THE PEW CHARITABLE TRUSTS

CONVERTING BASIC FINANCIAL SERVICES FEES INTO PROSPERITY:

An Untapped Opportunity for Consumers and Banks

EXECUTIVE SUMMARY

Fees generated from basic financial services like overdraft protection and out-of-network ATM charges now add up to $58 billion in annual revenue for financial institutions. Yet, for as much money as is generated from these fees and for as controversial as they have become, very little is actually known about who relies on these fee-based services, which hinders the development of appropriate policy and market-based responses. Using data from a new survey of California households commissioned by the Annie E. Casey Foundation, The Brookings Institution, The Pew Charitable Trusts and the William J. Clinton Foundation, this paper examines the underlying market for four major basic banking fees and finds that:

About 21 percent of households with a bank account report that they have overdrawn their accounts at least once in the last year. Contrary to common perception, the majority of households that overdraw their bank accounts are middle-class families (in the second and third income quartile) that are headed by white, middle-aged, college-educated adults who have internet access and a mobile phone, speak English at home, and typically overdraw their accounts just two times a year. However, the small share of households that rely heavily on overdrafts (three or more times during a year) consists primarily of low-income households and collectively represents a comparatively large percentage of the overdraft market overall.

About 24 percent of households with a credit card report that they fell behind on their monthly card payments at least once in the last year. Delinquent credit card customers in California tend to be middle-income, have a college education, and work full-time. Most are white and about a quarter are foreign-born. Nearly all own a mobile phone and have regular access to the internet. The majority of these households also subscribe to or regularly read print magazines, own stocks or mutual funds, and bank online.

About 41 percent of households report that they use a foreign (or out-of-network) ATM. The out-of-network ATM fee market in California consists primarily of middle- and higher-income households whose heads have college degrees and work full-time. Most are white and about a fifth are foreign-born, and nearly all own a mobile phone and have regular access to the internet.

About 12 percent of households pay fees to cash checks and pay bills because they lack a bank account. The majority of unbanked households in California include low-income, full-time employed, foreign-born Hispanic workers who do not have a high school diploma, have never had a bank account, are paid in checks by their employers, and use money orders to pay their monthly bills. About half own mobile phones, a third have regular internet access, and scarcely any read print magazines.

In total, about 58 percent of California households pay fees for overdrawing their checking accounts, falling behind on their credit card payments, using out-of-network ATMs, or cashing checks. Contrary to common perception, the bulk of households paying these basic banking fees is middle-class, relatively well-educated and technologically sophisticated consumers. In addition, fee usage tends to be highly episodic for most households, not something that occurs regularly and systematically. The lone exception is in the check-cashing market, which is dominated by lower-income households with low levels of educational attainment, that rely heavily on expensive non-bank services.

We conclude with a recommendation for how policymakers can lower these $58 billion in annual fees. In particular, state and local governments can connect consumers to fee-based products and services that are already widely available at a lower cost. For instance, the majority of households that overdraw their checking accounts have a savings account they could link to and avoid all or a majority of the fees they currently pay. We also find that the majority of unbanked households in California have characteristics that suggest they could save a substantial amount of money by opening a low-cost account at a bank or credit union. There are also numerous low-cost options available to consumers to eliminate or reduce costs associated with credit card delinquencies and out-of-network ATMs.

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INTRODUCTION

Fees associated with basic financial services and transactions are both a growing source of revenue for banks and an increasingly prevalent component of household budgets. Banks, for instance, saw their noninterest service fee revenues from deposit charges alone increase from $8 billion in 1987 to more than $38 billion in 2007, or by about 375 percent.[1] In comparison, median household income grew by just 10 percent during the same period.[2] This is not a pure apples-to-apples comparison, since banks earn noninterest fee income from commercial enterprises as well as from individual consumers, but estimates suggest that consumers generate a large share of this amount.[3]

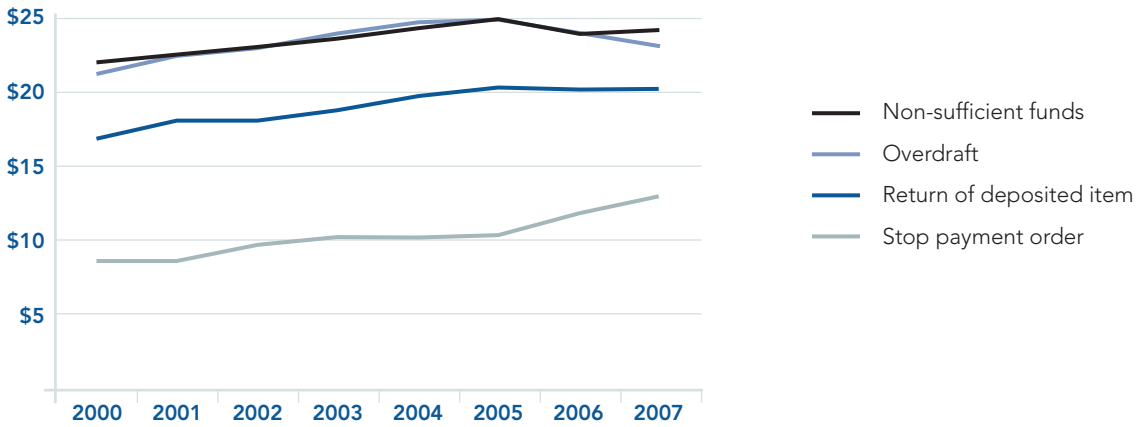
Growth in fee revenue reflects a broad expansion in the range of basic financial services afforded to customers. Most prominently, depository institutions now charge fees for over two dozen different services associated with checking accounts, from widely reported fees such as those charged for overdrawing accounts and using out-of-network ATMs, to more exotic fees like those associated with abandoned accounts and account reconciliation.[4] Non-depository institutions, too, charge customers for a range of financial services including cashing checks, issuing customer ID cards, and loading money onto prepaid debit cards, among many others.[5]

While not all of these fees are new to the market, many now come in new variations.[6] Many have also become increasingly expensive, according to a recent report by the GAO.[7] In one analysis of proprietary data, for instance, the GAO found that average nonsufficient funds and overdraft fees rose by about 11 percent between 2000 and 2006, then estimated to be about $25 per incidence. Increases in the cost and prevalence of fees are the result of a number of market dynamics, including the growing attraction for financial institutions to "nudge" consumers into automated interactions (e.g., debit card transactions instead of teller transactions), the substitution of fee income for traditional sales income (e.g., the replacement of sales "add-on" charges by foreign-currency exchange fees), a growing appreciation for the revenue potential of these fees, service expansions (e.g., the growing convenience of electronic payments), and improvements in the ability of financial institutions to manage risk.[8]

Yet, for the amount of money that is generated from these fees and for as controversial as many of them have become, very little is actually known about who relies on the services for which they are charged, which hinders the development of appropriate policy and market responses.[9] For instance, if bank fees for basic services are being paid primarily by lower-income

FIGURE 1

GROWTH OF AVERAGE BASIC BANKING FEES, 2000-2007



Source: General Accountability Office, 2008. "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts." GAO-08-281
Note: Figure was recreated using estimates.

customers—as some have asserted—then traditional bank accounts may not be appropriate for those households, since their tight budgets may make the costs of managing a bank account more expensive than the alternatives.[10] On the other hand, if bank fees for these same services are primarily being paid by middle- and higher-income households, then the primary driver of these fees is perhaps not tight budgets but some type of behavioral issue, such as absentmindedness or poor money-management skills, suggesting a policy response more oriented around education.[11]

Similarly, if non-bank fees for check cashing and bill payment are being charged predominantly to people who misunderstand or are distrustful of banks, then policy may be needed to help overcome these perception barriers. But, if instead these fees are being charged to people who live in a cash economy and don't see the need for bank accounts, then the liquid, paperless structure of a non-bank relationship is likely preferable.[12]

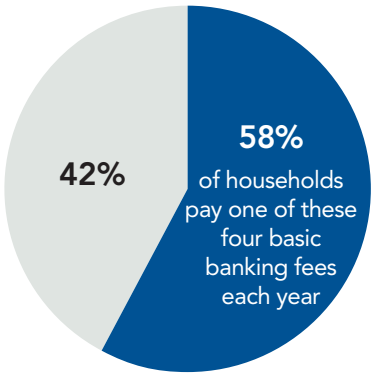
Appropriate market responses are also curbed by the lack of information about the customers of basic financial service fees. For instance, the fact that depository institutions currently charge up to two dozen different fees seems to suggest that a bank could potentially differentiate itself and pick up market share by offering fewer or less expensive fees.[13] Yet, if the bulk of these fees is being charged to moderate- and lower-income households, then there may not be much of a market opportunity for differentiation because these households represent a comparably smaller and less attractive segment.[14]

This paper responds to these questions by analyzing the results of the first-ever survey of household financial services uses and needs in California. The survey, administered in May 2008, was commissioned by the Annie E. Casey Foundation, The Brookings Institution, the William J. Clinton Foundation, and The Pew Charitable Trusts, in partnership with the Office of Gov. Arnold Schwarzenegger and the Office of Mayor Antonio Villaraigosa of Los Angeles. California was selected for this analysis because state and local leaders there are launching market-based initiatives to bring down the cost of some of these fees for households. This report will provide the baseline upon which those initiatives can be evaluated, as well as one of the first-ever glimpses into consumer demand for these transaction fees.

We find that about 58 percent of households in the state are now being charged overdraft charges, credit card late payment fees, out-of-network ATM charges, or check-cashing fees—four widely utilized basic financial services fees.[15] Across the United States, those fees now add up to over $58 billion in annual costs

FIGURE 2

OVERDRAFT, OUT-OF-NETWORK ATM, CREDIT CARD DELINQUENCY, AND UNBANKED FEE MARKETS



21% of households with bank accounts overdraw their accounts at least once a year. (Nationwide, fees add up to $34.1 billion.)

41% of households with bank accounts pay out-of-network ATM fees. (Nationwide, fees add up to $18.1 billion.)

23% of households with credit cards fall behind on their monthly payments at least once a year. (Nationwide, fees add up to $4.4 billion.)

12% of households lack a bank account and instead pay fees to cash checks and pay bills. (Nationwide, fees add up to $1 billion.)

Source: Authors' analysis of survey data; Stephens Inc., Moebs Services, Inc., R.K. Hammer, Bankrate.com.
Note: Overdraft fees, out-of-network ATM fees, credit card delinquency fees, and the various fees paid by unbanked households do not represent the entire basic banking fee market. In addition to these four, there are a number of basic banking fees that are reviewed in our Methodology section, including inactive account fees, teller service fees, bounced-check fees, credit card annual fees, and credit card over-limit fees, among others.

to consumers.[16] Contrary to common perception, the bulk of households paying these basic financial service fees is middle-class, relatively well-educated and technologically sophisticated. Usage of most of these fees also tends to be highly episodic for most households, and not something that occurs regularly and systematically. The lone exception is the check-cashing market, which is dominated by lower-income households with low levels of educational attainment that heavily rely on expensive non-bank services.

