Check-Cashing Outlets in the U.S. Financial System

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In the current debate over banking reform, some policymakers and consumer advocates have expressed concern that many lower-income Americans have lost access to basic payment services provided by banks. Reports of branch closings and increased service charges have led to proposals that banks be required to provide basic banking services to all consumers.

Most discussions of this issue are incomplete, however, because they overlook existing alternatives to banks for those who cannot or choose not to use banks to meet their payments needs. This article examines the role of check-cashing outlets (CCOs), a principal alternative to banks for many low- and moderate-income consumers.1 Despite evidence of rapid growth over the past decade, relatively little is known about the check-cashing industry. Understanding who uses CCOs and why provides new insight into the costs of payment services and adds a new dimension to the debate over basic banking services.

The first section of the article provides an overview of the check-cashing industry, including its services, fees, structure, and recent growth. The second section examines who uses CCOs and why, and offers possible explanations for recent growth. The final section addresses the regulation of CCOs and their possible role in providing basic banking services to low-income consumers.

An Overview of the Check-Cashing Industry

The check-cashing industry began in the 1930s as a response to banking problems during the

1. In Indiana, Illinois, Minnesota, and Wisconsin, firms that cash customers’ checks for a fee are said to be in the “currency-
Depression and to changes in employer payment practices, CCOs originally specialized in cashing payroll checks but over the years have evolved to provide a variety of payments services. Largely unregulated, the check-cashing industry has grown rapidly in the past decade, expanding beyond its traditional base in urban areas.

**Services Provided by CCOs**

Nonfinancial businesses have cashed consumers' checks for many decades. Traditionally, this role was filled by bars, grocery stores, or other businesses that would cash third-party checks for regular customers or for customers making purchases. Such establishments rarely charged an explicit fee for cashing checks. The cost of the service was covered by the additional sales it generated.1

It is difficult to establish exactly when firms began to specialize in check-cashing and to levy a fee for the service. Most evidence suggests that CCOs evolved from other businesses that cashed checks on the side. CCOs apparently first appeared in Chicago and New York in the 1930s and spread to other large urban areas.

Most accounts cite widespread banking problems and changing employer payment practices as the principal factors motivating the early development of CCOs. For example, in Chicago, specialized check-cashing firms arose to provide payments services during the banking crisis of the 1930s (Illinois Department of Financial Institutions 1980). In addition, CCOs were stimulated by firms converting from cash payrolls to payroll checks during the 1930s and 1940s (Wolf).

The core business of a contemporary CCO is cashing checks for a fee. The fee is intended to provide the check-casher a profit after covering expenses, which include the cost of maintaining a storefront and insurance and personnel costs. Moreover, because the check-casher advances funds on checks that must subsequently be cleared through the banking system, CCOs incur interest expenses on the funds advanced. And, CCOs run the risk that some cashed checks will be uncollectible because of insufficient funds or fraud.1

Because of the risks associated with advancing money on checks, many outlets cash only customers' payroll or government entitlement checks. Some CCOs also cash personal checks but typically charge a higher fee for this service to cover the higher risk that the check will bounce. Many CCOs cash personal checks only after they have confirmed with the bank it is drawn on that there are sufficient funds.

In some states, CCOs make "payday" loans. They do this by cashing a customer's personal check, which is sometimes postdated, and agreeing to hold it until the customer's payday. Since this amount to making an unsecured loan, check-cashers generally charge much higher fees for this service. It is generally offered only to customers with stable employment records who have maintained bank accounts in good standing for several months.4

While most CCOs derive most of their revenue from check-cashing fees, almost all CCOs do more than just cash checks.5 They typically

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1. As is clear from this explanation, all check-cashing outlets must work closely with at least one bank. This is because a CCO needs a bank to clear the large volume of checks the firm cashes. Moreover, most CCOs rely on bank lines of credit to meet their periodic, substantial needs for cash.

2. For lack of data, the article does not attempt to examine recent trends in check-cashing by these nonfinancial businesses. It also excludes from the analysis mobile payroll services.

