WALL STREET JOURNAL

Footnote to Financial Crisis: More People Shun the Bank

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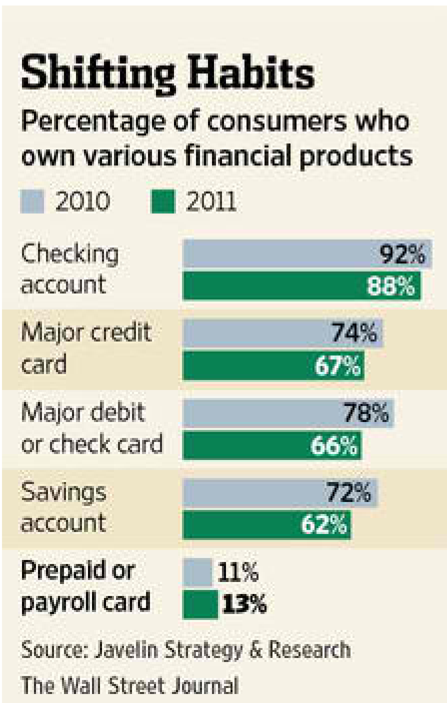
By GARY FIELDS And MAYA JACKSON-RANDALL

The Russell family of Kirkland, Wash., makes about $230,000 with Charles Russell, 43 years old, working as a systems analyst for Microsoft Corp. According to the U.S. Census Bureau, that puts them among the top 5% of American households.

But their affluence might not be apparent based on the way Mr. Russell conducts his personal finances. He has no bank account, having dumped it due to irritation over fees and overdraft penalties. Instead, for more everyday transactions he uses a debit-card offered by NetSpend Holdings Inc. NTSP -1.40%



"I have no need, desire or want to go to a regular bank," says Mr. Russell, who adds that a savings feature on the card offers a competitive interest rate.

Middle-class Americans are spending less time in the bank lobbies their parents would recognize. Today, 8.2% of the nation's households—nearly 12 million—are managing their finances without a bank, according to Census-based data the Federal Deposit Insurance Corp. will make public Wednesday. That is up from the 7.7% the bank regulator found in its 2009 report.

Another 24 million households, defined by the government as "underbanked," have a bank account but still dabble outside of the formal banking system by using payday loans, prepaid cards and other alternative means, the FDIC found. This population that has left banks, or uses their services infrequently, makes up 28.3% of America's households, the agency says. That is a slight increase from the 25.6% who fit into those categories in 2009.

Some are prompted by irritation over banking charges, including overdraft fees that cost Americans $31.6 billion in 2011, according to research firm Moebs Services Inc. Others are spurred by tight credit conditions spawned by the financial crisis and a loss of confidence in traditional institutions. Those drawn to newer nonbank options, such as NetSpend and Green Dot Corp., GDOT +0.67% tout the benefits of new technology and services, such as real-time text alerts.

WALL STREET JOURNAL

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The phenomenon shows how consumer behavior has changed in the five years since the onset of the global financial crisis. Previously, the federal government tried to lure millions of "unbanked" citizens—typically low-wage earners—into the financial main. Not having or using a bank account was an indicator of economic distress.

The FDIC figures are the latest bit of evidence that consumers are acting differently. A Federal Reserve report released Monday showed that consumer borrowing shrank in July for the first time in nearly a year by a seasonally adjusted $3.28 billion to $2.705 trillion, even though the government says consumer spending rose. The decline was due mostly to a 6.8% drop in credit-card debt. The information is in sync with an August Federal Reserve Bank of Cleveland study that found the number of people without credit cards has grown to 24% from 18% in the last four years.

Adam Solis typifies the new mood. The 39-year-old makes about $55,000 working for a utility company in Los Angeles, which puts him just above the U.S. median household income. He has a checking and savings account at a credit union but prefers using a Green Dot debit card he picked up from a Walgreens pharmacy. Citing high bank fees and a desire to better control his spending, he loads hundreds of dollars onto the card each month.

Emily Berl for The Wall Street Journal

Adam Solis has both a checking and a savings account. Still, for everyday purchases he prefers

to use a prepaid debit card.

"I see it as a long-term deal," says Mr. Solis.

Prepaid debit cards, offered by both NetSpend and Green Dot, are the fastest-growing type of payment vehicle, according to the Federal Reserve. Customers buy the plastic at grocery and convenience stores, then load money onto the cards in order to pay for a wide variety of services and purchases—just as they would with a regular credit or debit card.

Green Dot, the largest prepaid debit card provider, was initially created in 1999 to give plastic to teens who wanted to shop online. Instead, it ended up attracting mainly adult customers with bad credit who couldn't qualify for regular cards. Buoyed by an exclusive relationship with Wal-Mart Stores Inc., WMT +0.75% the number of active cards in circulation has grown to about 4.4 million, making Green Dot the largest prepaid debit-card company in the U.S.