We conclude with a recommendation for how policymakers can lower these $58 billion for bank customers. In particular, we highlight a potentially powerful new role for public leaders to play as market intermediaries that can connect households to existing lower-priced alternatives. Of particular importance is the unbanked market, which relies largely on unnecessarily overpriced products and services. We believe that the non-banks serving much of this market operate on an economic model that is at a sharp competitive disadvantage, and as a result can be cannibalized by depository institutions. This model could also effectively reduce other fees. Our results indicate, for instance, that most households that overdraw their accounts have a savings account, which could be linked to cover overdrafts—a lower-cost service option that most banks offer, according to recent research.[17] We also find that about 60 percent of households do not compare checking accounts at the time of opening, suggesting that financial institutions with more convenient ATM networks could be identified for households.

Finally, we do not comment on the validity of these fees, as others have elsewhere. We do not have data that speak to the margin generated by these fees and therefore cannot reliably assess the extent to which there are excesses. We also do not have data that adequately capture whether consumers are being steered by financial institutions into product agreements that increase the likelihood of service charges. We do have rigorous data, though, on the total value of these fees, the variance in usage across different types of households, and the economic and behavioral variables that drive consumption. This information allows us to develop a number of recommendations for how the total value of these fees can be lowered, even while the value of the services tied to them is substantially expanded for both financial institutions and consumers.[18]

METHODOLOGY

About the survey

The data used in this report are from a statewide survey of household financial behavior in California. The survey was administered by California Survey Research Services, Inc. (CSRS) and commissioned by the Annie E. Casey Foundation, The Brookings Institution, the William J. Clinton Foundation, and The Pew Charitable Trusts, in partnership with the offices of Gov. Arnold Schwarzenegger and Mayor Antonio Villaraigosa of Los Angeles. The survey instrument was developed in collaboration with each of these institutions as well as a number of financial institutions; the San Francisco Office of the Treasurer; and Emerging Markets, Inc., a business consulting firm in Los Angeles.[19] It is the first-ever publicly available survey to look at consumer finance behavior at the state level.

The survey instrument consisted of about 100 closed-ended questions covering a broad range of household financial behavior.[20] These included questions about use of both mainstream (e.g., banks, credit unions) and alternative (e.g., check cashers, payday lenders, pawnshops) financial institutions, as well as questions about both basic (e.g., deposit accounts) and more sophisticated (e.g., loan and investment products) financial services. Respondents were also asked for their demographic and socioeconomic information, such as race and educational attainment, and about aspects of their non-financial consumer behavior (e.g., access to the internet, mobile phone ownership, magazine preferences). A copy of the survey instrument is available from the authors upon request.

The survey was administered in May 2008 by telephone to a random sample of households throughout California.[21] These households were selected via random digit dial (RDD) within each of the state's four income quartiles as determined using microdata from the Census Bureau's 2006 American Community Survey. The bottom quartile includes households with an annual income of $30,000 or lower, the second quartile includes households with an annual income of $30,000-$60,000, the third quartile includes households with an annual income of $60,000-$110,000, and the top quartile includes households with an annual income of $110,000 or higher.

Respondents for each household had to be at least 18 years old and play a leading role in the household's budgeting.[22] CSRS made up to four attempts to reach households in the RDD sample and, when applicable, callbacks were rescheduled to a time more convenient to the respondent. The rules for the distribution of call attempts were those used by the CfMC computer-assisted telephone interviewing (CATI) system.[23] The survey was administered in both English and Spanish and took an average of about 13 minutes to complete.

In total, CSRS completed interviews with 2,001 households in California. Sampling errors are 2.2 percent for the entire sample. For instance, if 50 percent of respondents in a subsample of 500 households responded "Yes" to a question, one could state that there were 95 chances out of 100 in a repeated sample of 500 responses that respondents would also report "Yes" within the interval between 47.8 and 52.2 percent. For the sake of simplicity, we do not present the confidence interval around estimates in this paper, although they can be made available from the authors upon request.

About the reviewed basic banking fees

Banks and non-banks now offer dozens of fee-based services tied to basic banking needs, including making deposits, paying bills, cashing checks, and taking out small-dollar loans.[24] Among banks, this includes charges on checking and some savings accounts for 1) abandoned accounts, 2) monthly maintenance, 3) early account closing, 4) account research and reconciliation, 5) ATM use, 6) debit cards, 7) debit card replacement, 8) check printing, 9) coin counting, 10) counter checks, 11) credit references, 12) deposited-item return, 13) inactive accounts, 14) money orders and cashier's checks, 15) non-sufficient funds, 16) overdrafts, 17) notary services, 18) checks, 19) return of checks with statements, 20) safe deposit box rental, 21) stop payment, 22) teller services, and 23) low balances. There are also numerous charges associated with different services provided to credit card customers, including 24) late penalty fees, 25) over-limit (exceeding the credit limit) fees, 26) payment processing fees, 27) returned-check fees, 28) cash advance fees, 29) convenience check fees, 30) balance transfer fees, 31) foreign currency transaction fees, 32) membership fees, 33) exchange rate fees, 34) card replacement fees, 35) revolving balance fees, 36) stop payment fees, 37) telephone payment fees, and 38) fees to obtain duplicates of account records. Similar types of fees also exist for personal loans and more specialized types of loans such as "gas loans." Not all banks offer each of these services and/or charge fees for them; rather, they represent a snapshot of the fees generally associated with these services.

Non-banks, too, charge for dozens of basic financial services, including 1) check cashing; 2) account setup; 3) ID cards; 4) ID card replacement; 5) ID verification; 6) bounced checks; 7) money orders; 8) bill payment; 9) small-dollar loans; 10) extensions, deferrals, renewals and rewrite services; and 11) collection services. As with the bank fees listed above, not all non-banks offer each of these services and/or charge fees associated with each; rather, this list represents a snapshot of the fees generally associated with these services.

Since research suggests that a large share of customers is often unaware of all of the dozens of basic banking fees that they are potentially being charged, a survey that directly asked households about their propensity to incur each of these specific fees would not have been reliable.[25] In any case, it would have been cost-prohibitive to ask each household if they had used the 48 different services listed above, in addition to information such as the household's demographic, socioeconomic, and non-financial consumer behavior (e.g., access to the internet, mobile phone ownership). For these reasons, we elected to ask households about only four of the most widely reported fees. These include a) overdraft and non-sufficient funds fees charged by banks, b) credit card delinquency fees, c) out-of-network ATM fees, and d) check-cashing and bill payment fees charged by non-banks.

About the market assessments

This report focuses on three dimensions of each of the reviewed banking fees. The first section is market sizing, which reviews information, where available, about the propensity of households to use each fee-based service. The second is an assessment of market components, which reviews the demographic profile of the users of each fee-based service as well as a profile of their non-financial behavior, where relevant. This non-financial behavior, such as magazine preference and mobile phone ownership, is valuable information for both policymakers and market-makers who are considering strategies to reduce these fees. Finally, the third section reviews market drivers, in which we discuss the various motivations that propel individuals to incur these service fees.

About the generality of the results

The survey was administered to a sample of California households, a population that collectively makes up about 12 percent of the national population.[26] California's population resembles that of the U.S. in some categories, but is quite different in others, suggesting that care should be taken in generalizing our results to reflect fee markets in other states.

One area of similarity is the distribution of income across households. In particular, there is an average difference between the two distributions of 2 percentage points across the income increments of $25,000 in each level of geography, as indicated in Table 1.[27] There are slightly more lower-income households and slightly fewer higher-income households in California than there are across the U.S. as a whole, but there is relative parity across these two levels of geography. Employment rates in the two geographies are also similar. In particular, 6.6 percent of California's civilian labor force was unemployed in 2006, compared with 6.4 percent of the national civilian labor force. Similarly, about 29 percent of Californians age 25 or older were college-educated, compared to about 27 percent of the same age group nationally. These data point to a relative parity across the two levels of geography in three major socioeconomic categories.

In other areas, however, there are sharp differences between the California population and the nation as a whole. Among these differences, California generally has a larger number of Hispanics, legal and undocumented immigrants, and a higher percentage of households that speak a foreign language at home. In turn, these differences may mean that the distributions we report for California may differ in meaningful ways from the national distribution.

TABLE 1

DEMOGRAPHIC VARIABLES, CALIFORNIA AND THE U.S.

	California	U.S.	Difference
Share of households with an income of…			
Below $25,000	21.3%	25.3%	4.0%
$25,000 - $49,999	23.1%	25.9%	2.9%
$50,000 - $74,999	18.3%	19.0%	0.7%
$75,000 - $99,999	12.7%	11.8%	0.8%
$100,000 - $124,999	8.8%	7.1%	1.7%
$125,000 - $149,999	5.1%	3.8%	1.4%
$150,000 or higher	10.7%	7.0%	3.7%
Civilian unemployment rate	6.6%	6.4%	0.2%
Share of adults 25 and older with a college degree	29.0%	27.0%	2.0%
Distribution of population by race			
White	42.8%	66.2%	23.4%
African-American	6.0%	12.2%	6.1%
Hispanic	35.9%	14.8%	21.1%
Other	15.3%	6.9%	8.5%

Source: U.S. Census Bureau, American Community Survey 2006.

FINDINGS

This section reviews the markets in California for four different sets of fee-based basic banking services, specifically fees charged for a) overdraft and non-sufficient funds; b) credit card delinquencies; c) out-of-network ATM usage; and d) check cashing, most commonly used by unbanked households. For each of these, we use the survey data to profile the market size, the major market components, and the market drivers.[28]

A. The Bank Overdraft and Non-sufficient Funds Fee Market

All depository institutions charge some type of fee when customers overdraw their bank accounts.[29] These fees come in many varieties. The most prevalent is an overdraft service, by which the overdrawn balance is temporarily loaned to the customer for a fee. Most banks that offer this program lend money in increments rather than the precise amount overdrawn.[30] Other types of overdraft protection include automatic transfers from one of the customer's other accounts, and an automatic overdraft line of credit. Of these three types of overdraft protection programs, nearly all banks report in a recent study that the fee-based overdraft program is profitable, about 60 percent report that the automatic line of credit is profitable, and only 40 percent report that the linked-account program is profitable. In addition to overdraft protection programs, a small number of banks report that they charge a non-sufficient funds fee and do not loan the customer money to cover the negative balance. It is more common, however, for banks to offer an overdraft protection program that is available only to certain segments of its customer base. Overdraft charges were estimated in a recent GAO assessment of industry data to average about $25 per incidence.[31]

MARKET SIZE

About one in five Californians, or 21 percent, report that they have overdrawn their bank accounts at least once in the past year.[32] Although we do not know the collective value of those fees for California households, we do know that, nationwide, an estimated $34.1 billion was paid in overdraft and non-sufficient funds charges by consumers in 2007.[33] While this value is sizable, the average California household with a bank account did not overdraw its account in the past year, suggesting that the majority of households do not pay this fee regularly. And, among the minority that have overdrawn their accounts, the median household reports doing so only two times in the last 12 months. These data suggest that the large amount of revenue made from overdrafts is likely a function of the fact that there is a very broad, occasional utilization of these fees by consumers.

