

Using CDFIs to Reach the Unbanked

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Introduction by Kirsten Moy and Alan Okagaki

The relationships among capital, community development and poverty alleviation are complex and significant. Research from the Community Development Innovation and Infrastructure Initiative (CDIII)¹, a national research project designed to evaluate the future of community development finance and intermediaries, revealed that while there is more capital and fewer gaps for community development lending than at any other time over the last 20 years, there are significant gaps in consumer financial services and products. The gap issue is not so much access as suitability and cost of the products and services offered.

The growth of financial service and credit providers that the unbanked have come to rely on such as check cashing outlets, “fringe banking” operations (e.g. payday lenders and pawn shops), and other consumer finance companies (e.g. rent-to-own) point to the clear need for financial services in these communities. However, long-term use of these services doesn’t offer an opportunity for the unbanked to build a financial foundation that will ultimately promote asset building, such as establishing credit.

¹ *The Community Development Innovation and Infrastructure Initiative (CDIII) was incubated at the John D. and Catherine T. MacArthur Foundation during its initial three-month research period. It was officially launched in December 1999 with support from the Ford, Surdna, Citigroup and ARCO Foundations, and additional assistance from J.P. Morgan and the Neighborhood Reinvestment Corporation. The second phase of the project seeks to raise capital to encourage research and development, to create innovative programs and build the infrastructure of the community development finance industry. Further information about the project is available from Kirsten Moy at (312) 565-9690, kirstenmoy@worldnet.att.net or Alan Okagaki at (406) 829-1575, alanokagak@aol.com.*

Extensive research confirms that there are many reasons aside from lack of proximity or limited hours that cause low-income individuals not to use banks; for example, fear that financial matters will be disclosed to creditors and deposit accounts liened, potential embarrassment of denial for loans or even applications for checking accounts. Other reasons are perhaps more straightforward such as a desire for privacy, high fees, high minimum balance requirements, discomfort in dealing with banks and, perhaps most significantly, a lack of education about banking. So despite the availability of low-cost or "lifeline" accounts offered by most banks, the use of "fringe" providers persists.

We coined the term Credit Plus to characterize a comprehensive approach of providing services beyond basic low-cost accounts to meet the needs of the unbanked. Such services

include: financial literacy, credit repair, counseling, as well as convenient bill paying services and small emergency loans, which are the two basic financial services most in demand by low-income individuals in addition to check cashing. The supplemental services covered under Credit Plus are instrumental in preparing the unbanked to participate in the mainstream financial system by tearing down the inadvertent wall of intimidation and mistrust that discourages them from using banks. Given the range of products and services mentioned, it seems unlikely that any one institution can reasonably and profitably provide them all. Innovative collaborations, partnerships and strategic alliances, such as with CDFIs and other community-based organizations, are required.

Research results of the CDIII project suggest that the most critical role CDFIs play is not the direct provision of finan-

cial services and capital, but rather, pioneering new markets, human development through training and technical assistance, product and program innovation, championing populations and communities to conventional financial institutions, and generally creating links to the mainstream economy. Yet, some investors expect CDFIs to act like banks with greater emphasis placed on their portfolios and technical proficiency as lenders, rather than on their overall impact on community development and poverty alleviation.

CDFIs can play a valuable role in building the bridge from unbanked to traditionally bankable, which is essential to asset building. Several creative partnerships are highlighted in the article that follows that show how some banks are utilizing CDFIs and other financial service providers to reach the unbanked.

USING CDFIs TO REACH THE UNBANKED

The Treasury Department estimates that as many as 11 million low-income American families do not have bank accounts. A 1995 Federal Reserve study revealed that an estimated 25 percent of low- and moderate-income families had no bank account. Other studies put the number of "unbanked" Americans (also known as "cash consumers") at a higher or lower number. What is clear, though, is that people without bank accounts tend to be poor, minority, and/or single heads of household. Families without bank accounts are subject to myriad fees associated with being a cash consumer. Every dollar consumers spend on fees for paying bills and cashing checks is a dollar that could have been used for savings or for improving the individual's quality of life. Having a bank account is also

an important tool to help families manage their assets and increase savings.