3. In the few states that regulate the check-cashing business, it is illegal for check-cashers to make such loans. In some unregulated states, payday loans are effectively illegal because the fees violate state usury laws.

4. Data from the Department of Financial Institutions in Illinois show check-cashing firms earn about 67 percent of their revenue from check-cashing fees and about 11 percent from sales of money orders.
offer a range of financial and nonfinancial services—they may sell money orders, make wire transfers of cash, and handle telephone and utility bill payments. In some states, they sell lottery tickets and public transportation passes, offer income-tax preparation services, and distribute welfare payments and food stamps. In addition, many sell cigarettes and candy or buy and sell gold jewelry.

**Fees Charged by CCOs**

CCO fees for cashing checks are usually expressed as a percentage of the face value of the check. In most states, check-cashers can charge whatever the market will bear; however, seven states currently set ceilings on check-cashing fees (Table 1). As shown in the table, the maximum permissible fee sometimes varies, depending on whether the check is drawn on an in-state or an out-of-state bank or is a government entitlement, payroll, or personal check. The different ceilings on fees across categories reflect the different speeds with which checks clear, different default risks, and the desire to limit the fees that public aid recipients pay for cashing their entitlement checks.

Outside of these seven states, commercial check-cashing fees vary widely. In 1989, the Consumer Federation of America (CFA) conducted a survey of the fees levied at check-cashing outlets in 20 major cities across the United States (Table 2). This survey suggests that CCOs charge roughly similar fees for payroll and government support checks. For both types of checks, fees range from about 1.0 percent to 3.0 percent of the face value of the check, with an average rate of about 1.75 percent.

About a third of the check-cashing outlets contacted by the CFA were willing to cash personal checks. Not surprisingly, given the default risk, they charge far more for this service. In the survey group, fees ranged from 1.66 percent to 20 percent of the face value of the check and averaged 7.7 percent.

CCOs also levy fees for the other financial services they provide, such as selling money orders or making wire transfers. These services are largely used to pay bills by customers who do not have checkable bank deposits. The data suggest that many CCOs set low prices on these services. For example, the CFA survey found that the average charge for a $50 money order was $0.55, and many CCOs charged a flat fee independently of the size of the money order. This compares favorably to the $0.75 charged by the U.S. postal system for money orders up to $700.

**Structure of the Industry**

An examination of the structure of the check-cashing industry indicates commercial check-cashing is a relatively large industry, domi-
TABLE 1
Maximum Check-Cashing Fees in Regulated States
(Rates are a percentage of the face value of the check)

<table>
<thead>
<tr>
<th>State</th>
<th>Legal ceiling rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>2% for non-public aid checks and 1.0% for state public aid checks. (Ceiling fees set in 1990.)</td>
</tr>
<tr>
<td>Delaware</td>
<td>1% or $4.00, whichever is greater. (Ceiling fee set in 1989. The previous ceiling rate was 0.5% or $0.25.)</td>
</tr>
<tr>
<td>Georgia</td>
<td>The larger of $5.00 or 3% for public aid checks, 10% for personal checks, and 5% for all other checks (payroll). (Ceiling fees set in 1990.)</td>
</tr>
<tr>
<td>Illinois</td>
<td>1.2% plus $0.90. (Ceiling fee set in 1986. The previous ceiling rate was 1.1% plus $0.75.)</td>
</tr>
<tr>
<td>Minnesota</td>
<td>2.5% for public aid checks above $500 (5% for a first-time customer), no limit on personal checks but the rate must be filed with the state Commerce Department and be “reasonable,” 3.0% on all other checks (6% for a first-time customer). (Ceiling fees set in 1991.)</td>
</tr>
<tr>
<td>New Jersey</td>
<td>1% for in-state checks and 1.5% for out-of-state checks or $0.50, whichever is greater. (Ceiling fees set in 1979. The previous ceiling rates were 0.75% on in-state checks and 1.0% on out-of-state checks, or $0.35.)</td>
</tr>
<tr>
<td>New York</td>
<td>0.9% or $0.50, whichever is greater. (Ceiling fee set in 1988. The previous ceiling rate was 0.75%.)</td>
</tr>
</tbody>
</table>

Source: State regulatory agencies.