MARKET COMPONENTS

The majority of households that overdraw their bank accounts are middle-class families (with an average of one child) who are headed by white, middle-aged, college-educated adults, have access to the internet at home, speak English at home, and own a mobile phone. They typically overdrew their accounts just two times in the past year, though we do not know whether those overdrafts were discrete charges (e.g., a single check) or multiple simultaneous charges (e.g., several checks).[34] However, the small percentage of households that rely heavily on overdrafts (three or more times during a year) is dominated by low-income families and collectively represents a comparatively large percentage of the overall overdraft market.[35] Below, we analyze in more detail each of the components of this market.

Household Income

About 76 percent of the households that overdraw their bank accounts are solidly middle- and upper-class. In particular, the largest share of households that overdraw is in the state's second household income quartile, earning an annual income of between $30,000 and $60,000. The next largest share earns between $60,000 and $90,000 a year. Collectively, these two groups account for about 59 percent of the market. Another 16 percent of the market is made up of households in the top income quartile, earning more than $90,000 a year. Lower-income households, or those in the bottom income quartile, represent about 26 percent of the total.

Within income groups, the highest propensity to overdraw a bank account was in the second income quartile of households earning between $30,000 and $60,000 a year. About 26 percent, or slightly more than one in four households in this lower-middle-income group, report that they have overdrawn their

bank accounts at least once in the past year. By comparison, about 21 percent, or slightly more than one in five households in the first and third income quartiles report that they have overdrawn at least once during the past 12 months. The overdraft rates across the first three income quartiles are very similar, though there appears to be a slightly higher propensity in the lower-middle-income quartile. Among households in the highest income quartile, about 16 percent, or slightly fewer than one in seven households report that they have overdrawn at least once. This is the lowest rate of all of the income groups, though the difference is relatively modest.

Lower-income families are less likely than middle-income families to overdraw their accounts for a number of reasons. For starters, lower-income households use their ATM cards less often and rely less on checks than higher-income households. In particular, about 56 percent of households in the bottom income quartile report that they use their ATM card once a month or less often, compared to about 48 percent of all other households. Similarly, about 39 percent of banked lower-income households report that they pay at least one bill every month in cash—a substantially higher share than those in other income groups (although 71 percent of lower-income households reports that they pay at least one bill with a check).

Lower-income households may also be more alert to the limitations of their budgets than other households simply because they have fewer financial obligations and must work with a smaller margin of error to cover the costs of living necessities. Just as someone walking along the edge of a cliff has a greater sense of their proximity to the drop than someone who is further away from it, so too is a lower-income family likely to have a greater sense of its budget limitations than a middle-income family.

Household Education

About 46 percent of households that report having overdrawn in the past year have a four-year college degree, and about 19 percent say they have a graduate degree. The remaining half of the market is divided among households with fewer years of education, with the next largest share consisting of households with some college education but no degree. Households with at least some college education represent about 76 percent of the market, suggesting that the bulk of the overdraft market is a fairly educated group. Still, there are much higher rates of incidences of overdraft usage in some select educational groups. For instance, households with trade school degrees represent just 4 percent of the overall overdraft market but face a nearly one-in-three chance that they will overdraw their bank accounts at least once in a 12-month period. Similarly, those without a high school diploma represent just 7 percent of the overall market, but 15 percent of these households report that they overdraw their bank accounts. Those with some graduate school education (but no degree) represent 4 percent of the market, but 16 percent of these households report that they overdraw at least once a year.

Race and Ethnicity

About 60 percent of California households that overdraw are headed by a white adult, another 20 percent are headed by a Hispanic, and all other races are in single digits. Within race categories, minority households are more likely to overdraw their accounts. In particular, about 36 percent of Hispanic households overdraw their accounts, 28 percent of African-American households overdraw their accounts, 24 percent of households of other-race households overdraw their accounts, and 19 percent of white households overdraw their accounts.

Even while minority households comprise the bulk of the overdraft market and are more likely than white households to overdraw, the majority of these households have not overdrawn their accounts in the last 12 months. In particular, about 62 percent of Hispanic households did not once overdraw their accounts in the last 12 months, about 66 percent of African-American households did not overdraw, and 75 percent of other-race households did not overdraw. In comparison, about 80 percent of white households did not overdraw. In addition, while the share of households that have overdrawn their accounts at least once in the last year is greater among minority households than among white households, our data suggest that households that do incur these fees do so roughly the same number of times regardless of race. The median number of overdrafts per year among white, Hispanic and minority households other than African-American is 2.0; and the median number of overdrafts per year among African-American households is slightly higher, at 2.5.

Household Access to the Internet

About 97 percent of households that overdraw their bank accounts have regular access to the internet and about 71 percent of these households report that they check their balances online. These technologically connected households are also surprisingly more likely to overdraw their accounts than less connected households. In particular, about 23 percent of households with internet access overdraw their accounts, compared to about 21 percent of households that lack internet access. More tellingly, 26 percent of households that report using online banking services to check their account balances overdraw their bank accounts, compared to just 16 percent of households that do not check their balances online. It seems, then, that having access to the internet and online banking services does not necessarily lead to a reduction in these costly behaviors.

Other Consumer Behavior

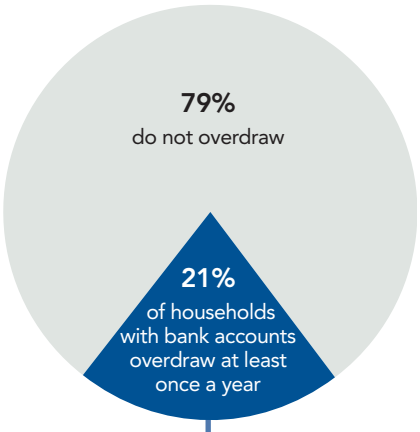
Households that overdraw their checking accounts also tend to be fairly sophisticated consumers. The vast majority are technologically connected, having both regular internet access and a mobile phone; more than two-thirds invest in the stock market; and about half consult with a financial adviser. In particular, 94 percent of these households have access to the internet, and 94 percent own a mobile phone. Approximately 67 percent go online to check their account balances, pay bills, or shop for other financial products. About 55 percent own stocks or mutual fund shares, and 54 percent report that they regularly speak to a financial adviser to manage their money and investments.

MARKET DRIVERS

There are a number of possible reasons why people overdraw their bank accounts. These include a) poor

FIGURE 3

CALIFORNIA'S OVERDRAFT FEE MARKET



Distribution across..

Income		Educational Attainment		Race		Employment		Internet Access	
Lower	26%	Some or no H.S.	7%	White	60%	Employed	86%	Have access	97%
Lower-middle	32%	H.S. diploma	13%	African-American	8%	Unemployed	14%	Do not have access	3%
Higher-middle	26%	Some college*	33%	Hispanic	20%				
Higher	16%	College degree	46%	Other	9%				

Source: Authors' analysis of survey data.
Notes: Due to rounding and a handful of missing survey responses, distributions may not always sum to 100%.
*"Some college" includes households whose heads have some post-secondary education and either a two-year degree, trade school degree, or no degree.

money management (e.g., inadequate planning, overspending), b) tight budgets (e.g., lower incomes, unexpected expenses, high debt-to-income ratios), and c) unexpected bank holds on deposited funds (e.g., a Regulation CC hold). We consider each of these potential drivers below.

Poor Money-Management Skills

One reason why 21 percent of households withdraw more money than they have in their accounts may be that they have difficulty managing their finances. This could be reflected by variety of indicators. Some households, for instance, may have difficulty controlling their spending or keeping track of their balances, eventually reaching a point at which they withdraw more money than they have available. Other households may miss-time their bill payments and send out bills before deposited funds are available for withdrawal. In addition, the survey findings indicate that more than 70 percent of households that overdraw also have a savings account, suggesting that households may not be aware of their banks' linked-account overdraft programs, often a suitable lower-cost option.

Tight Budgets

Tight budgets are another potential cause of overdrafts. With less money to cover the costs of living, there is a greater chance that a household will withdraw more money than is available in its account. This scenario may be triggered by any number of factors. Households with high debt-to-income ratios, for instance, likely face tighter budgets, spurring them to more frequently overdraw their accounts than less indebted households might. Unexpected expenses, like health care costs or car repairs, as well as the presence of more dependents, also place greater pressure on household budgets.

Unfortunately, only one of these potential indicators of a tight budget—household size—can be directly observed in these data. In particular, households containing two or fewer individuals had a one-in-seven probability of overdrawing their bank accounts over the course of a year, whereas households with three or more individuals had about a one-in-four probability of overdrawing. This effect is likely a proxy for a more direct, unobservable indicator of a tight budget, such as a household's debt-to-income ratio, but the data are insufficient to address this potential cause. Nonetheless, the limited evidence reported here suggests that there is a relationship between overdraft propensity and household fiscal pressure, but it is one that does not seem to depend on income.

Delays in Bank Deposit-Clearing Process

Another potential driver of a household's propensity to overdraw may be unexpected bank delays in processing deposited funds. By law, banks must make direct-deposit funds available on the "payment date," funds from local checks available within two business days of depositing, and funds from non-local checks available within five business days of depositing.[36] Nonetheless, there are a number of exemptions from these rules which could trigger a household to overdraw. These include situations in which the deposit is a) made in a new account with the bank, which carries different funds-holding timelines; b) a large amount (over $5,000); c) made to an account that is frequently overdrawn; or d) deemed questionable for some allowable reason, such as suspicion of fraud.[37] Unfortunately, none of these events can be observed in the data, but the data do show that readier access to money does not reduce overdrafts, suggesting that any relationship between holds on funds and use of overdrafts must depend on that hold being unexpected by a household.[38]

B. The Credit Card Delinquency Fee Market

The fee structure for credit cards has grown increasingly complex over the last two decades.[39] When credit cards were introduced in the 1950s, the only predominant charges were the card's (fixed) interest rate and an annual fee. Today, consumers are faced with a range of other, more complicated service fees including: 1) late penalty fees, 2) over-limit (exceeding the credit limit) fees, 3) payment processing fees, 4) returned check fees, 5) cash advance fees, 6) convenience check fees, 7) balance transfer fees, 8) fees to make purchases in foreign currencies, 9) membership fees, 10) exchange rate fees, 11) card replacement fees, 12) revolving balance fees, 13) stop payment fees, 14) telephone payment fees, and 15) fees to obtain duplicates of account records.

