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*Insights*

Community Affairs  
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## Reaching Minority Markets: Community Bank Strategies

### **Abstract:**

The growth of minority populations and projected increases in their buying power provide significant opportunities for retail growth by financial institutions. Community banks are using a variety of strategies to target specific minority markets in the United States. This report will examine selected community bank strategies, their impact on bringing unbanked consumers into the banking system, and some risks and regulatory considerations associated with each strategy.

The information presented here was obtained from a variety of sources including financial institutions. Discussions with financial institutions focused on community banks, so that the strategies presented in this report might be appropriate for other community banks that are interested in expanding outreach to minority markets. Thus, references to “banks” in this report generally apply to community banks.

### **I. What Are the Strategies Presented in this Report?**

Depending on their business model and targeted customer base, community banks are using a variety of strategies to reach minority consumers. Some banks use a number of these strategies simultaneously, and others have selected specific approaches from the larger list of strategies. Generally, these strategies include tailored products and services, nontraditional banking products, alternative credit analysis for loans, transition programs to traditional banking products, a focus on employee hiring and development, and a commitment to serving small business needs in the community.

### **II. Why Are these Strategies of Interest to Banks?**

These strategies are attractive because they can assist banks with developing customers from growing minority markets, many of whom currently use nonbank financial service providers, such as check-cashing outlets and money transmitters, for their financial service needs. In addition, community banks that are located in towns or neighborhoods that have undergone a significant increase in their minority population have adapted these strategies to meet the needs of a new customer base.

The minority population in the United States is expanding, fueled by continuing immigration and a higher birthrate than exists for nonminorities. Banks are responding to this demographic trend as they have found these consumers to be a potential source of retail growth. According to a 2003 survey by the American Bankers Association, nearly half of banks are either active in multicultural marketing or plan to market to different ethnic groups.<sup>1</sup> As shown in Table 1 below, some minority groups account for a high percentage of unbanked consumers, making these groups a source of significant potential growth for banks.

**Table 1**  
**Bank Account Ownership by Race/Ethnicity**

Race/Ethnicity	Have Bank Account
African-American	75.9%
Hispanic	75.0%
White	94.8%
Other	94.7%

Source: Compiled from 2004 Survey of Consumer Finances.

According to U.S. Census reports, Hispanics accounted for about half the growth in the U.S. population between 2000 and 2004, showing a presence that is increasing even faster than in the 1990s. In another contrast to the 1990s, births have overtaken immigration as the largest source of Hispanic growth. Although immigration continues at a fast pace, new immigrants are now outnumbered by Hispanic babies born in the United States. One in five children under 18 in the U.S. is Hispanic.<sup>2</sup>

Of particular interest to community banks in rural areas, Census data confirm that racial and ethnic diversity, once primarily a characteristic of urban areas, has rapidly become a hallmark of suburbs and small towns.<sup>3</sup> For example, during the 1990s, rural Hispanic population growth more than doubled from the previous decade and far outpaced that of all other rural residents. Hispanics made up less than five percent of rural residents in 1990, but they accounted for over 25 percent of all rural population growth from 1990 to 2000.

Despite their historic concentration in the Southwest, half of all rural Hispanics now live outside the Southwest. Moreover, rural Hispanics in the Midwest, Southeast, and Northwest, though small in number, are growing far more rapidly than all other racial and ethnic groups.<sup>4</sup> There are a number of reasons for the growth of Hispanic populations in rural areas, including the availability of steady employment in the agribusiness, meat processing, and textile industries.

<sup>1</sup>“Banks Will Boost Marketing Budgets in 2004,” American Bankers Association (ABA) press release, September 15, 2003, cited in Anna Paulson, Audrey Singer, Robin Newberger, and Jeremy Smith, “Financial Access for Immigrants: Lessons from Diverse Perspectives,” Federal Reserve Bank of Chicago and The Brookings Institution, May 2006, p. 30. Note: the ABA survey covered banks of all asset sizes and was not restricted to responses from community banks.

<sup>2</sup>D’Vera Cohn, “Hispanic Growth Surge Fueled by Births in U.S.,” *Washington Post*, June 9, 2005, p. A1.

<sup>3</sup>John D. Hawke Jr., “Growing Diverse Banking Markets,” *Community Developments*, Office of the Comptroller of the Currency, Summer 2001, p. 3.

<sup>4</sup>William Kandel and Constance Newman, “Rural Hispanics: Employment and Residential Trends,” *Amber Waves*, U.S. Department. of Agriculture Economic Research Service, June 2004, p.1.

The purchasing power of minority markets is also growing. Between 1990 and 2010 the buying power of Hispanics is expected to grow 412 percent, the buying power of Asian-Americans is expected to grow 397 percent, and that of African Americans 222 percent, compared to growth of 177 percent for all U.S. consumers. The relative gains in minority buying power reflect more than just a higher projected population growth for these groups compared to whites, and incorporate factors such as an increasing number of jobs across the nation and rising levels of educational attainment among minorities.<sup>5</sup>

In relative terms, the combined African American and Hispanic consumer markets are larger than the economies of all but nine countries in the world.<sup>6</sup> Furthermore, by 2010, it is likely that the buying power of African Americans and Hispanics will surpass the GDP of Canada, which is the ninth largest economy in the world.<sup>7</sup>

