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More companies target ' **unbanked** ' consumers

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NEW YORK (CBS.MW) - Regional lender KeyBank recently held focus-group meetings with people who don't have bank accounts to find out why they avoid the system.

"They bashed banks," said Bruce Murphy, the Cleveland-based company's president of community-development banking. "They've had bad experiences" with high fees often levied against lower-income consumers on minor transactions.

Soon after, KeyBank (KEY) began offering paycheck and government check cashing services for a 1.9 percent fee - lower than most competitors - as well as a financial-education center offering tips on improving credit histories.

The effort will add to the bank's account holders and mortgage business, Murphy said. "We will break even in a three-year time frame and make money in four years. We're comfortable with the data we see so far."

While dubious, high-cost check-cashing and overseas money transfers persist, a growing number of companies are vying to win business from an estimated 10 million **unbanked** U.S. households with new products, services and in some cases, lower prices.

The competitors include traditional banks, check-cashing stores, money-processing firms and even Wal-Mart (WMT), which now offers

check cashing at some of its stores.

The Federal Reserve Board estimates 9.7 percent the U.S. population doesn't have a bank account, with most of that group earning under \$24,999 per year. It's a market that banks rarely pursued until recently, as the rival check-cashing business ballooned into an estimated \$60 billion to \$80 billion a year industry.

"**Unbanked** households represent a potentially profitable class of customers," the Fed suggested in 2001.

The nation's central bank revisited the **unbanked** issue this summer when Fed Governor Ben S. Bernanke said money transfers from U.S. immigrants to developing countries totaled more than \$90 billion in 2003, according to U.S. Treasury figures.

Fresher data released this summer puts total payments to Latin America and Caribbean at \$38 billion in 2003, up 19 percent from the previous year, he said.

"The challenge for regulators, researchers and immigrant advocates is to ensure that remitters can send funds to their home countries conveniently, safely, and at a reasonable cost," Bernanke said.

### Fee flap

In California, a legal fight broke out over Wells Fargo (WFC) and Bank of America (BAC) charging workers a \$5 fee to cash payroll checks drawn from their employers' accounts at those banks. The fee brushes up against a California law requiring employers to compensate workers without "discounts" on their pay.

"A lot of our employees don't have bank accounts, some because they don't qualify, they may have filed bankruptcy or their ex-spouse overdrew their account and the banks don't take them," said Donna Chaffee, co-owner of Ability Answering Service in Bakersfield, Calif., who joined in lawsuit against Wells Fargo.

"You shouldn't have farm workers with no accounts paying a \$5 fee on a \$50 check - they're taking 10 percent of their paycheck," said Drew Pomerance, a Los Angeles lawyer involved in the case.

In a statement, Wells Fargo said non-customers can avoid the fee by depositing the check in their account at their own bank or opening a Wells Fargo checking account. Bank of America, the plaintiff in a second suit over the \$5 fee issue, declined to comment.

### Market opportunity

Along with check cashing, money cards are blossoming on the heels of Visa's move in 2001 to set up a system to allow employers to deposit money onto ATM cards.

Bank of America, Bank One (later purchased by JP Morgan) (JPM) ), First Tennessee National, US Bancorp (USB) and FleetBoston (later purchased by Bank of America) were early participants in the effort.

"Payroll cards and other store valued cards, when accompanied by reasonable fees and linked to mainstream banking services, represent a promising way to increase consumer choice and to lead **unbanked** customers up the ladder of financial sophistication," the U.S. Treasury's Comptroller of the Currency Administrator of National Banks said in an article last week.

For smaller financial service firms, the money-card business presents an opportunity to compete with larger companies.

San Antonio, Texas.-based Payment Data Systems (PYDS) rolled out a debit card system this summer with Pronto Banco, the Secure Cash Network and GTS Prepaid that offers bill paying and money transfers to Mexico.

The ATM card allows **unbanked** customers to send one of two cards to a friend or relative outside the U.S. to provide access to funds, the company said.

Payment Data Systems CEO Michael Long, who hopes to move his company's stock to the Nasdaq from the bulletin board, said the service costs about half the roughly 10 percent fee charged by First Data Corp.'s (FDC) Western Union unit.

Despite the lower price for the service, Long said, "We think we're reserving enough margin for ourselves without gouging these folks."

First Data officials did not return an e-mail and phone call from CBS MarketWatch.

### Check cashing stores

Despite the effort by mainstream banks, plenty of the **unbanked** still prefer to take their business to check cashing stores, said Eric Norrington, spokesman for Ace Cash Express (ACE), operator and franchiser of a network of 1,200 stores in 36 states.

Charging an average fee of about 2.3 percent to cash checks, the company reported 2003 revenue of \$232 million, up from \$229 million. Net income rose to \$12.7 million from \$10 million for the same period.

"Very often, these people have rejected the banking system and they come to us and they get better service and better hours (with) no surprise fees tacked on at the end of the month," Norrington said. "Our customers work very hard -- some have more than one job, and they manage their lives. The notion that they must have a bank that they have to walk into is a misnomer."

Two years ago, the company started offering a debit card to customers in place of cash for a purchase price of \$9.95.

"We had a customer acceptance that exceeded expectation," Norrington said. "This is something the market was ready for."

Next up will be a direct-deposit card for employers to give workers in place of a paycheck, he said. The card allows cash withdrawals, purchases and other services with no need to cash a check.

Ace Express's business has caught the attention of brokerage firm Morgan Keegan, which initiated coverage Sept. 20 at an "outperform" rating. Three other brokerages already covered the company.

Analyst Robert Todd said in a note to clients that he expects the company to outperform the S&P 500 (\$SPX) in the next six months based on store growth, new products, an improving economy and attractive valuation. But he sounded a cautious note.

"While Ace Express's target markets are underserved by traditional banks, which occasionally make forays into the segment, it remains a

highly competitive marketplace," Todd said.

Some of those challenges will come from KeyBank -- at least if Bruce Murphy has his way.

"We're competing to bring people back into the segment," he said. "As our volume in this segment grows, you can lower the cost and offer more services. We have to build our client base to advance what we're trying to do....Most people (still) don't think about this segment as an opportunity segment."