In addition to a proliferation of service fees, variable interest rates have also become more common. A GAO survey of popular credit cards, for example, found that the annual percentage rate (APR) varies across

types of transaction (e.g., retail purchases, cash advances), bill payment history (e.g., delinquency APR and cure APR), and credit utilization (i.e., over-limit APR). In addition, the majority of credit cards began to shift from charging a fixed APR to a variable APR in the 1990s, leading to interest rate fluctuations that the cardholder might not anticipate upon enrollment.[40] According to the Federal Reserve's semiannual Survey of Credit Card Plans, for example, 59 percent of the 150 credit cards surveyed carried variable APRs. All told, credit card APRs[41] can range from about 8 percent to over 30 percent, depending on the type of transaction and the cardholder's credit standing.[42]

Since 1978, credit card interest rates have been subject to usury laws in the state where the credit card company (or division) is located. For this reason, most card issuers are located in states with nonexistent or very high interest-rate caps, notably Delaware and South Dakota.

MARKET SIZE

Approximately 64.2 million credit cards are owned and used by about 84 percent of California's households.[43] Among these cardholders, about 24 percent, or 2.4 million households, reported falling behind on their monthly payments at least once in the 12 months prior to the survey.[44] Although we do not know the collective value of late payment fees for households in California, we do know that, nationwide, credit card owners pay an estimated $18.1 billion in late fees each year.[45]

MARKET COMPONENTS

Contrary to common perception, delinquent credit card customers in California tend to be middle-income, have a college education, and work full-time. Most are white and about a quarter are foreign-born. Nearly all own a mobile phone and have regular access to the internet, and the majority subscribe to or regularly read print magazines, own stocks or mutual funds, and bank online. Below, we analyze in more detail each of these components.[46]

Household Income

More than half of California's credit card delinquency market is comprised of middle- and higher-income households. In particular, about 53 percent of households that fall delinquent on their credit card payments are in the top two income quartiles, another 30 percent are concentrated in the next lowest income quartile, and about 17 percent are in the bottom quartile and earn less than $30,000 a year. Within income groups, households in the second income quartile are slightly more likely as a group to fall delinquent on their credit card payments. In particular, about 27 percent of households in this income quartile pay their credit cards late, compared with 24 percent of households in the bottom income quartile, 22 percent of households in the third income quartile, and 23 percent of households in the top income quartile.

Household Education

More than 55 percent of households that fall delinquent on their credit card payments have a college degree, suggesting that the majority of households that pay their credit card bills late are relatively well-educated. Within educational groups, the likelihood of falling behind on payments is more or less even across households of all education levels. In particular, about 27 percent of households without a high school diploma fall behind on their credit card payments, 24 percent of households with only a high school diploma fall behind, 23 percent of households with some college education or a two-year degree fall behind, and 24 percent of households with a college degree or higher fall behind.

Household Race and Ethnicity

The credit card delinquency market in California is comprised primarily of white households. In particular, about 67 percent of households that fall behind on their credit card payments are white, 16 percent are Hispanic, 6 percent are African-American, and the remaining 11 percent are spread out across households headed by other races. Within race categories, the likelihood of falling behind on payments is somewhat higher among minority households, but the majority of all households, regardless of race, are paying their credit card bills on time. One out of every three, or 33 percent of, Hispanic households were delinquent on their credit cards, 28 percent of African-American households were delinquent, and 30 percent of other-race households were delinquent. In comparison, 22 percent of white households, or slightly more than one in five, were delinquent on their credit cards.

Household Employment Status

The majority of households that fall behind on their credit card payments contain at least one full- or part-time worker. In particular, 83 percent of households that were delinquent on their credit cards included a worker of any type, about 76 percent of households that were delinquent on their credit cards included at least one full-time worker, and 31 percent of households that were delinquent included only a part-time worker. Among working households that fell behind on their credit card payments, there is typically only one full-time worker and no part-time workers.

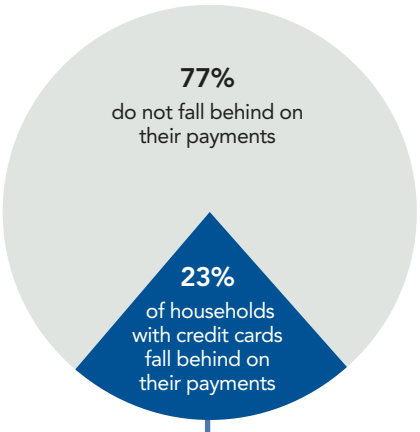
Working households in California are more likely than non-working households to become delinquent on their credit cards. In particular, about 26 percent of households with credit cards and at least one full- or part-time worker fell behind on their payments, compared with 17 percent of unemployed households with credit cards. This trend is also true for households with at least one full-time worker, 26 percent of which were delinquent on their credit cards; and for households that only work part-time, of which 27 percent were delinquent.

Other Consumer Behavior

Finally, households that fall behind on their credit card payments tend to be fairly sophisticated consumers. The vast majority are technologically connected, having both regular access to the internet and a mobile phone; nearly two-thirds invest in the stock market; and the majority consult with a financial adviser. In particular, 92 percent of households that become delinquent on their credit cards have regular internet access; 91 percent own a mobile phone; and approximately

FIGURE 4

CALIFORNIA'S CREDIT CARD DELINQUENCY FEE MARKET



Distribution across..

Income		Educational Attainment		Race		Employment		Internet Access	
Lower	17%	Some or no H.S.	5%	White	67%	Employed	83%	Have access	92%
Lower-middle	30%	H.S. diploma	11%	African-American	6%	Unemployed	17%	Do not have access	8%
Higher-middle	28%	Some college*	28%	Hispanic	16%				
Higher	25%	College degree	55%	Other	11%				

Source: Authors' analysis of survey data.
Notes: Due to rounding and a handful of missing survey responses, distributions may not always sum to 100%.
*"Some college" includes households whose heads have some post-secondary education and either a two-year degree, trade school degree, or no degree.

60 percent go online to check their account balance, pay bills, or shop for other financial products. About 65 percent of the households in this market also own stocks or mutual fund shares, and 59 percent report that they speak to a financial adviser regularly on how to manage their money and investments.

MARKET DRIVERS

There are a number of possible reasons why people fall behind on credit card bills. Major potential drivers include a) poor money management (e.g., poor communication between spouses, inadequate planning, overspending, misunderstanding of credit card fees) and b) tight budgets (e.g., lower-income households, unexpected expenses, high debt-to-income ratios). We consider each of these below.

Poor Money-Management Skills

One reason why households may occasionally fall behind on their bill payments is difficulty managing finances, which may take a variety of forms. Some households, for instance, may have difficulty controlling their spending, and eventually reach a point where they are no longer able to afford their payments. Other households may not have a set schedule by which they pay their bills every month, leading to occasional missed payments. Bill payers who regularly travel for work may be out of town on a payment due date. Among married couples who manage their credit cards jointly, there may be instances where the occasional miscommunication results in a late payment. Still other households may select a suboptimal credit card contract, increasing the probability of delinquency.

Although poor money-management skills cannot be directly observed in the data, clear evidence of this effect is available from extant research. Recent research by economists at the Federal Reserve Bank of Chicago, for instance, found that about 40 percent of a sample of 200,000 credit card accounts were suboptimal contracts, leading to hundreds of dollars in unnecessary costs for some borrowers.[47] These additional costs may increase the probability that households fall behind on payments. Other work has found that "a sizable proportion" of consumers who pay credit card late fees have enough money in their deposit accounts, leading to the conclusion that these fees were incurred because of "the inattention of individuals to their credit card payments and expenditures."[48] Our survey results appear to provide corroborating support for this conclusion, since a majority of the market paying these fees belong to the second income quartile or higher.

Tight Budgets

Tight budgets are another potential cause of credit card delinquency, indicated in a number of different ways including high debt-to-income ratios, unexpected expenses, and the presence of multiple dependents. Specific indicators of each of these household qualities likely vary, but it is important to point out that unexpected expenses may include issues related to credit card contracts themselves. Recent research by the GAO has found that many consumers have a poor understanding of credit card fees.[49] This lack of awareness, combined with the increasingly complex terms of these contracts outlined above, suggests that some share of households may face unexpected expenses tied to unanticipated rate increases in their monthly bill obligations. Although these variables cannot be directly observed in the survey data, extant research suggests that tight budgets play a role in driving delinquency behavior. Recent research by the Federal Reserve Bank of Boston, for instance, has found that high debt-to-income ratios are associated with a higher propensity to fall behind on credit card payments and with bankruptcy.[50]

C. The Out-of-network ATM Fee Market

Checking account owners that use an ATM outside of their bank's network typically incur two separate fees. One fee is charged by the bank or retailer that owns the ATM (a surcharge fee) and the other fee is charged by the financial institution at which the customer's account is located (an out-of-network or foreign ATM fee). The average surcharge fee (charged by ATM owners) in 2008 was $1.97, and the average out-of-network ATM fee (charged by the customer's financial institution) was $1.46.[51] Added together, the average customer using an ATM outside of his bank's network incurs usage charges amounting to $3.43 per withdrawal.[52]

MARKET SIZE

About 40 percent of California households with a debit card reported using an ATM outside of their bank's network at least once in the last year.[53] The bulk of these households went to out-of-network ATMs

only "some of the time" and a minority reported using them "all of the time." In particular, 88 percent (about 3.7 million households) used out-of-network ATMs occasionally, and the remaining 12 percent (about 498,000 households) reported using them on a regular basis. Although we do not know what the collective value of these out-of-network ATM fees is in California, we do know that an estimated $4.4 billion is paid in these fees each year nationwide.[54]

MARKET COMPONENTS

The out-of-network ATM fee market in California consists primarily of middle- and higher-income households with college degrees, who are sophisticated consumers and work full-time. Most are white and nearly all own a mobile phone and have regular access to the internet. Below, we analyze in more detail each of these components.[55]

Household Income

The majority of California households that use out-of-network ATMs earn above the state's median income. In particular, about 57 percent of the market consists of households in the top two income quartiles, another 26 percent are concentrated in the second income quartile, and only about 17 percent are in the bottom income quartile. These data suggest that the majority of the out-of-network ATM market in California are made up of households that earn more than the median income, and more than 80 percent earn a moderate or better income.

