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Research Snapshot:

Make the Invisible Underbanked Visible

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Research Summary

Having access to a financial institution – and using that financial institution – may be second nature to you, but for one out of every five American households it is not. Such access may instead be part of a complex web of financial services individuals tap into to survive. Chen and Friedline describe these individuals as "underbanked." In general, they have bank accounts (unlike the "unbanked" who lack a bank account entirely), but they also make use of "alternative financial services" like payday loans or pawn shop services. And the number of underbanked individuals is worth repeating: They represent 20% of the U.S. population, more than five times the number of individuals who are unbanked.

About the Unbanked

There are approximately 10 million households in the U.S. that are unbanked, and they make up 25-30% of those households earning $18,900 or less per year. African American, Hispanic, and American Indian households are more likely to be unbanked than white households (21.7%, 19.3%, and 15.6% versus 3.3%), and those with low levels of financial literacy, those with lower credit scores, and those who rent instead of own are more likely to fall into this category.

Key Point: Some triggering events may push someone into being unbanked, including loss of employment and a decline in income. Without regular deposits in a bank account, it may be unaffordable to keep one. The average overdraft charge was $31.26 in 2012, and the average minimum balance required to avoid fees on a checking account is $400 – a tough amount to maintain for someone without income or whose income is less than $19,000 per year.

About the Underbanked

In this study, the authors examined data from the National Financial Capability Survey to better understand individuals who are underbanked, and their analysis yielded two key points.

Key Point: Income volatility had one of the strongest associations with being underbanked. Of course, that doesn't mean that every client with income volatility will make use of alternative financial services, but it does suggest that income volatility may lead clients to seek out such alternatives.

Key Point: Despite what you might assume, income is not a predictor of being underbanked – even though income volatility is. Individuals from all income quintiles in the survey were underbanked, meaning those at the highest income levels per year may also find themselves making use of alternative financial services.

This is just a snapshot of a really excellent paper with a fascinating overview of banking habits. Read the full study to better understand the other literature in the field, the methodology, and the limitations of the study.

Chen, Z. & Friedline, T. (2022). Make the invisible underbanked visible: Who are the underbanked. *Journal of Financial Counseling and Planning*, 33(2), 21-46.

Study Details

- **Quantitative Study:** *Survey using 2015 National Financial Capability Study data*
- **27,564 respondents**
- **Nationally representative sample**
- **~500 respondents per state**

Bridge to Practice

As with all research, this isn't necessarily generalizable. There are limitations and more questions to answer. ***Nevertheless, there are interesting findings you can think about incorporating in your practice.***

Ask about alternatives.

We know from this research that income levels do not predict whether or not someone is underbanked. Don't assume that your clients avoid alternative financial services. Instead, consider asking your clients with curiosity – not judgement – about any alternative financial services they may use. That way, you can create a plan to serve your client effectively.

Provide alternatives to alternatives.

There are high costs and few protections associated with many alternative financial services, especially payday loans, refund anticipation loans, and pawn shop services. Consider not only helping your clients understand the risks and drawbacks of these services, but also providing them with real alternatives. Perhaps you have a relationship with a financial institution that could provide a line of credit to a client, instead of a payday loan? Perhaps a key aspect of your work with a client could be to build their own emergency reserve fund? Perhaps you can help them identify emergency support services in lieu of pawn shop services?

Expand your own definitions.

Questions about an expanded definition of alternatives – including Venmo, Cash App, and PayPal – are not necessarily part of the survey data, even though they may be part of your clients' experiences – especially their experiences accessing money. For example, loans up to $200 can be made through Cash App for an upfront fee of 5% of the borrowed amount, plus 1.25% per week after a four-week period. Make sure you are talking to your clients about all types of alternative financial services, even if that means expanding your understanding of these products.

Watch for triggering events.

If your clients lose income or employment suddenly, they may be at risk of becoming unbanked. These types of triggering events may make maintaining a bank account unrealistic for some clients, and without a bank account, it is much harder to access support services – not to mention function in the economy overall. Make sure you are watching for such triggering events in your clients – and advising them accordingly.

Definitions

- **Unbanked:** An unbanked individual is one without a bank account who may make use of alternative financial services instead.
- **Underbanked:** An underbanked individual is one with a bank account that may also use alternative financial services simultaneously.
- **Alternative financial services:** Alternative financial services (AFS) are ways of accessing money outside a traditional institution. AFS may include payday loans, rent-to-own products, refund anticipation loans, auto title loans, or the use of pawn shop services.
- **Financial inclusion:** Financial inclusion represents the efforts to expand access to basic banking products and services for addressing economic inequality.
- **Access:** Access (in contrast to use) focuses on a person's ability to use available financial services and products from traditional institutions like banks and credit unions, often by looking at geography and price.
- **Use:** Use (in contrast to access) focuses on the actual consumption of financial services once they are accessed, often measuring the frequency of use and the duration of use.