The company last year bought Bonneville Bank, of Provo, Utah, which it renamed Green Dot Bank. The acquisition allows Green Dot to issue its own cards, rather than having to rely on partners.

Today, Green Dot says the median income for customers is about $45,000, or nearly double what it was seven years ago; roughly half of users directly deposit their pay onto the cards. Such data "more than ever, proves to me that this is a more mainstream product," says Chief Executive Steve Streit.

A Green Dot card costs as much as $4.95 at a retail store plus a $5.95 monthly maintenance fee, depending on usage. There is no monthly fee if $1,000 or more is deposited in the period, or the card is used 30 times. Reloads, performed online or at retail, can cost up to $4.95 each, depending on the method.

Many companies market the cards as alternative to checking accounts and report customers are depositing wage checks directly onto them. Some consumers use cards to carry government benefit payments from federal and state agencies.

Pew Charitable Trusts estimates the total that flows through these cards will reach $201.9 billion by 2013 compared with $28.6 billion in 2009. Industry groups and credit counselors cite the inability to overspend as a top reason for the uptick.

Mr. Russell had a bank account in 2007 when he was a Realtor in California. The downturn wiped out the real-estate market, and his finances. The miscellaneous fees and penalties came next. He closed the account.

WALL STREET JOURNAL

Footnote to Financial Crisis: More People Shun the Bank

A new job in Washington state required he have somewhere for direct deposits. He considered opening a bank account but his wife suggested a prepaid card offered by GreenDot rival NetSpend.

The card comes with FDIC insurance of up to $250,000, fraud protection and a savings interest rate that is "competitive if not a little more than a traditional bank," says Mr. Russell.

Other nonbank service providers are proving more appealing to the middle class. Cash Advance Centers Inc. is one of the country's largest payday lenders—a borrowing option once synonymous with low-wage earners. A decade ago, payday lenders were widely considered to be a predatory group. Issuing loans against a customer's future paycheck, such storefronts were criticized by consumer advocates for providing easy money at usurious interest rates.

Cash Advance Centers estimates the average income of its customers rose $9,000 to $50,000 in the first quarter of 2010. In 2011, it jumped again to about $54,000. With its attractive storefronts located in many suburban areas, the company today says 22% of its customers earn more than $75,000.

All of this activity has traditional banks on notice. Some are adding fees while others are trying to deepen relationships with their customers, trying to become a one-stop-shop. Their offerings look a lot like those offered by their new rivals.

Emily Berl for The Wall Street Journal

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Prepaid debit cards

Regions Financial Corp., RF -1.21% one of the largest U.S. banks based on assets, is now offering consumers services including small-dollar loans, check-cashing services, money grams and prepaid cards. The average income of consumers using Regions' new products: $50,000 a year.

J.P. Morgan Chase JPM +2.17% & Co., the nation's biggest bank by assets, began selling prepaid-debit cards in its branches this summer. U.S. Bancorp, USB +0.62% BB&T Corp. BBT -0.06% and American Express Co. AXP -0.50% also now sell prepaid cards. To market its product, Amex has begun using the slogan, "spends like cash, feels like membership."

Meanwhile, a handful of banks, including Regions, U.S. Bancorp and Wells Fargo WFC -1.27% & Co., also offer "direct-deposit loans." Much like the payday loans offered in storefronts and strip malls, the direct-deposit advances provide borrowers with emergency cash for shortfalls between paychecks. These loans can be expensive. Regions, for example, charges $2 on every $20 borrowed.

"I think there's a misconception about who the underbanked are—they're our customers," said John Owen, who leads Regions' consumer services group.

Nevertheless, consumers' comfort level outside the traditional banking system worries some economists and policy makers.

The contention: Not using a bank account and related services makes it harder to save and to build a credit score, says Mauro Guillen, director of the Lauder Institute of Management and International Studies at the University of Pennsylvania's Wharton School. "It's not a good thing that people, in an economy like this, stay outside the formal sector," Mr. Guillen said.

Fees and interest rates can be high. If customers roll over their payday loans beyond the typical two-week period—as they often do—the amount owed can ratchet up fast, making them tougher to pay off. Interest rates on these types of loans are often equivalent to annual percentage rates in the triple digits. Pew estimates that the average borrower takes out eight loans of $375 annually, and pays $520 on interest.