Increasing the availability of basic financial services to cash consumers is an area of ongoing concern for financial institutions. Recent years have seen a proliferation of low-cost bank accounts, as well as an increase in the availability of basic banking education for consumers, as banks attempt to reach unbanked populations. There remain, however, certain segments of the unbanked population that are more difficult for traditional financial institutions to reach. These segments often struggle with social, language and economic barriers that make them unlikely to seek out traditional bank services.

Providing services directly to these segments requires a special understanding of the needs and requirements

of these consumers. The staffs of traditional financial institutions may not possess the specialized training necessary to, for example, provide financial services to a homeless person receiving general assistance. The question of delivery cost is also relevant. Often it simply is not economically feasible for traditional financial institutions to provide the labor-intensive services desired by the "persistently" unbanked.

But are these segments completely unreachable? A number of innovative pilots and successful models underway throughout the 12th District clearly show that banks can serve, and are serving, this population by working with CDFIs, community based organizations and other financial services providers. These partnerships, by filling the expertise gap, offer banks the

opportunity to reach the unbanked while receiving additional benefits such as the ability to serve the credit needs of its entire community, the opportunity for CRA credit, and the possibility of “graduating” these consumers to traditional financial services.

One example of such a partnership is the relationship that the Commerce Bank of Washington has developed with the Compass Center of Seattle, Washington. This program illustrates an effective means of providing banking services to the homeless (Box 1). A similar program serving the homeless and very low-income customers also exists in San Francisco. Like the Compass Center, the Northeast Community Federal Credit Union, which was established in 1981, provides support and counseling as part of their service to customers.

Homelessness is one barrier to participating in the mainstream financial system. Another barrier may be limited English or banking skills. Partnering with a community-based financial intermediary or organization may be an especially effective method of reaching this segment. Partnering with a Community Development Credit Union (CDCU) such as Chicanos por la Causa in Phoenix, Arizona, which specializes in serving multi-lingual communities, can provide financial institutions with an edge in serving these segments.

There are a couple of ways in which traditional financial institutions can partner with a CDCU. Banks can make direct investments in CDCUs through a deposit or an equity investment. Banks can also invest indirectly

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through the National Federation of Community Development Credit Unions (NFCDCU), who then passes the money on to a CDCU in the investor’s geographic area. The NFCDCU offers a secondary capital program, a non-member deposits program and a grant program to facilitate investment in credit unions. Investments and deposits in CDCUs are eligible for consideration under the Investment Test as qualified investments. If the CDCU has also been certified as a CDFI, the bank’s investment may qualify for a Bank Enterprise Award (BEA). Banks can also qualify for Service Test credit by providing technical assistance such as training tellers or assisting bank management. According to Suzanne James of the NFCDCU, providing assistance with activities like teller training has a much greater impact than deposits.

A portion of the unbanked population, perhaps a significant portion, have a knowledge gap, or perhaps an awareness gap that prevents them from entering the financial mainstream and as a result resort to frequenting check

cashers. This group may be ready for traditional financial services but do not possess the financial literacy to competently utilize bank services, or simply may not be aware that their financial circumstances could be improved by using mainstream services. Another segment may be locked out of the banking system due to a scarred checking account record or blemished credit history.

The difficulty of reaching this segment of the unbanked population has been addressed in a unique and straightforward way by the partnership of a financial institution with a check casher. Because check cashers do not have community development as their primary purpose, a partnership may not be eligible for CRA credit; however, they potentially offer other worthwhile benefits. Check cashers generally have the physical distribution, network and customer profile to effectively reach consumers without bank accounts. The partnership between Union Bank of California, Nix Check Cashing and Operation Hope leverages the customer base of a check casher to introduce unbanked consumers to traditional financial services. Union Bank of California has its own teller window at select Nix locations, in addition to ATM services and financial planning information for customers. Operation HOPE’s role will include overseeing consumer protection and community education.