### ***Community Reinvestment Act***

Minority communities include consumers with a wide range of incomes. However, as minorities compose 60 percent of unbanked families, and nearly 80 percent of unbanked have incomes less than \$30,000 annually, banks have noted that some of their strategies designed to attract minority customers may receive favorable consideration under the Community Reinvestment Act (CRA).<sup>8</sup>

Improving access to financial services for low- and moderate-income individuals is favorably considered under a bank's CRA examination regardless of the size of the bank. For example, in banks that have assets of \$1 billion or more, the OCC evaluates the availability and effectiveness of their systems for delivering retail banking services under the service test of the CRA. Banking services may be considered as community development services under the service test when they have a primary purpose of community development, are related to the provision of financial services, and have not been considered as retail banking services.<sup>9</sup>

CRA examinations for community banks with total assets between \$250 million and \$1 billion (intermediate small banks) include consideration of both the extent to which the banks provide community development services and the responsiveness of these services to the community development service needs of their communities. Even smaller banks, with total assets less than \$250 million, may enhance their CRA performance by providing community development services, branches, and other services and delivery systems that enhance credit availability in their assessment areas.

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<sup>5</sup>Jeffrey M. Humphreys, "The Multicultural Economy: America's Minority Buying Power," *Georgia Business and Economic Conditions*, The University of Georgia, Third Quarter 2005, pp. 2-3.

<sup>6</sup>Measured by gross domestic product (GDP) in U.S. dollars.

<sup>7</sup>Humphreys, "Multicultural Economy," p. 1.

<sup>8</sup>Data compiled from Federal Reserve Board's 2004 Survey of Consumer Finances.

<sup>9</sup>See 12 CFR 25.24(d) for the performance criteria by which the OCC evaluates the availability and effectiveness of retail banking services. See 12 CFR 25.24(e) for the performance criteria by which the OCC evaluates community development services

Table 2 below highlights a sampling of activities that receive favorable consideration as community development services. Some of these activities are addressed in this report.

**Table 2**  
**Typical Community Development Services**

<ul style="list-style-type: none"> <li>• Providing financial services to low- and moderate-income individuals through branches and other facilities, unless the services are otherwise evaluated as a retail banking service for CRA purposes</li> </ul>
<ul style="list-style-type: none"> <li>• Providing reasonably priced international remittances services that increase access to financial services by LMI individuals</li> </ul>
<ul style="list-style-type: none"> <li>• Providing other financial services such as low-cost bank accounts or free government check cashing that increases access to financial services for LMI individuals</li> </ul>
<ul style="list-style-type: none"> <li>• Providing technical assistance on financial matters to nonprofits serving LMI or economic development needs</li> </ul>
<ul style="list-style-type: none"> <li>• Lending employees to provide financial services for organizations facilitating affordable housing</li> </ul>
<ul style="list-style-type: none"> <li>• Providing financial counseling or education to promote community development and affordable housing</li> </ul>
<ul style="list-style-type: none"> <li>• Establishing school savings programs and teaching financial education for LMI individuals</li> </ul>

### **III. How Do these Strategies Work?**

This section of the report provides a sampling of strategies for reaching minority markets that some community banks have found to be successful. While the majority of these strategies are designed to appeal to low-income consumers, consumers of all different income ranges are present in minority communities and desire access to the wide variety of financial products and services appropriate for their income levels. Not every strategy discussed here is relevant for every minority community; a strategy’s relevance will depend on whether the community has immigrants and the extent to which particular products and services are relevant to a specific community.

Overall, these strategies have a goal of bringing both deposit and loan business to a bank. The deposit account is a typical entry point for cross-selling other products and services, especially loans. The bankers interviewed believe that the industry is losing many potential minority customers to check cashers, in part because some minority consumers may be less likely to frequent a bank for various cultural reasons. As a result, banks are using various strategies, such as the ones described in this report, to overcome barriers that may exist to minorities’ use of traditional financial institutions.

## Typical Products

• Low-minimum-balance accounts
• Credit-builder certificate of deposit (CD)
• Check cashing
• Remittances
• Automobile loans
• Affordable mortgages
• Targeted small business services

## Typical Services

• Customer comfort
• Alternative credit analysis
• Transition programs to bank products
• Financial education
• Community outreach
• Non-standard hours

## A. Deposit and Cash-Based Services

### *Depository Services*

Some banks have discovered that standard checking and savings accounts were attractive only if the minimum opening and average balances to avoid service charges were set at a negligible level. One bank found that a \$100 requirement needed to be reduced to \$10 to attract a significant number of new customers. To reduce the costs of maintaining low balance accounts, some banks do not offer checks with these accounts but will provide a debit card.

Some banks have developed “second chance” accounts for consumers who have overdrawn accounts in the past.<sup>10</sup> Most banks require customers who are offered these accounts to complete a financial education program.

### *Credit-Building Products*

As many as 50 million Americans may have little or no credit history and are characterized as having a “thin credit file” or being “unscorable.”<sup>11</sup> These Americans traditionally represent consumers new to the credit system, such as students, young adults, and immigrants. To address this lack of a credit history, some banks offer products such as CD-guaranteed loans that help people develop a credit history. With this product, a customer borrows \$1,000 from a bank and immediately invests the funds in a one-year bank CD that will serve as collateral for the loan. The loan is generally priced at a spread of 2 to 3 percent above the interest rate on the CD.<sup>12</sup> Over the next year, the customer makes monthly payments of principal plus interest to repay the loan. After 12 months, the borrower has received the \$1,000 principal plus interest from the CD and has established a credit history.