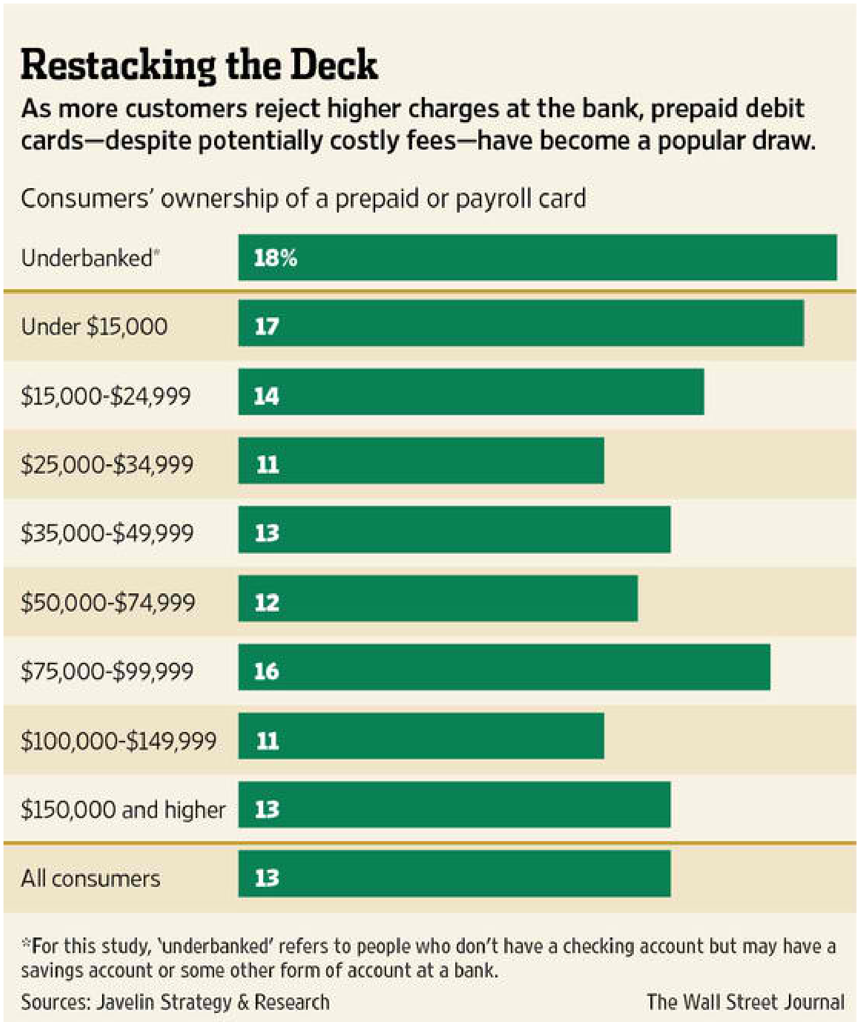
While some states already regulate payday lenders and check-cashing businesses, the newly created Consumer Financial Protection Bureau has its sights on more tightly regulating this market—especially payday lenders and prepaid card companies—at the federal level.

Richard Cordray, the head of the CFPB, said the agency's focus is "on whether that consumer can get the same consumer protections and safeguards no matter which services or products he or she chooses to use to manage household finances."

WALL STREET JOURNAL

Footnote to Financial Crisis: More People Shun the Bank

The consumer financial landscape, however, has been inextricably altered by the credit crunch and new federal regulations on the financial industry. After the financial crisis banks tightened lending standards and many raised fees on checking accounts. As a result some consumers decided to look elsewhere for loans and alternative ways to manage their cash.



Industry groups, such as the Network Branded Prepaid Card Association, say consumers cite convenience as one of the top reasons the nontraditional products are gaining popularity, as well as technologically sophisticated services.

A Federal Reserve study released in June highlights the dilemma for traditional banks. Of the 9.6% of families who don't have a checking account, almost one third of them say they don't like dealing with banks. In 2001 that number was 22.6%. Additionally, 7.4% of the families without checking accounts cited high minimum balance requirements as the reason they didn't have checking. That number was 6.5% in 2001.

New Washington regulations have restricted banks' ability to collect fees on debit cards, credit cards and overdraft services, which have long-been significant sources of revenue. It costs banks about $300 a year to maintain a checking account, according to Boston-based research firm Celent. But the new strictures are making it harder for institutions to break even on many accounts.

At an April meeting of the FDIC, bankers who sit on an agency advisory committee argued they were competing at a disadvantage. They said prepaid cards undermined their efforts to bring consumers into the banking mainstream and complained that prepaid-card companies don't have to meet the same consumer protection and anti-money laundering rules as traditional bank products, such as debit cards and credit cards.

"Innovation has gotten so far ahead of our ability to really understand what is happening that it gives me more pause than excitement about the potential to serve clients that we're trying to serve," said Bruce Murphy, president of community development banking at Keybank.

The advantages are more clear-cut for Pam Pittman, who makes more than $55,000 a year in Delaware where she works for the Postal Service. Ms. Pittman says she has "nothing against banks," and she maintains a checking account, but adds she sometimes needs the kinds of smaller loans offered only by payday lenders.

She says she took out a payday loan recently to cover household expenses after her employer cut her hours.

At the time, Ms. Pittman says she didn't even bother trying to obtain a loan from the bank, citing her less than impeccable credit—as well as the reluctance on the part of banks to make small loans. "It's just a different time," she says.

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