TABLE 2
National Check-Cashing Fees

<table>
<thead>
<tr>
<th>Service</th>
<th>Minimum charge</th>
<th>Maximum charge</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll checks</td>
<td>.9%</td>
<td>3.0%</td>
<td>1.74%</td>
</tr>
<tr>
<td>Government checks</td>
<td>.9%</td>
<td>3.25%</td>
<td>1.73%</td>
</tr>
<tr>
<td>Personal checks</td>
<td>1.66%</td>
<td>20%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Money orders ($50)</td>
<td>$ .19</td>
<td>$ .99</td>
<td>$ .55</td>
</tr>
</tbody>
</table>

Source: Consumer Federation of America (1989).

Historically, CCOs have been regulated extensively in only a few states. However, this picture is changing as national chains begin to develop and as more states consider regulating CCOs. CCOs are currently regulated in only eight states. Seven states set ceilings on check-cashing fees and require that CCOs be licensed and abide by other regulations. These regulations generally require check-cashers to post their fees in a prominent location in the outlet and to provide customers with receipts. Often, the regulations require the CCO owner to meet a minimum bonding or capital requirement. Some states prohibit newly opened outlets from locating within a specified distance of existing CCOs. All states specify record-keeping requirements for the firms, and several of the states require check-cashers to report large sales of money orders or large wire transfers. This is to prevent check-cashing firms from being used in a money laundering process. Typically, the state banking department is responsible for issuing licenses and enforcing the regulations.

Because only a few states regulate the commercial check-cashing business, it is impossi-
ble to know exactly how many check-cashing firms are currently operating. However, across the United States there were 4,289 yellow-page listings of check-cashing firms in early 1991. This count is a lower-bound estimate of the total number of commercial check-cashing outlets nationally. In six of the eight states that require CCOs to be licensed, for example, the yellow-page count closely approximates the number of licenses outstanding. However, the yellow-page count understates the number of licensed outlets in New York by about 20 percent and by almost 50 percent in Georgia.

Given the sparse information on the industry, any estimate of the size of the industry in dollar terms is subject to a large margin of error. However, a conservative estimate indicates that the industry cashed about 150 million checks in 1990 with a combined face value of $45 billion. From this activity, the check-cashing industry earned approximately $790 million in fees.11

The vast majority of CCOs across the country appear to be owned by local independent operators, many of whom own three to ten outlets in a given area. There is evidence, however, that large national chains are developing. For example, one check-cashing company owns over 100 stores in the Northeast and is publicly traded on the over-the-counter stock market. And some check-cashing franchise operations have grown rapidly in the past few years. Recently, Western Union, which has provided money-wiring services to many check-cashers, announced plans to develop a national network of check-cashing outlets (Wall Street Journal).

The Growth and Location of the Check-Cashing Industry
Data on the check-cashing industry are sparse but nevertheless indicate that the industry is growing rapidly. Moreover, the evidence suggests that the industry is beginning to expand beyond its traditional concentration in lower-income urban areas.

In interviews, check-cashers who have been in the business many years said that the industry grew slowly until the early or mid-1980s and then expanded rapidly. Unfortunately, there is not sufficient data to confirm this view.12 However, American Business Information (ABI), a firm that tracks yellow-page listings of businesses, reported 4,289 listings of check-cashing (or currency exchange) outlets nationally in July of 1991. In 1987, the earliest year it provided data, ABI reported just 2,151 listings.

11. In arriving at these estimates, it is assumed that there were 4,250 check-cashing outlets operating in 1990, each cashing an average of 35,000 checks. This estimate of the average number of checks cashed is below the scale of operation of most check-cashing outlets in Illinois, New Jersey, and New York, as reported by the regulatory agencies in those states. However, outlets in these three states must do a greater volume of business than the national average to survive because these states have regulated fees lower than those charged elsewhere. Interviews with check-cashers in the unregulated states suggest most outlets handle between 25,000 and 40,000 checks annually.