These same trends persist within income groups: higher-income households have a much higher probability of using out-of-network ATMs than households with lower incomes. In particular, households in the lowest income quartile have about a one-in-three chance of using an out-of-network ATM, while households in the highest income quartile have a nearly one-in-two chance. Being able to access funds at an out-of-network ATM is a convenience that households that earn more are clearly more willing to consume.

Household Education

The majority of the out-of-network ATM market are well-educated. In particular, about 53 percent of households that use out-of-network ATMs have a college degree or higher and 25 percent have a graduate degree. About 30 percent of the households in this market have an incomplete college education or a two-year degree, another 11 percent have only a high school diploma, and just over 5 percent did not graduate from high school. These data clearly indicate that using out-of-network ATMs is a luxury that well-educated households rely on more often than less-educated households.

Households with lower levels of education are also comparably less likely as a group to use out-of-network ATMs than those with more years of education, although these differences are quite modest. For instance, about 35 percent of households with a high school diploma or less used an out-of-network ATM in the past year, compared to about 42 percent of households with at least some college credits. Higher-educated households are also more likely to use out-of-network ATMs regularly than less-educated households; about 14 percent of households with college degrees reported going to out-of-network ATMs "all of the time," compared to only 7 percent of households that have only high school diplomas.

Household Employment Status

The majority of households that incur out-of-network ATM fees contains at least one full- or part-time worker. In particular, 86 percent of households that use out-of-network ATMs include a worker of any type; about 79 percent include at least one full-time worker; and 31 percent include only a part-time worker. Working households that use out-of-network ATMs typically have only one full-time worker and no part-time workers.

Working households in California are more likely than non-working households to use ATMs outside of their bank's network. In particular, about 43 percent of households with bank accounts and at least one full- or part-time worker use out-of-network ATMs, compared with 22 percent of unemployed households with bank accounts. This trend is also true for households with at least one full-time worker, 44 percent of which use out-of-network ATMs; and for households that work only part-time, of which 32 percent use out-of-network ATMs.

Other Consumer Behavior

Households that go to ATMs outside of their bank's network tend to be fairly sophisticated consumers. The vast majority are technologically connected,

having both regular access to the internet and a mobile phone, nearly two-thirds invest in the stock market, and about half consult with a financial adviser. About 92 percent of these households have regular internet access and 93 percent own a mobile phone. Approximately 77 percent go online to check their account balance, pay bills, or shop for other financial products and services; about 65 percent own stocks or mutual fund shares; and 59 percent report that they speak to a financial adviser regularly on how to manage their money and investments.

MARKET DRIVERS

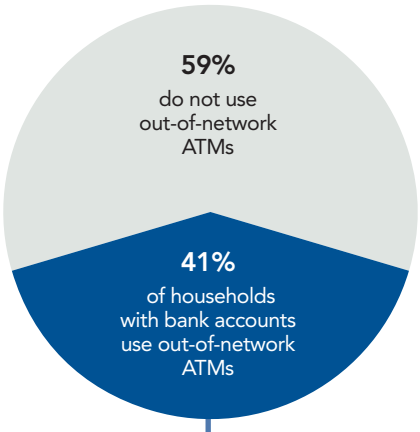
There are a number of possible reasons why people use out-of-network ATMs. Major potential drivers include a) poor money management skills (e.g., lack of attention to accessibility of bank ATMs at the time of account opening) and b) an unforeseen need for cash (e.g., when making a purchase from a retailer that does not accept electronic payments). We assess each of these potential drivers in more detail below.

Poor Money-Management Skills

One possible driver of the propensity to use out-of-network ATMs is a household's money-management skills, which could be reflected by a range of different behaviors. Households may not give much thought to the accessibility of a bank's ATM network at the time of account opening, for instance. Other households may not be aware of the fees that their banks charge for using other banks' ATMs. Still other households may simply be willing to pay for the convenience of using the ATM located most closely to them.[56]

FIGURE 5

CALIFORNIA'S OUT-OF-NETWORK ATM FEE MARKET



Distribution across..

Income		Educational Attainment		Race		Employment		Internet Access	
Lower	17%	Some or no H.S.	5%	White	68%	Employed	86%	Have access	92%
Lower-middle	26%	H.S. diploma	11%	African-American	8%	Unemployed	14%	Do not have access	8%
Higher-middle	28%	Some college*	30%	Hispanic	13%				
Higher	30%	College degree	53%	Other	9%				

Source: Authors' analysis of survey data.
Notes: Due to rounding and a handful of missing survey responses, distributions may not always sum to 100%.
*"Some college" includes households whose heads have some post-secondary education and either a two-year degree, trade school degree, or no degree.

There is some evidence to support the role of these factors in driving households to use out-of-network ATMs. About half of these households, for instance, did not do any comparison shopping prior to opening a checking account. This suggests that over half of the out-of-network ATM market did not compare the proximity of their bank's ATM network to that of other banks' networks when they were selecting an account. Unfortunately, many of the other potential indicators of a tight budget cannot be directly observed in the data, making it difficult to assess all of the effects that a tight budget might have on delinquency behavior. Nonetheless, the limited evidence reported here suggests that there is a relationship between the use of out-of-network ATMs and poor money-management skills, although it is not dependent on household income.

Unforeseen Need for Cash

An unexpected need for cash may be another driver of a household's use of out-of-network ATMs. When making purchases from merchants that do not accept electronic payments, for instance, consumers may find themselves needing to use the nearest ATM to access cash. The survey data provide some support for this driver, including the fact that 89 percent of the out-of-network ATM market report that they use this service only "some of the time," and just 11 percent report that they use this service "all of the time." While some of the households that sometimes use this service are likely driven by poor money-management habits, we suspect that having an unexpected need for cash explains at least some of the variance, given that such a high share of this market uses out-of-network ATMs only occasionally.

D. The Check-Cashing Market

Over 26,000 non-bank institutions in the U.S. cash checks and sell bill-payment solutions, predominantly to households without a basic transaction account at a depository institution.[57] Fees for check cashing are regulated by states and in California are as follows: cashiers are allowed to charge up to 3 percent (3.5 percent without an I.D.) of the face value of a government-issued or payroll check, and 12 percent of the value of a personal check.[58] They are also allowed to charge a $15 fee for each bounced check and a $10 one-time account-setup fee. Money-order providers are also regulated, although state law does not set a maximum fee. Research has found that non-banks tend to match fees to the maximum allowed rates, defying expectations about the effect of competition on rates.[59]

MARKET SIZE

Although households with bank accounts have self-reported in past surveys that they sometimes use non-banks for certain services, households without bank accounts are the dominant share of the check-cashing and bill-pay market, which we estimate to include about 12 percent of all households in California. In total, we estimate that over $1 billion on these services is spent in California every year by households without a bank account, often at one of the state's 7,800 non-bank check-cashing establishments.[60] We are unable to identify the additional amount of money spent by households with a bank account and focus exclusively here on the unbanked component of the market.

MARKET COMPONENTS

The majority of unbanked households in California include low-income, low-educated, full-time employed, foreign-born Hispanic workers who have never had a bank account, are paid in checks by their employers, and use money orders to pay their monthly bills. About half own mobile phones, a third have access to the internet, and almost none read print magazines. The majority are, in short, likely suitable for an appropriate starter account, although these households may be difficult to find and may require services like longer hours and multilingual tellers and ATMs. Below, we analyze in more detail each of these market components.[61]

Household Income

About 89 percent of unbanked households in California belong to the state's bottom income quartile, earning less than $30,000 a year, and the remaining 11 percent are nearly all concentrated in the next lowest income quartile. Within income groups, lower-income households are also much more likely as a group to be unbanked. In particular, about 20 percent of households in the bottom income quartile are unbanked, suggesting they have a one-in-five chance of being unbanked, while only 1.7 percent or less of households in other income groups are unbanked.

However, even while lower-income households dominate the unbanked market and are much more likely as a group to lack a bank account, the vast majority of lower-income households have an account and report that they regularly deposit and withdraw money, albeit less often than other income groups. In particular, about 80 percent of lower-income households in California have a bank account and about 50 percent of these households report that they withdraw and deposit money on a weekly basis, while about 88 percent report using the account at least monthly. In comparison, about 65 percent of all other households with accounts report that they withdraw or deposit money from their bank accounts on a weekly basis, and 97 percent report using the account at least monthly. This suggests that lower-income households use their accounts less frequently than higher-income households, as earlier research has found.[62] Nonetheless, the majority of California's lower-income households already have a bank account and most use the account at least once a month.

Household Education

More than 60 percent of households without a bank account did not graduate from high school and another 24 percent have only a high school diploma, suggesting that the majority of unbanked households have only basic reading and math skills. Within educational groups, less-educated households are also substantially more likely as a group to be unbanked. In particular, about 34 percent of households without a high school diploma are unbanked, suggesting they have a one-in-three chance of being unbanked; 10 percent of households with only a high school diploma are unbanked; and less than 2 percent of all other educational groups are unbanked. In fact, of all of the indicators of being unbanked, educational attainment is by far the most powerful predictor.

Yet, even while households with less education represent the bulk of the unbanked market and have the highest likelihood of lacking an account, the vast majority of these households already have an account. In particular, over 60 percent of households without a high school diploma have bank accounts and about 90 percent of households with only a high school diploma have bank accounts. This suggests that educational attainment is not an insurmountable barrier to being unbanked, although it does mean that an individual with less education is more likely to lack an account.

Household Country of Origin

Nearly 70 percent of unbanked households in California were born in a foreign country, where only about one-third had a bank account, suggesting that a large share of the state's unbanked households have no substantial experience with banking. Households that immigrate to the U.S. are also more likely as a group to lack a bank account relative to all other groups. In particular, 16 percent of households that immigrated to the U.S. lack a bank account, compared to just 2 percent of households born in the U.S. Nonetheless, the fact that 84 percent of foreign-born households have a bank account clearly indicates that being born outside of the U.S. is not a barrier in and of itself to owning a bank account.

Household Race and Ethnicity

California's unbanked market is dominated by minorities, especially Hispanics. In particular, about 72 percent of unbanked households in the state are Hispanic, 14 percent are African-American, and the remaining 14 percent are spread out across households headed by whites and other races. Within race categories, too, minority households are more likely to lack a bank account. About 24 percent of Hispanic households and 11 percent of African-American households are unbanked. In comparison, just 1 percent of households of all other races do not own a bank account.

However, even while Hispanic households comprise the bulk of the unbanked market and are much more likely as a group to lack a bank account, the vast majority of these households are banked and report that they deposit and withdraw money on a regular basis, though with less frequency than other households. In particular, 76 percent of Hispanic households in California have a bank account, of which about 55 percent report that they withdraw and deposit money at least weekly and about 90 percent report doing so at least monthly. African-American households are also highly likely to have an account. About 89 percent of African-American households own a bank account, of which about 55 percent use their accounts at least weekly, and 92 percent at least monthly. In comparison, just under 76 percent of households of other races use their bank accounts at least weekly, and nearly 96 percent use their accounts at least monthly.