### *Cash-Based Services*

Much of the lower-income minority market is currently being served by nonbank, largely cash-oriented providers. The Survey of Consumer Finances, conducted every three years by the Federal

<sup>10</sup> See “Building Loyalty Through Second-Chance Checking Accounts” in *From Margins to the Mainstream: A Guide to Building Products and Strategies for Underbanked Markets*, National Community Investment Fund, 2005, at <http://www.cfsinnovation.com/publications.php>.

<sup>11</sup> Martin Bosworth, “New Forms of Credit Scoring,” *ConsumerAffairs.Com*, April 2005, at [http://www.consumeraffairs.com/news04/2005/credit\\_scoring\\_new.html](http://www.consumeraffairs.com/news04/2005/credit_scoring_new.html).

<sup>12</sup> “Best Practices in Immigrant Lending,” Prepared for the American Bankers Association, ShoreBank Advisory Services, May 25, 2004, p. 4.

Reserve System, asks families that do not have a checking account to give a reason for not having an account. The most commonly reported reason (28.6 percent) was that the family did not write enough checks to make account ownership worthwhile. Another 14 percent reported that they did not have enough money to make account ownership worthwhile, and 22.6 percent reported that they did not like dealing with banks.<sup>13</sup>

Cash-based services include check cashing, money orders, remittances, prepaid telephone cards, and bill payment. Some banks have found that offering these services is critical to attracting consumers who rely on nonbank providers because of the convenience of obtaining all of these services in one location. Some banks reported that they have account holders who use check-cashing services to cash their paychecks in order to take advantage of non-recourse check cashing.

Most banks provide their customers with recourse check cashing, whereas nonbanks typically provide their customers with non-recourse check cashing. Under recourse check cashing, if a bank customer presents a check that is returned for insufficient funds in the check writer's account, the bank where the check was cashed will debit its customer's account for the amount of the check. This makes the bank customer responsible for the amount of the check.

Under non-recourse check cashing, once a check has been presented and returned because of insufficient funds, the bank or check casher generally will absorb the amount of the check and usually will pursue a legal remedy against the person who presented the check only if fraud is involved. Non-recourse check cashing is therefore a more expensive way to cash checks for both the bank and the customer; however, it limits the exposure of the person presenting the check.

A number of banks will enroll non-account holders as regular check cashers and give them an identification card to make subsequent visits to cash checks less time consuming. Banks that offer these services to frequent check cashers reported that they put these customers through the same identification screening that they use for account holders.

There was a wide disparity of views on offering check-cashing services among the banks interviewed. Some offered recourse and non-recourse check cashing with a different fee structure for each. In these banks, account holders who use recourse check cashing can cash checks at no charge, while those who opt for non-recourse check cashing pay a fee.

Some banks also offer check-cashing services to non-account holders as a means to attract unbanked customers for future growth. However, other banks believe that broadly offering check-cashing services to non-account holders is too risky, and offer just limited check-cashing services to non-account holders – cashing only government-issued checks and those issued on accounts that the bank holds (“on us” checks).

### ***Transition Programs to Traditional Banking Products***

The banks interviewed that provide check-cashing services to non-account holders all use their tellers to market traditional depository products, such as savings and checking accounts. The tellers gradually provide additional information about the benefits of opening an account to repeat check-cashing customers as these customers become more comfortable with the bank. These banks cautioned, however, that the transition process is not quick as it requires customers to develop a level of confidence in the bank and in their ability to understand products, such as bank accounts, with which they are unfamiliar. Once customers obtain a comfort level with the

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<sup>13</sup> Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, “Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances,” *Federal Reserve Bulletin*, March 22, 2006, p. 10.

institution, they are generally receptive to a step-by-step entry into the banking system, taking on one product at a time. All of the banks interviewed expressed a desire to expand the range of products used by all customers, with a particular eye on loan products.

### ***Remittances***

Banks with a sizeable immigrant customer base generally offer remittance products. Many banks have found remittances to be an important addition to their product mix, in part because the United States is the leading source of remittances,<sup>14</sup> sending an estimated \$47 billion abroad in 2004.<sup>15</sup> Reportedly, 69 percent of Hispanics living in the United States send money outside the country.<sup>16</sup>

Some banks offer these products only to bank account holders, while others view them as an entry-product and offer them to both account and non-account holders, although they may charge a premium for non-account holders. However, many consumers have a high level of loyalty to their current provider of remittance services, and banks have found that consumers are not especially price sensitive when deciding which remittance product to use. As a result, banks have found that while they must offer remittance products, the bank needs to have other products and services that draw consumers into the bank.

There are a few major models for bank involvement in small denomination remittances. In one model, banks in the United States have developed joint arrangements with banks in foreign countries allowing for account-to-account transactions. For community banks, this can be achieved through use of products such as the Federal Reserve's ACH Mexico Service, *Directo a México*. In a second model, banks issue additional ATM cards that can be used to withdraw funds, but not make deposits, abroad. In a third model, some banks offer products, through arrangements with a money transfer operator, that allow account holders and non-account holders to bring cash to a bank branch to be sent abroad. This arrangement enables a bank to offer a remittance product that takes advantage of the money transfer operator's extensive distribution network abroad.

