The "Unbanked" and "Underbanked" in the US: Who Are They and How Are They Different?

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The majority of U.S. adults use banks to conduct routine financial transactions, while some individuals do not have banking access or choose to seek alternative financial services. How individuals manage their finances through different financial products can determine successful financial outcomes or serious financial problems (Lin et al., 2019; Hogarth & Anguelov, 2004). Significant gaps in access to basic financial services exist among different demographics, including racial minorities, less educated, single unmarried, and those with low incomes (Servon & Kaestner, 2008). The main purpose of this study was to determine who is "unbanked" or "underbanked" and what similar or different characteristics may be indicators of being "unbanked" and "underbanked."

This study employed data from the 2018 FINRA Investor Education Foundation's National Financial Capability Study (NFCS). In this study, the "unbanked" were defined as those who had neither a checking nor savings/money market account, and the "underbanked" were defined as those who had either a checking or savings/money market account, but used alternative financial services more than two times in past five years. Understanding the differences and similarities between the "unbanked" and "underbanked" provided important insights for financial practitioners, advisors, and policy makers. Based on previous literature, key independent variables include comfort with banking, income drop, region, and other demographic characteristics. Logistic regression analyses were employed to predict factors associated with the likelihood of being "underbanked" and "unbanked."

The descriptive results show that 5.8% of respondents were "unbanked," whereas 36.3% of them were "underbanked." Among the "unbanked," 61.3% used some form of alternative financial services instead of using traditional financial services such as a bank or credit union. The descriptive results also reveal that among the "unbanked," about 34.6% used any of the five alternative financial services more than two times in the past five years and 44.5% of the "underbanked' used alternative financial services more than two times. The logit results show that all else being equal, those with more comfortable feelings toward using mainstream financial services were less likely to be "unbanked" or "underbanked." On the other hand, those with more volatile incomes were more likely to be "underbanked" than those with a steady paycheck. Volatile incomes was not significant in predicting the likelihood of being "unbanked." The logit results also show that the frequent use of alternative financial sources such as pawnshop, payday lender or tax refund advance increased the likelihood of being "unbanked." Regional factors were significant for both "unbanked" and "underbanked" regression models. Those living in the South region were more likely to be "unbanked" or "underbanked" than those living in the Midwest region. It was also revealed that those living in Northeast and West regions were less likely to be "underbanked" than those living in the Midwest region were; however, these region variables were not significant in predicting the likelihood of being "unbanked."

It has been noticed that ethnic minorities were more likely to be "unbanked" or "underbanked" in the literature. Logit results show that there were no significant differences in "unbanked" banking status across race/ethnicity. However, this variable was a significant predictor of the likelihood of being "underbanked," suggesting that Black, Hispanic, and Asian/Other individuals were more likely to be "underbanked" than their White racial counterparts. Those who were making income less than $25,000 per year were more likely to be "underbanked" or "unbanked" than those with annual income higher than $25,000. Similarly, those with less than a college degree were more likely to be either "unbanked" or "underbanked." The logistic regression results also indicated that age, gender, education, marital status, and employment status were statistically significant in predicting "unbanked" or "underbanked" status. Those with age less than 54 year-old, less educated, unemployed, and divorced/separated individuals were more likely to be "unbanked" or "underbanked."

Similarities were found in the socio-demographics between the "unbanked" and "underbanked." For example, younger age (18-37), divorced singles, racial minorities, less educated, unemployed,

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income <$25,000 per year, and south regions were similar across the two groups. Differences between the “unbanked” and “underbanked” were found in the feeling of comfort banks/credit unions; More “underbanked” individuals reported that they felt uncomfortable going to a bank or credit union branch than “unbanked” individuals. In addition, differences between the “unbanked” and “underbanked” were found in the types of alternative financial service usages. Among those “unbanked,” 14.7% reported they took loans from the pawnbroker, 10.5% had tax refund loans, and 9.8% used payday loans.

Regarding implications for financial professionals, it is important for them to separate these two groups of the population in educating and guiding their personal finances. High levels of objective financial knowledge was significant for not being “underbanked.” Ethnic minorities were significant for the “underbanked”; Blacks, Hispanics, and Asians/others were more likely to be “underbanked” than their White racial counterparts. Financial practitioners can seek to assist diverse communities in providing financial education. These communities are currently underserved, which puts them at an even greater disadvantage and likelihood to be “underbanked.” By targeting populations in need of financial education, financial professionals can help make a difference in American communities and their financial well-being.

There are some implications for policy makers. It is important for government or policy makers to help the vulnerable population –”unbanked” by making financial assistance available and more accessible. Considering that the “underbanked” were individuals who used alternative financial services often, more relevant and urgent regulations could be developed to prevent abuse of financial practices employed by many payday lenders, pawnshop brokers, or auto-title lenders. Further, lower levels of comfortable feelings about going to banks or credit unions was important for both the “unbanked” and “underbanked.” This could be due to a lack of communication and transparency from banking institutions. Thus, policy makers can seek to make improvements in the banking process to better disclose information to consumers and help them better understand the benefits and process of using a bank account.

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