Household Bill Payment Behavior

The unbanked market also has been found by past research to vary by bill payment behavior, with some households operating strictly in a cash economy and others in a quasi-banking economy, relying on checks from employers and money orders to pay bills.[63] Our survey finds that the quasi-banking group dominates the unbanked market in California. In particular, nearly 60 percent of unbanked households are paid in checks by employers, including nearly 80 percent of working unbanked households.

More tellingly, over 83 percent of unbanked households in the state report that they pay at least one major monthly bill—gas, electricity, water, telephone, or rent—with a money order and only 25 percent report that they pay a bill using cash. This suggests that even while unbanked households are cashing their paychecks and filling their wallets with cash, most are walking into a non-bank or bank, handing cash over to a teller, and buying a money order with which to pay their monthly bills. Most are not paying bills in cash, suggesting the need for a bank relationship that supplies these households with low-cost bill-payment tools.

Household Prior Experience with Banks

Survey data suggest that most unbanked households do not have a checkered history with banks that would render them ineligible to open an account. In particular, about 50 percent of unbanked households in California have never owned a bank account in the past, which is consistent with the demographic information reported above on the share of foreign-born households in this population that have had no prior experience with a bank. Among the half of unbanked households that have had a relationship with a bank in the past, more than 30 percent ended their banking relationship more than six years ago, which is when banking history records no longer influence an individual's eligibility to open an account.

Household Access to the Internet

Since providing banking services over the internet is less costly than retail alternatives such as branches and ATMs, banks are very interested in transitioning customers—particularly the low net-worth customers in the unbanked market—to automated interactions. Some of these interactions can occur online; however, the data indicate that only about 31 percent of unbanked households have access to the internet and as few as 15 percent have internet access at home. This share rises when we look at unbanked households with a worker, 36 percent of which have internet access, indicating that some potential cost savings could be realized by moving these households to online banking despite the fact that they are only a modest share of the overall unbanked population.

Household Access to Mobile Devices

Mobile banking is another potential strategy that banks can use to lower the costs of serving this market. About 45 percent of all unbanked households own a mobile phone, including about 52 percent of unbanked households with a worker. Within the first group, about 42 percent pay for their phone using prepaid cards purchased at convenience stores, gas stations, non-bank financial services providers, and other retail establishments.

MARKET DRIVERS

What causes people to eschew bank accounts and rely instead on fee-based check-cashing services has been the subject of much research.[64] Among the reasons suggested for the lack of a bank account are 1) the lack of access to bank branches (e.g., physical location or hours of service), 2) negative bank histories records (e.g., fraud, identity theft), 3) the lack of trust in or comfort with banks, 4) concerns about high fees, 5) a misunderstanding of banks, 6) the lack of appropriate paperwork, 7) language barriers, and 8) the lack of need for an account in a cash economy.

In general, the survey evidence provides limited support for most of these potential causes, although a lack of trust in and misunderstanding of banks emerge as the two strongest potential causes of being unbanked. We address each of these drivers in turn below.

Access to Banks and Credit Unions

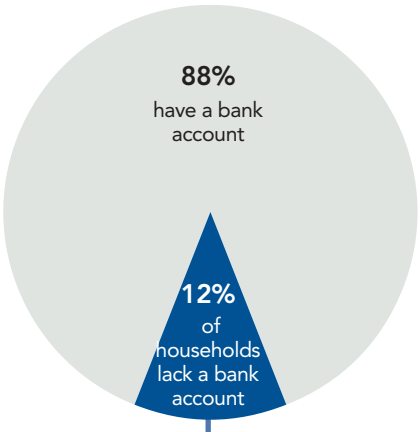
Some research has found that many neighborhoods where lower-income families live and work do not have bank branches, suggesting that a lack of access to a branch may be one driver of the unbanked market.[65] Similarly, some have suggested that the branches that are located in such neighborhoods are open only during working hours Monday through Friday,

making them inaccessible to lower-income workers. The survey data provide only modest support for this possible driver of the unbanked market.

For starters, about 50 percent of the unbanked households surveyed indicated that the lack of a bank or credit union branch located near their place of employment was a very important reason why they were unbanked. To assess the integrity of this self-reported response, we analyzed an inventory of the location of all bank and non-bank retail stores in California, which was collected for a previous paper.[66] The proximity argument initially seemed to be confirmed by these inventory data. In particular, we found that about 42 percent of the state's lower-income census tracts have at least one bank or credit union branch, which would seem to support this self-reported impression and help explain why so many households in California choose non-bank alternatives instead. But this reasoning fell apart when we considered the location of non-bank alternatives, the competition to banks in this market. We compared the location of every non-bank check-cashing establishment in California to that of bank branches, expecting to find the non-banks concentrated primarily in underserved neighborhoods. Surprisingly, we found just the opposite. In fact, more than 83 percent of non-bank check cashers are located within one mile of a bank or credit union branch, and most are located within a half-mile of a branch. This suggests that access to a branch is not as important as it may appear from an analysis of self-reported data, since unbanked households are doing as much commuting to their non-bank of choice as they would otherwise be doing to the bank branch located in the same neighborhood.

FIGURE 6

CALIFORNIA'S UNBANKED MARKET



Distribution across..

Income		Educational Attainment		Race		Employment		Internet Access	
Lower	89%	Some or no H.S.	60%	White	5%	Employed	73%	Have access	31%
Lower-middle	9%	H.S. diploma	24%	African-American	14%	Unemployed	27%	Do not have access	69%
Higher-middle	1%	Some college*	11%	Hispanic	72%				
Higher	2%	College degree	5%	Other	7%				

Source: Authors' analysis of survey data.
Notes: Due to rounding and a handful of missing survey responses, distributions may not always sum to 100%.
*"Some college" includes households whose heads have some post-secondary education and either a two-year degree, trade school degree, or no degree.

Next, we looked at how access to banks may be constrained because of the shorter service hours they keep relative to non-banks, some of which stay open well past traditional business hours and are often open on weekends. About half of the unbanked household population indicated that banks' limited hours were a "somewhat" or "very important" reason why they were unbanked. But a fifth of these households reported having no workers in their household, calling into question whether hours of service are in fact a significant barrier. Without a worker in the household, it is not clear why members of the household could not access a bank or credit union during normal business hours. Even more telling, among unbanked households that claim that service hours are a somewhat or very important barrier to opening a bank account, 73 percent also report that they have never considered opening an account. If that is the case, it is not clear how these households would be able to reliably assess whether the bank was open during hours that suited their schedules (or whether they actually needed to use a bank during business hours). This suggests that the vast majority of households that cite hours of service as a barrier to opening an account either do not have any employed members or have never thought about opening an account, calling into question whether these households can accurately assess how significant a barrier this is.

Negative Bank History

Another reason frequently cited as a reason why households eschew banks relates to prior bank experience. Households that have had trouble managing an account in the past may simply decide they would be better off outside of banks, or they may have committed fraud or some other type of offense that has rendered them ineligible for an account. The survey data provide only modest support for this driver. About 49 percent of survey respondents report that they have had a bank account in the past, but 30 percent of these households closed their accounts over six years ago—after the point at which banks consider banking history. This suggests that 85 percent of unbanked households have either never had a bank account or have a history with a bank that dates past the point at which it would disqualify them from reopening an account. Of the remaining 15 percent of unbanked households that have had an account at some point in the prior six years and decided to close it, we know nothing about the reason why they chose to do so. Collectively, then, this evidence indicates that there may very well be some unbanked households with negative bank histories that prevent them from opening bank accounts, but it is likely a small share of the overall market.

Lack of Trust or Comfort in Banks

About 67 percent of households in California without a bank account report that their lack of trust in or discomfort with banks is a "somewhat" or "very important" reason why they are unbanked. This seems consistent with the data reported above that 85 percent of unbanked households have either never had an account with a bank or closed their last account more than six years ago. Given that such a large percentage of the unbanked population has no or very dated experience with a bank, it seems reasonable that such a large share of unbanked households would be mistrusting of or uncomfortable with these institutions.

Concern about High Fees

About 56 percent of unbanked households reported that "high bank fees" are a reason why they do not have bank accounts. With high-profile fees for services such overdrafts and nonsufficient funds now averaging around $25 per incidence, it's easy to understand why this impression exists.[67] Yet a closer analysis of survey data suggests that this is not as serious a barrier for most unbanked households as one might conclude by accepting self-reported responses at face value.

First, the median unbanked household in California pays approximately $700 a year just to cash checks and an unknown additional amount to pay bills and take out short-term loans at pawnshops and tax preparers.[68] Unlike many bank fees, these costs are fixed, not variable. In contrast, this same household would pay about $100 in maintenance fees for the most expensive starter account at one of California's largest banks (which, incidentally, are the banks that are most prevalent in lower-income neighborhoods). As we report in the previous sections, most lower-income households do not pay for other types of basic banking fees, like overdraft or out-of-network ATM charges, so it is unlikely that most of these households would pay additional fees. These data suggest that most unbanked households would save money by opening a bank account, regardless of what the perception of fees may be.

Second, of the 56 percent of households that think fees are higher at banks than at non-bank alternatives, nearly half report that they have never considered opening a bank account before. If that is the case, then it is unclear how these households would be able to accurately evaluate whether they would be paying higher fees at a bank than at a non-bank alternative.

Lack of Appropriate Paperwork

About 70 percent of unbanked households report that they were born in a foreign country, and an unknown share lacks the traditional identification needed to open an account. Although the banking regulatory agencies are very clear that non-traditional paperwork such as Consular ID cards is an acceptable form of identification, research has found that branch staff are not always fully informed of these policies, rejecting otherwise worthy account applicants.

Language Barriers

About 72 percent of unbanked households report that they do not speak English at home, compared to just 9 percent of all California households. Other than niche banks, most banks logically should cater their service to English speakers, since this is the language that most California households speak at home. Consequently, however, it is likely the case that banks may not have the resources to sufficiently staff their branches with multilingual tellers. This may serve as an important barrier to certain individuals' ability to open a bank account.

Live in a Cash Economy

Another potential reason why some households are unbanked is that they live in a cash economy and therefore find banks unnecessary. However, we generally found the opposite to be the case. In fact, the survey data suggest that nearly 60 percent of unbanked households are paid in checks by employers, including nearly 80 percent of working unbanked households. Similarly, over 83 percent of unbanked households in the state report that they pay at least one major monthly bill with a money order, while only 25 percent report that they pay a bill using cash. Most unbanked households, these data suggest, are not living in a pure cash economy and still rely heavily on traditional paper checks, as a means to both access their income and pay bills.

