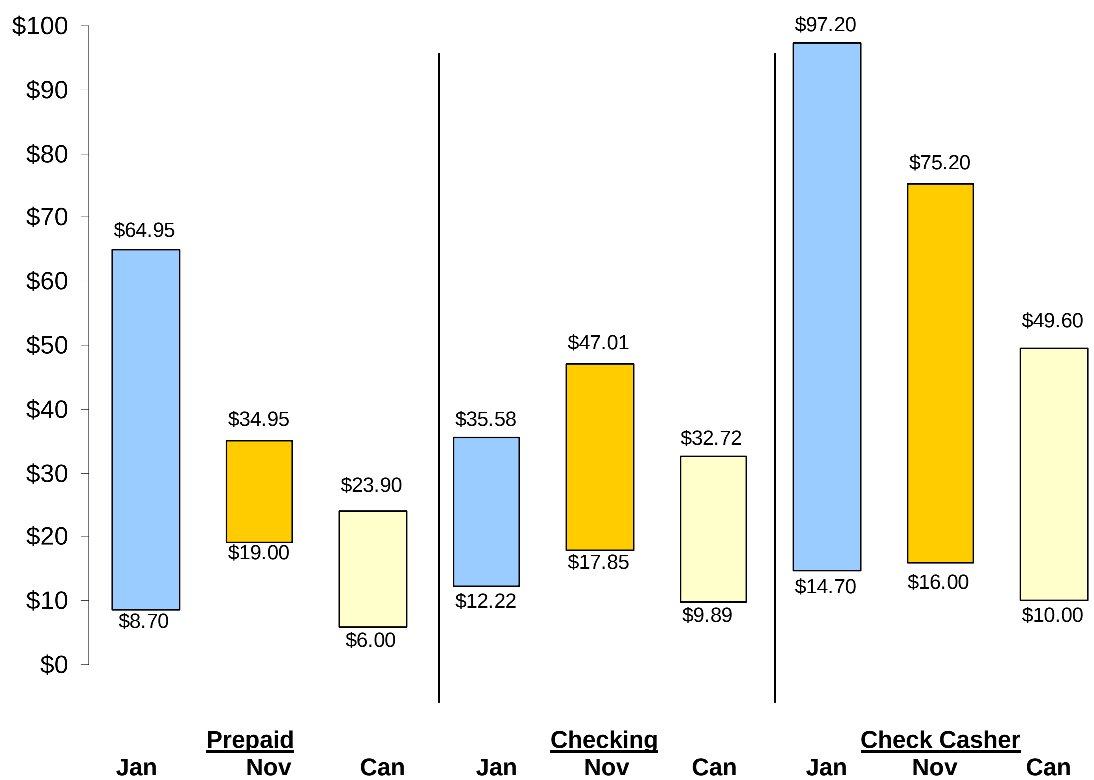
The certainty, simplicity and transparency of using a check casher or prepaid card represent meaningful advantages for Ms. Cancer. Because she does not conduct very many transactions each month, Ms. Cancer could theoretically pay less each month to conduct her transactions by using only a check casher, particularly if she has access to a low cost method of cashing checks. However, then she would not have as easy of access to a savings account. In addition, Ms. Cancer could lower her monthly spending by using a prepaid card which charges per transaction rather than a flat monthly fee. However, Ms. Cancer views the flat fee as one of the primary advantages of the card. In addition, because of the rewards system offered by the prepaid card company and the check casher, she is paying less than she was previously for money orders or to access cash. Ms. Cancer also reports having had difficult experiences with customer service at banks in the past. In contrast, she finds the staff at the check casher and the prepaid card company to be consistently friendly, helpful and generally "great".

Ms. Cancer could also lower her monthly financial services spending by consolidating all of her spending and saving onto one prepaid card. However, Ms. Cancer is intentionally using two cards in order to bucket her expenses into short-term and long-term needs.