### ***Other Nontraditional Services***

Some banks have found that in order to make themselves attractive to consumers who rely on check cashers for a variety of services, they need to make the bank just as convenient. Consumers who patronize check cashers use these businesses to cash checks and to conduct a variety of financial transactions. In addition to remittances, these include purchasing money orders, prepaid telephone cards, cellular phone minutes, and stamped envelopes.<sup>17</sup> As money orders are most commonly used for paying bills, check-cashing stores serve as a location where people cash checks, mail bill payments, and make purchases all in one location.

## **B. Alternative Credit Analysis and Related Products**

All of the banks interviewed emphasized the importance of loan products in a bank's profitability analysis of customer relationships, especially for customers who maintain low balances in their accounts. However, many of their targeted customers either do not have a traditional credit history or have a credit rating in need of repair.

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<sup>14</sup> Devesh Kapur and John McHale, "Migration's New Payoff," *Foreign Policy*, November/December 2003, p. 50.

<sup>15</sup> *The Index of Global Philanthropy 2006*, Hudson Institute, p. 30.

<sup>16</sup> David Gosnell, "U.S. Bank Stands by Remittance Card Program," *Prepaid Trends*, Vol. 1, Issue 10, June 21, 2006.

<sup>17</sup> See OCC Interpretive Letter 718 in Office of the Comptroller of the Currency, *Interpretations and Actions*, Vol. 9, No. 4, April 1996. National banks may dispense from their CBCT (Customer-Bank Communication Terminal) branches public transportation tickets, event and attraction tickets, gift certificates and prepaid phone cards.

In order to evaluate the creditworthiness of a borrower lacking existing credit lines, these banks have turned to other factors. Banks will examine factors such as rent payments, bill payment histories from utility and telephone companies, insurance payments, child-care expenses, use of payday loan stores, and length and projected stability of employment in determining whether or not to make a loan. A number of firms have developed scoring models that incorporate data from these and other sources.<sup>18</sup> Banks may offer a variety of products based on alternative credit analysis, including automobile loans, unsecured credit cards with small lines of credit, and home mortgages.

### **Potential Sources of Payment Data<sup>19</sup>**

• Energy payments (water, electric, gas)
• Telecommunications (landline, cellular, cable television)
• Automobile insurance
• Homeowner's insurance
• Rental payments
• Child care payments
• Health care payments
• Certain retail payments (e.g., furniture rental)

The use of alternative data presents potential benefits for borrowers and lenders. Scoring based on these data may allow consumers who lack a traditional credit history to obtain a loan, whereas in the past, they may not have been able to obtain a loan from a traditional financial institution. Lenders may find that augmenting credit files with alternative data may help improve the precision of existing credit risk models for certain borrowers.<sup>20</sup>

Banks that have been successful in using alternative credit analysis are offering a number of affordable loan products, including 95 percent to 97 percent loan-to-value (LTV) residential mortgage products that may be purchased by the secondary market. They may process these loans in-house or may establish relationships with loan originators who already have a presence in the community.

Banks that offer these affordable home loans generally require borrowers to complete a financial education program; often, some instruction is conducted at the bank and some at a nonprofit partner. In addition, some banks require that the first few payments be made in person with the loan officer, so the bank can make sure that the borrowers are budgeting appropriately.

<sup>18</sup> See Anna Afshar, "Use of Alternative Credit Data Offers Promise, Raises Issues," *New England Community Developments*, Federal Reserve Bank of Boston, Third Quarter 2005, pp. 2-3, for examples of scoring models: First American CREDCO's Anthem, Payment Reporting Builds Credit (PRBC), Fair Isaac Corporation Expansion Score. See Barry Wides, "Taking the Nontraditional Route to Bring Borrowers into the Prime Mortgage Market," *Community Developments*, Office of the Comptroller of the Currency, Summer 2005, for discussion of Fannie Mae and Freddie Mac guidelines for using alternative credit reports. See 12 CFR part 202 – Federal regulations require banks to carefully evaluate their policies and scoring models to ensure that all applicants for credit are evaluated consistently, without regard to race, color, national origin, or any other prohibited basis.

<sup>19</sup> Information Policy Institute, "Giving Underserved Consumers Better Access to the Credit System: The Promise of Non-Traditional Data," July 2005, p. 8.

<sup>20</sup> Afshar, "Use of Alternative Credit Data," p.2.

In addition to mortgage loans, some banks incorporate the use of alternative credit analysis in other product offerings. For example, depending on where a particular community is situated and the availability of public transportation, its residents may need automobiles to get to their jobs. To address this need, some banks have developed automobile loans for borrowers without a formal credit history, using alternative credit analysis. The banks view these loans as a good introductory credit product, since they are secured, short-term, fixed-rate loans with low-dollar balances.

### **C. Communicating with and Reaching Customers**

*Making the Customer Comfortable* — According to the banks interviewed, having tellers and other bank staff members who make customers feel comfortable is crucial to attracting unbanked minority customers. Some banks mentioned that having one or two bilingual employees is not enough; customers must feel comfortable that many employees at the bank can help them with their transactions. These staff members should be fluent in the languages used in the community where the bank is located and should be able to direct and serve customers when they enter the bank. In some communities, this may require the bank to be able to service customers who have a variety of foreign language needs.

Some banks stated that in hiring people, they look for a skill set that matches the job description and for people who want to work with underserved customers. These banks actively seek employees who are comfortable in serving customers apprehensive about using bank services and who would make customers intimidated by banks feel welcome. In turn, these banks stated that they provide developmental opportunities for their employees and give them a sense that they are an important part of the bank's business.