This partnership with Nix is based on another innovative program developed by Union Bank of California to penetrate significantly underserved areas: *Cash & Save*. *Cash & Save* incor-

A New Revolution in Banking: The Compass Center Bank

THE COMPASS CENTER, a social service agency in Seattle, Washington, is leading a revolution in banking by providing services normally inaccessible to low-income and homeless people. Support from area banks and the surrounding community is making this possible.

The Compass Center Bank opened in the early 1970s to serve low-income and homeless individuals who for a variety of reasons could not use a traditional bank. Many of the people who use the banking service suffer from mental health problems, drug and alcohol addiction, and/or a poor credit history.

At first, the bank was very basic. Tellers, who were really social workers, recorded transactions in carbon receipt books while a bookkeeper controlled a drawer of money in a back office and balanced the books and receipts by hand at the end of the day.

Two years ago, John Kephart from The Commerce Bank in Seattle visited the Compass Center and recognized a need for the bank to move into the 21st Century. He knew that the federal government was going to mandate a complete transfer from paper checks to electronic direct deposit of government benefits into an individual's bank account. The Commerce Bank, along with five other area banks: Key Bank, Wells Fargo, Bank of America, Washington Mutual, and the Federal Home Loan Bank of Seattle, donated time, money and equipment so that the Compass Center could become fully automated. The Commerce Bank also donated the bank accounts for Compass Center clients. Other banks' staff has provided extensive training on the ITI and EZ Teller systems and offer ongoing support with problems ranging from accounting to supplies.

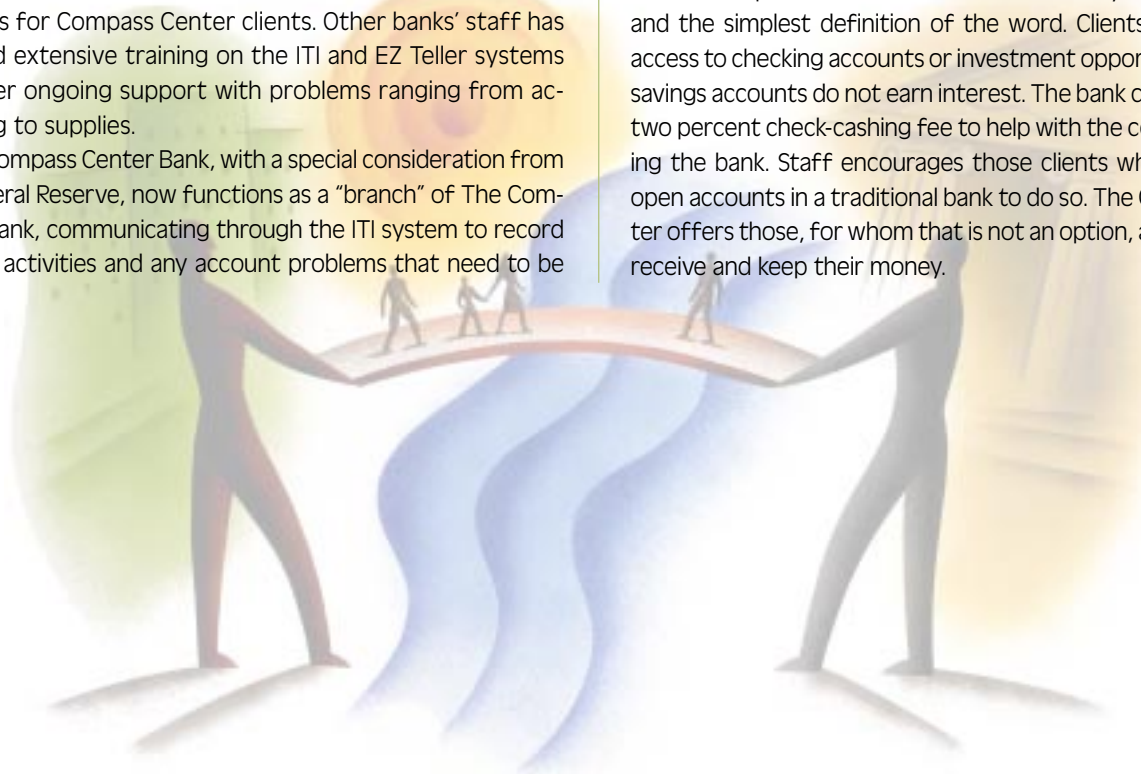
The Compass Center Bank, with a special consideration from the Federal Reserve, now functions as a "branch" of The Commerce Bank, communicating through the ITI system to record account activities and any account problems that need to be

