

The Post Office and Financial Services for the Unbanked: Some Practical Matters

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April 2014

In January of this year, the Office of Inspector General of the U.S. Postal Service published “Providing Non-Bank Financial Services for the Underserved,” arguing that the Post Office (PO) could provide financial services at significantly lower rates than check cashing and pay day lenders charge. These postal banking services, the report suggested, could offer greater financial security for underserved populations, and generate earnings to reduce the present PO deficit.

Community Development Finance (CDF) has had exactly that mission and experience. Since May 2009 when we first opened in the Fruitvale neighborhood of Oakland, California as the only non-profit check cashing store in the country, we have followed a similar business model: offering financial services mostly at much lower cost than for-profit check cashers and payday lenders, in addition to providing financial coaching, small business services, referrals to banks and credit unions, and policy analysis.

Based on CDF’s experience to date, we believe that it is possible to create large scale, economically viable statewide or national lending programs over the period of a few years to significantly impact this market. The type of proposed loan program, if operated carefully and on scale, can offer significantly lower-priced and improved products to customers compared to the existing, market-rate products. The present, market-rate lending and credit programs – not only pay day and installment loans, but also other forms of credit available to the unbanked such as car title loans, pawn loans, rent-to-own, subprime credit cards, (and bank overdraft fees), etc. – do take advantage of the unbanked and it is critical to develop better solutions. An alternative, scalable, economically viable lending program is a better approach than eliminating what little access to credit the unbanked have available to them. A program like this one needs to offer fair pricing for the customer, but must also allow the lender – the PO in this case – to cover costs and make some level of profit if any level of scale is to be reached.

Based on our five-year experience, we offer some insights about the practical considerations of these services.

Start-up challenges: First, there will be many start-up costs, including software, hardware and equipment, a marketing plan, staff training and the possibility of hiring new staff (both on the local and administrative levels). The startup period will take time and incur significant costs. Local or state licenses may have to be obtained depending on the requirements for a government agency. Operating procedures and policies will be necessary, including compliance procedures for the Patriot Act and Bank Secrecy Act. A bank may be needed to support the operations.

Branch implementation: Second, branches will face many operational issues in implementing the proposed programs, including these examples:

- Will the services be available only electronically or will the branches be assisting customers?

- What hours will the financial services be available and when will the PO branches be open? Will branches keep their current schedules in place or will they extend them – including over holidays – to serve patrons’ financial needs (which are likely to occur more often and at different times than mailing needs)?
- Will the PO need to make changes to the spatial makeup of branches to accommodate traditional post office customers and financial services customers, especially at busy times?
- What security measures will be needed if large amounts of cash will be available at branches to perform check-cashing services? Will the PO install bulletproof glass and steel enclosures? Hire armed guards?
- Will the PO offer services in every branch with longer hours and higher operating costs even if there are few potential customers or if the area already is saturated with stores? Or, will the PO offer services only where there are “bank deserts” – defined in the Report as areas with one or no bank branches? What about neighborhoods whose needs and material situations change over time?
- What criteria will the USPS use to determine which vendors to contract for equipment and technology services?
- What reporting formats will the USPS use? What accounting methods will the USPS use?
- What salary structures and labor considerations will replace current USPS arrangements, given the different expertise necessary, the lower salaries and benefits at check cashing stores, and the devastating impact of potential postal workers’ strikes on the operation of financial services? Will the PO adopt a different approach to customer service more appropriate for financial services? Banks and credit unions have difficulty offering these financial services in part because of a higher cost structure; the PO may face a similar issue.
- How will the USPS handle the negative cash flow that is likely to occur at the beginning of the transition to postal banking services?

These operational and financial issues are vital determinants of the potential success of a postal banking plan. If the costs are too high, the chances for generating additional revenue are reduced – and policymakers and the public will be less likely to support postal banking services.

Products, pricing and policies: Third, there are also key policy decisions about products and pricing, including more key trade-offs.

- Which financial services will be offered? The Report focuses on lending and prepaid cards. And the Report and the Appendix also discuss savings accounts, payment services, check cashing, money transfer and other services. The overall product mix, including phasing-in, is crucial. Many unbanked people prefer to obtain many services at the same time; if they cannot obtain all of them, some may still opt for higher priced stores that offer a full line of products they need with more convenient hours of service. Others, however, may go to different places offering the best prices. But some services may not add much to PO profits and could be time-consuming to provide. Important trade-offs may have to be made.
- If check cashing is offered, how will the PO address losses from bad checks? One way is to tighten the check cashing policies but this will result in fewer checks cashed in order to avoid losses; fewer unbanked people will be served as a result. Check-cashing through smart phones increases the risk of fraud. Staff training to detect bad checks must be very strong in this area, too, along with the need for certain equipment and software to lower the risk.