According to a report commissioned by the American Bankers Association, ethnic staff members know and can address some of the major concerns that consumers from the same ethnic group may have and not necessarily voice. Staff members who can easily communicate with members of the community can increase a feeling of comfort and understanding while also acting as embedded marketing tools within the community. Because word-of-mouth recommendations are often how members of a community, especially those with limited English proficiency, decide where to obtain services, having staff members from within the community provides ongoing opportunities to let people know that the bank has products and services to meet their needs.<sup>21</sup>

Training all staff, particularly front-line staff, about the cultural background of the community increases the ability of staff to respond to customers who may be from a different cultural background. For example, with some cultures, relationship building is an important part of business transactions, and may take longer, and require more personal interaction than bankers would expect with consumers born in the United States.

Some banks put a focus on being as straightforward as possible with their customers and making sure that they only direct customers to products and services that they need. Concentrating on particular products reflects an understanding of the target community.

Some banks also integrate a foreign language into basic marketing materials, such as brochures, and other materials, such as deposit slips. However, banks generally do not provide legal documents, such as formal disclosures and most loan documents in foreign languages. None of the banks interviewed who provided materials in foreign languages provided legal documents in foreign languages due to concerns about compliance issues. Some banks provide a foreign interpretation of legal documents to customers but are careful not to describe it as a translation of a legal document.

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<sup>21</sup> "Best Practices in Immigrant Lending," p. 11.

## ***Community Outreach and Financial Education***

Banks have found that community outreach – publicizing the bank to local community groups, churches, and schools – to be an important component of establishing trust in the bank. This outreach entails getting involved in the community, coupled with sensitivity to the community’s culture and an awareness of what the community is looking for in its banking services.<sup>22</sup> Many community groups, especially social service organizations, already have the trust of the local community and can broker relationships between individuals and financial institutions.

Partnerships with community groups are usually formed to provide credit counseling or other types of financial education, first bringing individuals into a depository relationship. Mortgages and consumer loans often result from both the account openings and appropriate financial education.<sup>23</sup> Some banks have found that it takes time and patience before they can establish a level of trust with community organizations and local churches, but persistence and a steady presence in the community work in the bank’s favor.

A number of banks collaborate with community organizations to deliver financial education.<sup>24</sup> Many banks have found that simply offering financial education classes does not attract many attendees. However, when banks partner with service providers who are providing financial education for a particular purpose, they often have more success. Banks will tailor the financial education program to the needs of the group being served. For example, if the bank partners with a service provider that works with young adults, ranging in age from 16 to 19 years old, the education will focus on building credit. If the bank partners with a service provider that focuses on welfare-to-work participants, the bank will address topics such as managing finances and applying for the Earned Income Tax Credit.

Some banks work through schools to provide financial education and will work with parent-teacher associations to provide instruction at school events. This instruction covers topics such as basic bank accounts, check writing, home mortgages, and predatory lending.

Some banks set up informational tables at community events such as festivals, cultural holidays and celebrations, and health and housing fairs. However, simply showing up at these events is not enough to build community trust. A substantive commitment to longer-term initiatives is usually required, and investment in local financial education programs or neighborhood development can demonstrate a bank’s long-term commitment to the community.<sup>25</sup>

## ***Advertising***

Most of the banks interviewed believe that a grapevine of customer satisfaction is their most effective marketing strategy. They generally believe that many new customers are referred by existing customers. These banks generally engage in targeted radio and newspaper advertising, for example, when they introduce a new product or at a time of year when their customer base returns from extended trips to a home country. Banks have also found that advertising in local establishments, like small grocery stores (*bodegas*) and barbershops, adds to a perception of credibility.

Most banks use radio advertising heavily but very limited television advertising. Banks offered differing opinions on the value of advertising in print media, with some feeling that it is necessary, while others believed that their customer base primarily uses other news sources.

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<sup>22</sup>“Banking Immigrant Communities: A Toolkit for Banks and Credit Unions,” Texas Appleseed, 2006, p. 11.

<sup>23</sup>“Best Practices in Immigrant Lending,” p. 11.

<sup>24</sup>See OCC Financial Literacy Resource Directory at <http://www.occ.treas.gov/cdd/finlitresdir.htm> for examples of organizations banks collaborate with to offer financial education.

<sup>25</sup>“Banking Immigrant Communities,” p. 12.

Banks have a variety of messages that they communicate to potential customers. Some focus on the financial benefits (“having a bank account saves you money”) with illustrations that spending \$25 per month at a check casher is \$300 annually that the customer could put in a savings account. Some focus on the security of not having to carry a lot of cash, since money can be deposited in a bank account and withdrawn or spent as needed using a debit card. Other banks publicize that their employees live in the community being served, can relate to its customers, and will help customers understand banking products and their use.<sup>26</sup>

### ***Extended Hours***

In response to the needs of the local community, some banks offer extended hours to provide services when many customers are not at work. Some banks offer extended drive-thru services on weekdays and Saturdays, while others will have offices open on Saturdays and Sunday afternoons. These hours are set in each location to accommodate customers and to compete with check-cashing outlets. Some banks take into consideration the usual working hours for the local community and maintain a variety of open hours at branches that serve particular communities.

### **D. Serving Small Business Needs**

Serving developing small business needs is a key component of some banks’ business models to reach minority markets. One bank noted that as a result of welfare reform, a significant number of women who had been on welfare in that community began child care businesses out of their homes. Since county law required that state subsidy payments to child care providers be made by direct deposit, this created a potential source of new small business customers for the bank.