DISCUSSION

We find that about 58 percent of households in the state are now being charged overdraft fees, credit card late payment fees, out-of-network ATM fees, or check-cashing fees. Across the United States, these fees add up to over $58 billion each year. And contrary to common perception, the bulk of households paying to use these basic banking services is middle-class, relatively well-educated, and technologically savvy consumers. Usage of most of these fees tends to be highly episodic for most households, and not something that occurs regularly and systematically. The lone exception is the check-cashing market, which is dominated by lower-income households with low levels of educational attainment and that rely heavily on expensive non-bank fee-based services.

In response, we review a new role for public leaders to serve as intermediaries in the market that can connect households to existing lower-priced alternatives. Oftentimes, there are financial institutions that sell lower-cost alternatives, but consumers sometimes have difficulty finding these products for a number of reasons. Using a model developed by the city of San Francisco, cities and states around the country can create enormous savings for their constituents by helping them find lower-priced alternatives to the products and services on which they currently rely. Of particular importance is the unbanked market, which largely relies on overpriced products and services. There does seem to be a minority of unbanked households that cannot be served by traditional bank accounts, requiring non-traditional services like prepaid products (although suitable prepaid products are extremely difficult to find in the market).[69] The survey data suggest, however, that a large share of the non-banks serving this market operates on an economic model that is at a competitive disadvantage and, as a result, can be cannibalized by depository institutions.

Before we review this recommendation in greater detail, it is important to stress that we do not comment on the validity of these fees, as others have elsewhere, because we do not have data that speak to the margin generated by these fees and therefore cannot reliably assess the extent to which there are excesses. We also do not have data that adequately capture whether consumers are actively steered by financial institutions into product agreements with an increased likelihood of service charges. Without that information, it is impossible for us to assess the validity of these fees.

Recommendation:
State and Local Market Intermediaries

State and local governments can connect consumers to fee-based products and services that are already widely available at a lower cost than those that they currently use. For instance, we discuss in the Findings section that most banks offer customers a range of overdraft protection programs, from the very expensive fee-based model to the less expensive linked-account or revolving-account model. These less expensive linked-account programs can potentially save consumers billions of dollars because, as we reviewed earlier, the majority of households that overdraw their accounts have a savings account they could link to. Similarly, we have pointed to a large share of the unbanked population currently relying on expensive non-banks who would be better off switching to low-cost starter bank account products. For a number of reasons, households have trouble finding these lower-cost alternatives on their own. Some do not understand the fee structure of these products; some have trust and misperception barriers; some simply do not spend the time to shop around, or are easily steered toward more expensive product alternatives. Regardless of the specific reason, policymakers can illuminate the product market for consumers and connect them to lower-cost services. This approach short-circuits other, more uncertain, politically difficult policy options. It also takes advantage of products that are already in the market.

One model of this intermediary function is the Bank on San Francisco program, which was launched by Mayor Gavin Newsom and City Treasurer José Cisneros in January 2006 and has since been replicated by nearly 40 other cities and the state of California.[70] This program is a public-private partnership that strives to connect the estimated 50,000 unbanked households in San Francisco to low-cost starter bank accounts. The Brookings Institution has estimated that unbanked, working households in the U.S. pay an average of about $1,000 every year just to cash checks, and face additional unknown costs associated with paying bills, borrowing money, and sending money electronically. In addition, unbanked households pay the opportunity cost of not being able to build a relationship with a bank and consequently gain access to wealth-building products and services. Many of these households stand to save money by gaining access to a starter bank account product.

The Bank on San Francisco program aspired to open 10,000 low-cost starter accounts for the unbanked population in its two years. It met that goal within one year, and is now working on opening a total of 20,000 accounts. The city is able to connect households to bank accounts by relying on media (e.g., public service announcements) and community partners, who essentially act as marketers and sales representatives on behalf of the participating financial institutions. In return for the city's subsidizing the cost of customer acquisition, participating banks agree to several product concessions that lower the costs of basic accounts for Bank On customers. More importantly, they agree to market the lowest-cost starter products to these customers rather than steer them into more expensive alternatives. Although many unbanked customers are worth relatively less in depository and cross-selling power than currently banked customers, financial institutions generate good publicity from their participation in these programs and win new customers, who bring new deposits and cross-selling opportunities. The outcome has been millions of dollars in savings on financial services for low-income consumers and the opportunity for these households to grow and build their wages into savings and wealth.

This type of successful intervention in the market could be extended to include calling households' attention to steps they can take to find other lower-cost products and services. Among the evidence reported in this paper, for instance, a majority of households that pay overdraft fees report that they also own savings accounts, which they could use to cover occasional overdraft fees. A majority of households also report that they did not compare checking accounts between institutions before deciding on one, suggesting that some of these households could be connected to a bank with a

more convenient ATM network. In addition to alerting households to these savings opportunities, cities and states could also make available lists of products, and/or services that assemble lists of these products, like Bankrate.com, BankingMyWay.com, LowerMyBills, CardTrak, E-wisdom, CardRatings, CreditCards.com, and Billshrink.com. They could also work with large employers, unions, membership groups, religious institutions, and any other aggregators of consumers in their communities, to advertise the fact that consumers are spending $58 billion a year nationwide on these fees and could save money from being connected to lower-priced alternatives in the market. Although many of these institutions do not bring a core focus on the financial services market, most are concerned about the well-being of their workers or members and should be motivated to help advertise the existence of these lower-priced product alternatives.

CONCLUSION

This paper has found that a majority of households in a survey of California households pay fees tied to basic bank and non-bank products. Contrary to common perception, the bulk of households paying these basic banking fees is middle-class, relatively well-educated and technologically sophisticated consumers. Usage of most of these fees tends to be highly episodic for most households, not something that occurs regularly and systematically. The lone exception is the check-cashing market, which is dominated by lower-income households with low levels of educational attainment that rely heavily on expensive non-bank fee-based services. We recommend that policymakers work with industry to lower the $58 billion paid in annual fees nationwide. In particular, we highlight a new role for public leaders to play as intermediaries in the market that can connect households to existing lower-priced alternatives.

ENDNOTES

1 Authors' analysis of data from the FDIC Institution Directory's Statistics on Depository Institutions. Please note, however, that this growth in noninterest income has also substituted for income once earned by financial institutions through other means. For instance, consumers now pay fees for foreign-currency transactions at ATMs in addition to or instead of at a foreign-currency vendor, once the primary mechanism for accessing capital in a foreign country. Similarly, Visa and MasterCard once added a 1 percent charge to any foreign transaction but now charge consumers a flat fee, which has the effect of moving "sales income" into the "fee income" side of a bank's ledger.

2 Authors' analysis of data from the U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements.

3 Estimate provided to The Pew Charitable Trusts by Moebs Services, Inc. For instance, Moebs estimates that consumers now pay $34 billion in overdraft fees every year. Note that a higher estimate published in a recent GAO report also includes enterprise overdrafts.

4 Bankrate.com (August 2008)

5 Please see, for instance: Appendix 3 in Matt Fellowes and Mia Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential" (Washington: Brookings Institution, 2008).

6 For instance, for an analysis of how the checking account overdraft fee has evolved, please refer to: *American Bankers Association Banking Journal*, "Consumer Checking Account Challenge: Giving an old banking spud new profit appeal" (2004).

7 General Accountability Office, "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts." GAO-08-281 (Government Printing Office, 2008).

8 Please see, for instance: Sumit Agarwal, John C. Driscoll, Xavier Gabaix, and David Laibson, "Learning in the Credit Card Market," Working Paper No. 13822 (National Bureau of Economic Research, 2008); Barry Williams and Gulasekaran Rajaguru, "The trade-off between bank non interest income and net interest margins," Working Paper (Bond University School of Business, 2008); Nadia Massoud, Anthony Saunders and Barry Scholnick, 2007, "The Cost of Being Late: The Case of Credit Card Penalty Fees," Chicago Meetings Paper (American Finance Association, 2007); Arnold S. Rosenberg, "Regulation of Unfair Bank Fees in the United States and the European Union: Current Trends and a Proposal for Reform." In *Evolving Legislation on Consumer Credit and Trade Practices*, APS Occasional Papers 7 (2007) (Proceedings of 2006 Malta Conference of the International Association of Consumer Law on Consumer Protection Law in the European Union); Timothy Hannan and Ron Borzekowski, "Incompatibility and Investment in ATM Networks," *Review of Network Economics* 6 (2007): 1-15; Sujit Chakravorti and William Emmons, "Who pays for credit cards?" The *Journal of Consumer Affairs* 37 (2) (2003): 208-230; Timothy H. Hannan, "Retail Fees of Depository Institutions, 1994-99" *Federal Reserve Bulletin*, January 2001; Christoslav E. Anguelov, Marianne A. Hilgert, and Jeanne M. Hogarth, "U.S. Consumers and Electronic Banking, 1995-2003" *Federal Reserve Bulletin*, Winter 2004; Joanna Stavins, "ATM fees: Does bank size matter?" *New England Economic Review* (Boston: Federal Reserve Bank of Boston, 2000); Joanna Stavins, "Checking accounts: What do banks offer and what do consumers value?" New England Economic Review (Boston: Federal Reserve Bank of Boston, 1999). Please see endnote 1 for examples of the substitution that has occurred in the market.

9 For an example of the controversy surrounding these fees, please see: Center for Responsible Lending, "Overdraft Loans Trap Borrowers in Debt: Unfair bank practices artificially increase fees" (2008). Or see recent hearings on these issues, including: *Overdraft Protection: Fair Practices for Consumers*, Hearings before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services, 110 Cong. 1 sess. (GPO, 2007); *The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers*, Hearings before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services, 110 Cong. 2 sess. (GPO, 2008)

10 Note, though, that having a lower income may also make a household more aware of its budget limitations than a higher-income household might be. We merely repeat this conjecture as an example of an opinion that has emerged in the context of little data.

11 Again, we state this as an example of a conjecture that can emerge in the absence of data. While it is certainly true that debt-to-income ratios are high among middle- and higher-income households, too, multiple years of data from the Federal Reserve's Survey of Consumer Finances make clear that this ratio is persistently higher among lower-income households.

12 For some past insight into this question, please see: Jennifer Roth, "Walk-in Bill Payment: The Rational Option for the 'Cash-Preferred' Market" (Needham: Tower Group 2008); Center for Financial Services Innovation, "Underbanked

Consumer Overview & Market Segments" (2008); and Fellowes and Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential."

[13] Bankrate.com (October 2008).