solved. An ACD machine dispenses money directly to the "tellers." Clients can now receive payments through the ACH from the Federal Reserve or Social Security, and employment checks can also be directly deposited.

The response from the community and clients has been positive and supportive. The clients now feel less marginalized and have some of the same benefits one would receive through a traditional bank. The self-worth of the clients can grow now that they have a progressive system to safeguard their money. While Compass Center clients remain vulnerable to muggings, drug and alcohol addiction and domestic violence, they are spared further possible trauma caused by the loss of their month's income.

It is important to remember that Compass Center employees are social workers, not bankers, and as such have a special relationship with their clients. The bank's regulations state that transactions may be refused at the discretion of Compass Center staff. A worker can and will invoke this clause if he or she thinks that a client is too drunk or high, that someone is being coerced into withdrawing their money, or that in some way the client is going to use the money to hurt his or herself. The bank is just one part of the Compass Center's Client Services Office where homeless and low-income adults receive a multitude of services including mail, representative payee services, free budgeting assistance, and information and referral.

The Compass Center Bank is a bank in only the most basic and the simplest definition of the word. Clients do not have access to checking accounts or investment opportunities. Their savings accounts do not earn interest. The bank charges a small two percent check-cashing fee to help with the cost of operating the bank. Staff encourages those clients who are able to open accounts in a traditional bank to do so. The Compass Center offers those, for whom that is not an option, a safe place to receive and keep their money.



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porates a three-step introduction to traditional financial services with the goal of converting check cashing customers into depository customers. First, the customer has access to products that meet essential financial services needs, such as check cashing, money orders, money transfer, and bill pay. Second, *Cash & Save* personnel, working with community organizations such as Operation HOPE, conduct basic banking seminars and presentations to educate customers on the benefits of establishing a banking relationship. Third, *Cash & Save* works with the customer to determine which account will best serve their financial needs. Once a banking relationship is established and the client has demonstrated discipline in handling a bank account, the client then transitions to conventional bank products. Union Bank of California reports that the transition rate for repeat *Cash & Save* check-cashing clients, who now hold bank accounts, is 40 percent.

The success of these unique partnerships makes clear that while some consumers are more difficult for traditional financial institutions to reach, none are out of reach when a bank partners with a community-based organization. The transaction cost to serve some segments of the unbanked is often too high for mainstream banks, and is better outsourced to CDFIs whose mission enables them to provide the *credit plus* services cost-effectively. Some of the models presented may be considered

risky or experimental, thus banks are encouraged to thoroughly undertake due diligence and carefully evaluate the risk relative to the benefit. Partnering with third parties to add value to a relationship, create new relationships, or perform a service cost effectively, is not a new idea. This familiar practice, applied to the goal of reaching unbanked consumers, can help banks meet community credit needs, satisfy their CRA obligations, and create new customer opportunities. **CI**

For more information on the above-mentioned programs, please contact the following:

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