Another bank serves a number of small landscape and construction contractors. These contractors have cash intensive needs as they often receive payments by check from a larger contractor but pay their own employees in cash on a weekly basis. The bank developed a service to pre-approve large cash disbursements for these contractors and has the cash ready for them when they bring in their checks from larger contractors. Some banks also have a fairly significant presence in providing retail and lending services to small grocery stores, bridal shops, and other “mom and pop” businesses located in minority communities.

Banks that serve immigrant populations with a higher level of assets often find that many of their customers are involved in international trade. Banks serving these populations often develop trade finance expertise.<sup>27</sup> The banks may also offer products, such as the Export Working Capital Program,<sup>28</sup> offered through a combined effort of the Export-Import Bank and the Small Business Administration (SBA), or other financing programs run by foreign governments.

Many banks use a variety of SBA loan programs and also use state and local loan guarantee and subsidy programs. For example, the SBA CommunityExpress Loan program is a pilot program, available to selected lenders in pre-designated geographic areas serving mostly low- and moderate-income areas.<sup>29</sup> The program also includes technical and management assistance, designed to help increase the loan applicant’s chances of success. The maximum loan under this program is \$250,000 and the standard SBA guaranty percentage and interest rates for 7(a) loans apply.

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<sup>26</sup> 12 CFR 202.4(b) bars creditors from making oral or written statements to applicants or prospective applicants that would discourage, on a prohibited basis, a reasonable person from making or pursuing an application.

<sup>27</sup> See FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual, “Trade Finance Activities,” pp. 238-241, at [http://www.occ.treas.gov/bsa/documents/BSA\\_AML\\_Man\\_2006.pdf](http://www.occ.treas.gov/bsa/documents/BSA_AML_Man_2006.pdf) for guidance on trade finance activities.

<sup>28</sup> See information on the Export Working Capital Program at <http://www.sba.gov/services/financialassistance/SpecialPurposeLoans/ewcp/index.html>.

<sup>29</sup> See information on the CommunityExpress Loan Program at <http://www.sba.gov/services/financialassistance/7alenderprograms/comexpress/index.html>.

## **IV. What Are the Key Risks and Regulatory Considerations Presented by these Strategies?**

Many of the products incorporated in these strategies are traditional bank retail and small business products and carry the risks associated with the provision of basic banking services. In addition to policies and procedures that banks use to address these basic risks, a number of banks have developed mechanisms to monitor the use of products, such as checking accounts, by consumers who are new to banking products.

### ***New Product Risks***

In offering new products and services, financial institutions face a number of risks that must be addressed. Many banks have found that engaging in new, expanded, or modified bank products or services has enabled them to expand their customer base. However, the bank's ability to effectively measure, monitor, and control the risks inherent in such products or services may be compromised if it is overly focused on expected returns, does not have a good understanding of the inherent risks, or has insufficient governance practices.

OCC supervisory guidance advises banks seeking to offer new products and services to oversee them through an effective risk management process that includes performing adequate due diligence prior to introducing the product, developing and implementing controls to ensure risks are properly measured and controlled, and developing and implementing appropriate performance monitoring and review systems. The guidance also advises bank management to have a realistic understanding of the risks and rewards of the product, and to clearly understand the rationale for offering the product.<sup>30</sup>

In a September 2004 *Insights* report on remittances, the OCC addressed a variety of risks related to banks offering remittance products.<sup>31</sup> In addition to the risks related to offering new products described above, offering remittance products includes risks related to customer identification (described below), money laundering, country risk, and third-party service providers.

### ***Customer Identification***

The banks interviewed that focus on immigrants reported that they had spent a significant amount of resources on developing customer identification policies and procedures to ensure compliance with Customer Identification Program (CIP) requirements.

The CIP rule implementing section 326 of the USA PATRIOT Act<sup>32</sup> outlines procedures for banks to follow in order to verify the identity of a customer who opens an account.<sup>33</sup> (For the purposes of the CIP rule, loans are also considered to be accounts.) Prior to opening the account, the CIP rule requires that, at a minimum, the bank request the name, address, date of birth, and U.S. taxpayer number from the individual opening the account. If the individual is not a U.S. citizen, the bank may obtain the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. Within a reasonable time after the account is opened, the CIP rule requires the bank to verify the customer's identity, for example, by asking to see some form of identification, such as a driver's license or passport or by using a non-documentary form of identification.

<sup>30</sup> See OCC Bulletin 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services," May 10, 2004.

<sup>31</sup> Office of the Comptroller of the Currency, "Remittances: A Gateway to Banking for Unbanked Immigrants," *Community Developments Insights*, September 2004, pp. 6-9, at <http://www.occ.treas.gov/cdd/Remittances1.pdf>.

<sup>32</sup> See 31 CFR 103.121. The federal financial regulatory agencies also jointly issued frequently asked questions regarding the customer identification program (CIP) rule. They are available at <http://www.fincen.gov/finalciprule.pdf>.

<sup>33</sup> If the customer purchases a remittance product that does not require an account, other identification and verification requirements may apply. See e.g. 31 CFR 103.33(e) (any funds transfer of \$3000 or more).

The CIP rule neither endorses nor prohibits bank acceptance of information from particular types of identification documents issued by foreign governments, such as the *matricula consular*. Instead, a bank must decide for itself, based upon appropriate risk factors, which types of documents it will accept.