- How will the products be priced? Will the PO continue its existing pricing patterns? Presently, the PO charges \$1.25 for money orders up to \$500 and \$1.65 for money orders up to \$1,000. This fee can be considered high; CDF charges \$.89 for money orders up to \$950. Money transfer fees may also be high. The Report suggests possible monthly fees of \$15 for use of a prepaid card; this also seems higher than many cards presently on the market.
- Other services would definitely be helpful in lowering costs for the unbanked, but will they generate enough revenue to address the PO's needs? Lending and check cashing tend to generate the most revenue and, in some cases, check cashing can generate more revenue than loans. Prepaid cards can generate a lot of revenue with high volume and fees; but charges beyond the interchange fee can add burdens for the users.
- Will enough customers switch over to postal banking services at all? The Report assumes that customers will move to a new business offering lower prices for the same or better services. This assumption does not always hold true. Some people will not make this type of change due to relationships, convenience, parking, security, business hours or lack of information about a new alternative. Financial projections need to account for this possibility.

Lending issues: Fourth, the loan program appears to be a cornerstone of the proposal and has some very useful elements that, if feasible, could help both the PO and the unbanked a great deal. However, there also are practical issues and trade-offs – many of them will be policy issues – here as well:

- Will the loans be underwritten or will most applicants be easily approved with little underwriting? If underwriting is used, what methodology will be used? Will the underwriting be electronic or manual and how will the system be developed and paid for? If manual, who will do it? Will credit scores be used to partly determine eligibility? The greatest need, in our experience, is for people who are both very low income and have very poor credit scores. Customers with the highest need levels also carry the greatest risks. CDF's .85% loss rate indicates people will repay their low-cost loans despite past problems.
- How will the loans be structured? The Report indicated use of an installment, amortizing structure with a lower APR of 28%. Pay day loans also can be structured to be affordable.
- How will the loans be priced? How exactly will the need to make a profit be balanced with the need to keep prices low? How can underwriting methods, economies of scale and electronic technologies be used to lower costs? This will be very difficult with smaller loan sizes. The Report shows a sample loan of \$375 at 25% with a \$25 fee that is paid off over 5.5 months yielding an interest return of \$48. This interest return may not cover costs and even if it is profitable, it may not generate much profit to reduce the PO deficit significantly.
- The dual goals of the proposed program – providing services to low-income people and generating a profit to reduce the USPS deficit – may be in conflict. The Report points out that the PO potentially could earn \$9 billion in revenue by targeting unbanked customers, representing about 10% of the fees that they presently pay. But for every dollar the PO charges over its breakeven costs, one dollar comes out of the pockets of low income, unbanked households. Since payday lenders made \$9.3 billion in 2012, a new PO lending program is unlikely to earn enough to cover very much of the existing deficit, especially given the proposed loan structure.
- How will the use of technology impact the programs? Technology will be essential to reduce costs and permit electronic transactions to take the place of visits to the PO branches. However, this type of lending is unsecured and is often based on trust and face-to-face

interactions. In removing these factors, loss rates typically increase with internet and electronic lending. Electronic decisions also tend to reduce or eliminate the possibility of making loans based on character and knowledge of borrowers. People who might be excellent borrowers with high need may be eliminated from consideration. Algorithms for computerized underwriting may be able to make these distinctions, although it may be difficult to create these criteria.

- How will collections be handled? The use of ACH is under fire from some of the states and the federal government. The Report's suggestion to use tax returns as a method of collection, while reasonable, will also have costs – staff time, accounting, reporting, notifying borrowers, following legal requirements, etc. There will be a time lag in recovery of unpaid loans and some defaults will still not be paid. Furthermore, collection efforts could be made before the loan is sent to the IRS and there will be costs associated with these efforts too. The same issue arises with other financial services, such as the recovery of bad checks.
- Different states have different requirements for lending and other financial services. This can create an added layer of complexity and cost.

The financial services business requires some degree of entrepreneurial skill and an innovative approach. It is a fluid business with rapid changes to neighborhoods, technologies and customer needs that require the business to be adaptable, track market changes, be responsive, etc.

The PO should be up to this challenge. But it must prepare carefully, developing a thorough transition plan covering start-up activities, operating costs, and financial projections. What products will be offered? How will they be phased in? What pricing will be used? What trade-offs are needed (and how will they be made) between earning profits to reduce the PO deficit and meeting the financial needs of low income, unbanked people? And, how much can the Post Office realistically be expected to earn toward reducing deficit, including new revenue from financial services customers who will purchase postal products and services? The Report understandably focuses on revenues without much discussion of costs and net revenue. Any next step must include some form of in-depth economic feasibility analysis.

Proposals for postal banking services should address these operational, policy, and economic issues. If feasible, postal banking has the potential to offer the unbanked a crucial new avenue to address their financial needs, while helping the U.S. Postal Service reduce its deficit.

This article can be viewed at CDF's website, communitycheckcashing.org; Dan Leibsohn can be reached at dleibsohn@sbcglobal.net. The article can also be viewed at <http://www.bankact.org/nuts-and-bolts>; BankAct provided extensive editing assistance.