[14] Banks would have to open more accounts belonging to households in this group to achieve the same potential float as they would by opening accounts for households with higher incomes; also, it's likely that fewer cross-selling opportunities exist within the former group. Large shares of unbanked households have low levels of education and speak Spanish, requiring higher levels of customer interaction, a primary cost driver in retail banking business models. There is also a large minority of unbanked clients with checkered account histories, indicating that there will be fewer qualified households returned from advertising investments in lower- and moderate-income markets compared to those made in higher-income markets. These facts make the basic lower-income market equation for bankers clear: lower relative benefits + higher relative costs = a less attractive business opportunity.

[15] We review in the Methodology section the full suite of fees that are now tied to basic banking services.

[16] Estimate provided to The Pew Charitable Trusts by Moebs Services, Inc.

[17] *American Bankers Association Banking Journal,* "Consumer Checking Account Challenge: Giving an old banking spud new profit appeal."

[18] We want to be clear that we do not have usable data on the margins generated by these fees and therefore cannot reliably assess the extent to which there are excesses. For commentary along these lines, please see: *Overdraft Protection: Fair Practices for Consumers*, Hearings before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services; and *The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers*, Hearings before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services.

[19] Emerging Markets, www.emergingmarkets.us (October 2008).

[20] One question was open-ended, asking the respondents to name the two magazines that they most frequently read.

[21] The sample was constructed to draw equal sample sizes from each of the state's income quartiles. For one assessment of how the landline population differs from the mobile phone population, please see: Michael W. Link, Michael P. Battaglia, Martin R. Frankel, Larry Osborn and Ali H. Mokdad, "Reaching the U.S. Cell Phone Generation: Comparison of Cell Phone Survey Results with an Ongoing Landline Telephone Survey," *Public Opinion Quarterly* 71 (5) (2007): 814-839.

[22] CSRS terminated 344 interviews with respondents who did not know or refused to provide their income information; these households are not included in the final 2,001 count.

[23] CfMC is a commonly used survey research software.

[24] Information about these fees was collected from a number of sources including a) the authors' analysis of bank websites, b) Bankrate.com (August 2008), and c) BankingMyWay.com (August 2008).

[25] For instance, please see: GAO, "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts."

[26] Authors' analysis of the American Community Survey.

[27] Ibid.

[28] For a helpful primer of bank-related markets discussed in this section, please see: Barry Scholnick, Nadia Massoud, Anthony Saunders, Santiago Carbo-Valverde, and Francisco Rodríguez-Fernández, "The economics of credit cards, debit cards and ATMs: A survey and some new evidence," *Journal of Banking & Finance* 32 (8) (2008): 1468-1483. For a helpful primer on the non-bank related markets discussed in this section, please see: Rebecca M. Blank, "Public Policies to Alter the Use of Alternative Financial Services among Low-Income Households" (Washington: Brookings Institution, 2008).

[29] For an analysis of how the checking account overdraft fee has evolved, please refer to *American Bankers Association Banking Journal,* "Consumer Checking Account Challenge: Giving an old banking spud new profit appeal." For the purpose of simplicity, we use the term "overdrafts" throughout this section to refer to both overdrafts and nonsufficient funds even though the two are technically different activities. However, the rates tied to both services, as well as the account balance threshold that triggers them, are nearly identical.

[30] For instance, an overdraft of $37 might lead to a loan of $50 or $100 from a financial institution.

[31] GAO, "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts."

[32] The phrase "past year" or "previous 12 months" throughout the paper refers to the period between May 2007 and May 2008.

[33] Estimate provided to The Pew Charitable Trusts by Moebs Services, Inc.

[34] Consider, for instance, a hypothetical household that had a checking account balance of $50 and was enrolled in a fee-based overdraft program. If this household were to write in one sitting four checks each worth over $50 and collectively totaling $250, they would pay four overdraft fees but likely recall it as only one overdraft incidence.

[35] Our data indicate that this group of high frequency overdraft users accounts for about 4 percent of the overall checking account market, but around 30 percent of all overdrafts (and, again, the data cannot distinguish whether these self-reported instances of an overdraft account for one or more fees at a time, so the overall share of overdraft revenue generated by this small share of households may be quite a bit larger).

[36] Allowable check-holding periods are governed under the Expedited Check Funds Availability Act, with implementing language in Federal Reserve Regulation CC. For a readable interpretation of these regulations, please refer to the Office of the Comptroller of the Currency's guide to funds-holding rules, available at www.helpwithmybank.gov/faqs/banking_funds_available.html#drop03 (October 2008)

[37] For a full list of allowances please refer to the Office of the Comptroller of the Currency resource, cited above.

[38] In particular, the data indicate that households that have their paychecks directly deposited stand a one-in-four chance of overdrawing their accounts, compared to about a one-in-five chance among households that deposit their paychecks themselves. Although funds are more swiftly made available for households that directly deposit, it's possible that the automation of this process may result in households being comparably less aware of their balances, spurring a modestly higher propensity to overdraw their accounts.

[39] GAO, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Customers."

[40] GAO, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Customers."

[41] Federal Reserve Board, "Survey of Credit Card Plans," updated on January 31, 2008. Full list of surveyed credit cards and more details on each are available here: www.federalreserve.gov/Pubs/shop/survey.htm (August 2008)

[42] GAO, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Customers."

[43] Estimates based on data from CardWeb.com, Inc., which reports that the average U.S. household owns 6.3 bank credit cards. Please see: Kathleen Day and Caroline E. Meyer, "Credit Card Penalties, Fees Bury Debtors: Senate Nears Action on Bankruptcy Curbs," *Washington Post*, March 6, 2005.

[44] It should be noted, however, that although nearly one in five households falls behind on its payment schedules, at least once a year, it's unlikely that these households consistently pay their bills late throughout the year. Quarterly data from TransUnion indicate that, in the 15-year span between1992 and 2007, the credit card delinquency rate in California hovered between 1.1 percent and 2.7 percent. These data suggest that there is substantial churn in this market; households are slipping up once or twice in the span of year, but for the most part report that they pay off their balances according to schedule. This evidence of churn is supported by additional recent research that found paying a fee taught consumers to avoid paying future fees.

[45] Kathy Chu, "Facing losses on bad loans, banks boost credit card rates," *USA Today*, February 8, 2008; R.K. Hammer Consulting Firm.

[46] For a recent assessment of the national credit card market, please see: Edward Castronova and Paul Hagstrom, "The demand for credit cards: Evidence from the survey of consumer finances," *Economic Inquiry* 42 (2) (2004): 304-318.

[47] The sample included credit cards that were active between 1997 and 1999. Sumit Agarwal, Souphala Chomsisengphet, Chunlin Liu, and Nicholas Souleles, "Do Consumers Choose the Right Credit Contracts?" Working Paper 06-11 (Federal Reserve Bank of Chicago, 2006).

[48] Nadia Massoud, Anthony Saunders, and Barry Scholnick, "Who Makes Credit Card Mistakes?"

[49] GAO, "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts."

[50] Joanna Stavins, "Credit Card Borrowing, Delinquency, and Personal Bankruptcy," *New England Economic Review* (Boston: Federal Reserve Bank of Boston, 2000).

[51] Laura Bruce, "2008 Checking Account Study," Bankrate.com (November 2008).

[52] For other related work in this area, please see: Christopher R. Knittel and Victor Stango, "Incompatibility, Product Attributes and Consumer Welfare: Evidence from ATMs," *B.E. Journal of Economic Analysis and Policy: Advances in Economic Analysis and Policy* 8 (1) (2008); Christopher R. Knittel and Victor Stango, "Strategic Incompatibility in ATM Markets." NBER Working Paper No. 12604 (National Bureau of Economic Research, 2006); Elizabeth W. Croft and Barbara J. Spencer, "Fees and Surcharging in automatic teller machine networks: Non-bank

ATM providers versus large banks." NBER Working Paper No. 9883 (National Bureau of Economic Research, 2003).

[53] Please refer to the section that reviews the unbanked statistics for an explanation of this range.

[54] Greg McBride, "2007 Checking Account Pricing Study," Bankrate.com (November 2008)

[55] For a recent assessment of the national market for debit cards, please see: Ron Borzekowski, Elizabeth K. Kiser, and Shaista Ahmed, "Consumers' Use of Debit Cards: Patterns, Preferences, and Price Response," *Journal of Money, Credit and Banking* 40 (1) (2008): 149-172.

[56] Some literature suggests banks have an economic incentive to over-supply ATMs because it increases out-of-network fee use and can be a lead-generation tool. For instance, please see: Dan Bernhardt and Nadia Massoud, "Endogenous ATM Networks and Pricing." Working paper (2005).

[57] There are other basic financial service fees charged to segments of this group, such as those associated with prepaid cards, short-term loans, and wiring money abroad, but in this section we focus on check cashing and bill payments because these are the two most basic and widely used fee-based services within this group. Please see Fellowes and Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential" for a detailed analysis of the location of non-bank retail outlets.

[58] For a full list of state check-cashing fees, please see: Fellowes and Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential."

[59] Fellowes and Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential."

[60] Estimates of the unbanked market and its spending are based on proprietary models owned by The Pew Charitable Trusts' Safe Banking Opportunities Project. We rely on both survey and external data to estimate the size of this market because of the difficulty associated with reaching unbanked households for telephone surveys. While the survey controls for this difficulty, we deemed the average of the two estimates (6 percent and 18 percent) to be a more appropriate measure.

[61] We considered running a structural equation model to determine different latent variable groupings, but concluded that it would be too difficult for industry to replicate this analysis with the available data. We also were unsure how industry would be able to find the latent variable groupings in the market with the available data. Further analysis is needed with data that are available to industry, such as an individual's credit score, geography, employment, and so on.

[62] For instance, please see: Ellen Seidman, Moez Hababou, and Jennifer Kramer, "Getting to Know Underbanked Consumers: A Financial Services Analysis" (Chicago: Center for Financial Services Innovation, 2005).

[63] For instance, please see: Seidman, Hababou, and Jennifer Kramer, "Getting to Know Underbanked Consumers: A Financial Services Analysis."

[64] For a recent discussion of this research, please see: Blank, "Public Policies to Alter the Use of Alternative Financial Services among Low-Income Households."

[65] For a discussion of this research, please see Fellowes and Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential."

[66] Fellowes and Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential."

[67] Please see section on overdrafts for a review of these fees.

[68] Unbanked spending estimates are based on a proprietary model owned by the Pew Charitable Trusts' Safe Banking Opportunities Project.

[69] The economics of these products are often not attractive today for either financial institutions or consumers, curbing broad adoption. See, for instance, James C. McGrath. 2007. "General-use prepaid cards: the path to gaining mainstream acceptance." No 07-03, Payment Cards Center Discussion Paper from Federal Reserve Bank of Philadelphia.

[70] Fellowes and Mabanta, "Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential."

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