In the cases where banks provide remittance services to non-account holders, some banks will put these customers through the same identification procedures that the bank uses for account holders, while other banks will do a more limited identification process that mimics what the banks believe the major money transmitters are using. This includes doing a meaningful check against Office of Foreign Assets Control (OFAC) screens.

### ***Account Monitoring***

To ensure proper usage of accounts by bank customers, some banks have designed extensive monitoring systems that track account patterns, such as overdrafts, and will alert bank staff if particular customers habitually write checks that exceed their regular deposits. The banks use some flexibility, as there are sometimes delays in salary payments that can result in customers needing to pay bills before their salary payments have been deposited. Such monitoring can help address issues associated with new checking account holders.<sup>34</sup>

Some banks will make a point of discussing the responsibilities of having an account or loan with first-time users of these products and provide a list of what steps customers should take if they are experiencing financial problems. By having this dialogue, the bank emphasizes the importance to customers of maintaining communication with the bank if they experience financial hardship.

As part of additional suspicious activity monitoring, banks have developed product specific policies, such as ensuring that aggregation and structuring of remittance transactions do not violate federal or bank standards. Many banks have developed monitoring systems to ensure that customers cannot circumvent these standards by sending remittances from different branch locations.

### ***Use of Alternative Payment Data***

Banks that use alternative credit analysis for customers who do not have a traditional credit history generally evaluate the effectiveness of alternative credit data on a case-by-case basis.<sup>35</sup> From a risk evaluation perspective, alternative credit information can be helpful if it is predictive and reliable, if data providers are willing to report it, and it is available for a large number of potential borrowers.

Predictive value refers to how well the data measure the likelihood that a borrower will make timely payments and is the primary measurement of the usefulness of any credit data.<sup>36</sup> Reliability is important in assessing usefulness as lenders need to know that their calculations are based on

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<sup>34</sup> Supervisory guidance advises banks that all overdrafts are subject to safety and soundness considerations. For details, see “Safety and Soundness Considerations,” in the federal banking agencies’ Joint Guidance on Overdraft Protection Programs, available at <http://www.occ.treas.gov/fr/fedregister/70fr9127.pdf>.

<sup>35</sup> See 12 CFR part 202. Federal regulations require banks to carefully evaluate their policies and scoring models to ensure that all applicants for credit are evaluated consistently, without regard to race, color, national origin, or any other prohibited basis.

<sup>36</sup> See OCC Bulletin 97-24, “Credit Scoring Models,” for information on use of these models as portfolio and risk management tools. For example, this guidance advises banks to validate or revalidate the credit scoring models’ performance regularly and to ensure the models’ compliance with fair lending regulations.

accurate information. For data providers to be willing to report data, the value to them of having their customers be more likely to make timely payments must outweigh the cost of implementing a reporting system. A final consideration in assessing usefulness is how many individuals with thin or no credit files are covered by a particular data source.<sup>37</sup>

## **V. Who Is Reaching Minority Markets Today?**

While immigrants with higher levels of education and higher asset accumulation generally use banks for many financial needs, lower-income immigrants and lower-income minorities are more likely to use check cashers to cash their checks and obtain a variety of other products and services. For example, check-cashing outlets also sell money orders that are used to pay bills, and other products such as prepaid telephone cards, cell phone minutes, and remittances. Check-cashing outlets process an estimated 180 million checks annually at a face value of \$60 billion, producing almost \$1.5 billion in fee revenues.<sup>38</sup>

Some community banks are reaching these markets. Many minority-owned institutions have a business mission of serving the minority communities in which they are located and use a number of the strategies discussed in this report. In addition, other community banks that are physically located in neighborhoods that have undergone a transition to become minority communities have adapted these strategies in order to stay in business.

A number of large banks also have developed targeted products and services to reach various minority communities that have a significant presence in their markets. Examples of these products include low-cost “checkless” checking accounts that can be linked to remittance products and savings accounts that can be linked to check-cashing activity. Some of these banks have also devoted resources to ensuring that customers from a variety of cultures will feel comfortable in doing business in their branches.

## **VI. How Does the Cost Structure Operate?**

Banks have proven that they are able to provide check-cashing services at a cost below what check cashers generally charge. However, a number of banks have found that when they offer lower prices for check cashing, check cashers will match those reductions in order not to lose customers.

Banks also have found that users of remittance products tend not to be especially price sensitive and will choose providers that they are comfortable using. Despite the fact that banks may underprice money transmitters, they typically have not matched the hours that money transmitters may be open or the network of locations that money transmitters have both in the United States and foreign countries.

Some of the banks interviewed stated that they did not expect their retail depository account services to provide immediate profitability for the bank when they first began to pursue unbanked markets. The first focus was on adding accounts, and that was typically accomplished by offering the accounts with lower fees and lower minimum balances than were prevalent in the market. Some banks are satisfied with attracting these introductory accounts as long as they do not lose money on them. These banks believe that by increasing their number of deposit customers, they are investing in a long-term strategy to cross-sell other products, such as loans. These banks recognize that it may take time for new customers to develop an understanding of the variety of financial products that banks offer.

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<sup>37</sup> Afshar, “Use of Alternative Credit Data,” p.4.

<sup>38</sup> Financial Service Centers of America, <http://www.fisca.org/FiSCA%20Check%20Cashers%20Broch.pdf>, p. 8.