Conclusion

As demonstrated by this analysis, the monthly financial services expenditure required to manage basic cash flows varies widely, depending on actual usage and choice of services and provider. There is no one right way for all individuals – even individuals who have similar characteristics in other ways such as income or household composition – to manage their financial services usage. It is clear that consumers are making trade-offs regarding the relative merits of different options – often by choosing a combination of services offered by different providers – in order to balance cost concerns with the other features that they need, such as convenience, accessibility, liquidity and simplicity.

Table 10: Summary of Financial Services Spending Alternatives



Each of the services studied can be used cost effectively. The key to keeping financial services expenditures low is to use the chosen product as effectively as possible. For example, if using a prepaid card, it is more cost-effective to get cash back at the point-of-sale than at an ATM and to choose a signature transaction instead of a PIN-based transaction at the point-of-sale. If using a checking account, it is far cheaper to avoid overdrafts and choose an account that has an achievable minimum balance. This point holds true for consumers of all incomes.[11]

[11] See Victor Stango and Jonathan Zinman, "What Do Consumers Really Pay on Their Checking and Credit Card Accounts? Explicit, Implicit and Avoidable Costs," forthcoming, for an analysis of the fees that people pay to use their

Just as importantly, this analysis and the underlying interviews suggest several ways that the financial products and services available to underbanked consumers today could be improved so that they better meet their needs.

First and foremost, access to and use of direct deposit needs to become ubiquitous. Direct deposit changes the economics for the financial services provider, making it easier to provide lower cost services and increasing the stickiness of the customer. Thus, direct deposit use is one of the best routes to lowering financial services spending, but many employees do not use or do not have the ability to direct deposit their paychecks.

Second, at the moment, it is near impossible to be 100% reliant on a prepaid card, reflecting that there is still missing functionality around check loading and bill payment. Underbanked consumers with prepaid cards often still use money orders, because not all payees accept direct deposit or debit payments. Courtesy checks or the ability to send a money order or paper check through prepaid cards could be useful features. Underbanked individuals often also need additional low cost methods of loading their income payments onto their cards: workers who do not use direct deposit often pay a fee to cash their paycheck and another fee to load the cash onto the card.

Third, the relative value and functionality of various products needs to be more transparent. This will better enable consumers to choose the product that is the best fit for their goals. Financial services companies could integrate more information into the account opening process in ways that would guide consumers to the best decision about which service to choose. A related point is that because underbanked consumers place a strong value on certainty about the fees to be paid, narrowing the variability of fees is crucial.

Fourth, additional functionality to facilitate budgeting is critical. As demonstrated by Ms. Cancer's use of two prepaid cards, many individuals would appreciate being able to segregate their funds into operating accounts, short-term savings for emergencies and long-term savings. Other budgeting approaches could be: 1) to enable account owners to opt out of overdraft protection; 2) to use text messages to remind cardholders and checking account owners about their budget, perhaps when they've spent a pre-identified amount during the month; or 3) to allow cardholders to set a spending limit above which their debit card (whether prepaid or associated with a checking account) would be denied even if there were available funds.

Finally, the connection between transactional products and long-term financial prosperity needs to be strengthened. Automatic transfers to a savings account associated with the transactional product can go a long way toward this goal. Similarly, credit-building features should be integrated into more transactional products. To the extent that transactional products enable the individuals using them to ultimately build creditworthiness, acquire assets and increase their financial prosperity, they will be more successful at meeting the full needs of underserved consumers.

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checking and credit card accounts, concluding that more than half of the $500 per year that the households studied pay annually in fees could be avoided with "minor changes in behavior."

About CFSI

The Center for Financial Services Innovation is the nation's leading authority on financial services for underbanked consumers. Since 2004, its programs have focused on informing, connecting, and investing – gathering enhanced intelligence, brokering and supporting productive industry relationships, and fostering best-in-class products and strategies. A non-profit affiliate of ShoreBank Corporation, CFSI works with leaders and innovators in the business, government and non-profit sectors to transform the financial services landscape. For more on CFSI, go to http://www.cfsinnovation.com

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