## VII. What Barriers Have Constrained the Growth of these Strategies?

A few key factors hamper the ability of community banks to pursue customers more widely in minority markets.

***Reluctance to use banks.*** Immigrants are unlikely to enter a bank branch if its physical appearance is intimidating, if few bank employees speak their native language, or if the immigrants are not aware that they can communicate with bank employees in their native language. Anecdotal evidence suggests that the formal culture of many banks intimidates consumers who do not have previous experience in using banks.<sup>39</sup> Other minorities may have had bad experiences with bank products in the past, may come from countries that have suffered major banking scandals or failures, or may believe that they do not have enough assets to make a bank account worthwhile. Overcoming this apprehension and building trust are big challenges for banks seeking to serve these markets.

***Competition from check cashers.*** The products and services offered by many check cashers drive consumer decisions on where to conduct financial business. Many consumers are reluctant to change habits if they already use products that meet their needs and are reliable. For consumers who send money abroad, the major money transmitters have leveraged their distribution capabilities and network to make their names synonymous with remittances.

***Costs of high-volume/low-asset accounts.*** Account maintenance is labor intensive and results in higher transaction processing costs for banks when a low level of deposits is held in the account coupled with a high level of transactions. If the bank is not able to effectively cross-sell other products, especially loans, to these customers, the bank often finds that the expense of maintaining the account outweighs its profitability. Further, some banks have found that when previously unbanked consumers first open accounts, some will visit teller lines repeatedly during any given month to check balances. This further increases the cost of account maintenance until the customer is comfortable with using other means to check an account balance, for example, by telephone, ATM, or Internet.

One bank found that when it publicized a new free checking program, it surpassed its expectations with customer growth, but fell short of its deposit growth goal. This added more low-asset, high-volume accounts to its deposit portfolio.

***Costs of educating new bank customers.*** New bank customers can require a significant amount of education and personal attention from bank staff. For example, first-time checking account customers may not realize the importance of safeguarding their checkbook. These customers may need to develop an understanding of fraud and security issues in addition to a basic working knowledge of how bank accounts operate. First-time borrowers may need attention if any early problems with making timely payments arise.

***Banking to separate markets.*** A few banks stated that they see the growth of separate banking models for different consumers. For example, a bank model that appeals to recent Hispanic immigrants may not appeal to other minorities or to other long-term bank customers. If the bank's business model includes reaching consumers in different minority and socio-economic communities, the bank must decide on an appropriate mix of products and services, as well as on delivery mechanisms to reach all of its potential customers successfully. However, developing and maintaining multiple products and delivery mechanisms can be costly.

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<sup>39</sup> Paulson, Singer, Newberger, and Smith, "Financial Access for Immigrants," pp. 12, 26.

## **VIII. Conclusion**

The minority population in the United States is undergoing a dramatic expansion, providing a potential source of retail growth for financial institutions. A number of banks have responded to this changing demographic by developing a variety of strategies to target these markets. While the most dramatic increases have appeared in the Hispanic population, bank efforts have not been limited to this group, as this report describes strategies being employed to reach a variety of minority groups.

Banks have found, however, that lower-income immigrants and lower-income minorities are likely to use check cashers and other nonbank providers to obtain the majority of their financial products and services. As a result, many of the strategies banks have developed to reach minority communities incorporate products and services designed for consumers who do not currently patronize traditional financial institutions and may have different needs from those of existing retail and small business customers.

This report identifies effective strategies that community banks are using to reach growing minority markets. These strategies, including effective customer service, relevant and nontraditional products, and ongoing communication with the target communities can help community banks build their minority customer base.

A number of banks have found that these strategies are drawing in new customers and increasing their retail deposit base. As these new customers develop a greater understanding of the variety of products and services that banks offer, banks are also seeing growth in the use of other products. Overall, banks that have adopted these strategies do so with a recognition that it may take time for new customers to develop an understanding of, and desire to use, the full range of financial products that banks offer.

## Resource Appendix

### General Background

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[http://www.texasappleseed.net/pdf/report\\_financial\\_ExpandAccess\\_2006.pdf](http://www.texasappleseed.net/pdf/report_financial_ExpandAccess_2006.pdf)

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Wides, Barry. "Taking the Nontraditional Route To Bring Borrowers into the Prime Mortgage Market." *Community Developments.* Office of the Comptroller of the Currency, Summer 2005.  
<http://www.occ.treas.gov/cdd/newsletters/summer05/cd/nocredit.htm>

## Financial Education and Community Outreach

### *OCC Financial Literacy Resource Directory*

This directory provides descriptions and contact information for a sampling of organizations that have undertaken financial literacy initiatives as a primary mission.

<http://www.occ.treas.gov/cdd/finlitresdir.htm>

### *MyMoney.gov*

MyMoney.gov is the U.S. government's Web site dedicated to teaching all Americans the basics about financial education. Throughout the site, you will find important information from 20 federal agencies.

<http://www.mymoney.gov/>

Samuel Frumkin was the primary author of this report. Also contributing were E. Matthew Quigley, William Reeves, Morey Rothberg, Barry Wides, and Julie Williams. *Community Developments Insights* reports differ from OCC advisory letters, bulletins, and regulations in that they do not reflect agency policy and should not be considered as definitive regulatory or supervisory guidance. Some of the information used in the preparation of this paper was obtained from publicly available sources that are considered reliable. However, the use of this information does not constitute an endorsement of its accuracy by the Office of the Comptroller of the Currency.