These estimates also assume that the average check has a face value of $300 and the average cashing fee is 1.75 percent. The $300 estimate is consistent with the data for Illinois, New Jersey, and New York and was thought reasonable by check-cashers in the unregulated states. The 1.75 percent fee agrees with the national average reported by the Consumer Federation of America (1989).
Explaining the Use and Growth of CCOs

Understanding the reasons behind the recent growth of check-cashing firms requires knowledge of who uses them and why. This section compares the cost and types of services offered by banks and CCOs, presents recent survey evidence on usage of CCOs, and examines factors behind their recent growth.

Comparing Banks and CCOs

Since both banks and CCOs provide basic payments services, a key question is why consumers use CCOs rather than banks. One possible explanation is that CCOs are cheaper than banks. Or, perhaps CCOs are more convenient than banks or provide a type of service that banks are unable or unwilling to provide.¹⁴

The information on fees presented earlier can help provide an estimate of the cost to a household of meeting its payment needs through a CCO. For example, assume a family cashes its paychecks or government entitlement checks at a check-cashing firm charging a 1.5 percent fee and buys six money orders a month at an average price of $0.50 per money order. In this situation, a family with a $10,000 yearly income (about 75 percent of the 1990 official poverty level for a family of four) would spend $186 annually on basic financial transactions. Since check-cashing fees are a fixed percentage of the value of a check, a family with higher income would pay more. Thus, in this example a family with $24,000 annual income would spend $396 annually for financial services.¹⁵

¹⁴. CCOs might also be used by those who do not want to create deposit-account records because of tax reasons, immigration status, etc.

¹⁵. This example assumes no taxes or withholding. The low-income family pays $150 ($10,000 × .015) for check-cashing and an additional $36 for money orders. The moderate-income family pays $360 for check-cashing and $36 for money orders.
The cost of obtaining similar services from a bank would be somewhat less, according to a 1990 national survey of bank fees by the Consumer Federation of America (1990). In estimating the cost of a checking account based on its survey data, the CFA assumed that a family maintains an average balance of under $400 in the account and that the account balance falls below $200 only once a month. In addition, the CFA assumed the family writes ten checks, makes four ATM withdrawals, and two deposits monthly and, over the year, the family bounces two checks and deposits one check that fails to clear. Based on this behavioral pattern, the CFA estimated that a family would pay $107.96 a year to maintain a noninterest-bearing checking account and would pay $111.39 a year to maintain an interest-bearing NOW account.

Regardless of the type of account maintained, it appears a family would save significant out-of-pocket costs by conducting its financial transactions through a bank rather than a CCO. Because the fees for cashing checks at a CCO are assessed as a percentage of the face value of the check, the difference can be small for very low-income households. For example, a family earning $10,000 a year would save only about $80 annually by using a checking account rather than a CCO, while a family earning $24,000 a year would save almost $300. However, the very poorest households may be least able to afford the additional cost.

Two explanations account for the success of the check-cashing industry in the face of this cost disadvantage. One explanation is that out-of-pocket expenses do not measure the full cost of using a financial institution. Convenience, quality, and type of service also matter. In these aspects, CCOs may have an advantage for many consumers since most CCOs have much longer opening hours than do banks and are located more conveniently for some consumers. Also, CCOs may be faster with the range of simple financial transactions in which they specialize.

Another explanation for the success of CCOs is that bank services do not fully substitute for CCO services. Most important, while CCOs are willing to assume the risk that a check they cash will bounce, banks generally will not. Most banks require a consumer to maintain a deposit account in order to cash checks, even government checks with a negligible default risk. For depositors, most banks require the customer either maintain sufficient funds in an account to cover the check or wait a few days for the check to clear. If the check fails to clear and the bank has cashed the check for a customer with sufficient funds to cover it, the customer’s account is docked for the amount of the check. Moreover, many banks charge the customer for the bank’s cost of handling a “returned” deposit.

Because of these differences in check-cashing policy, consumers without bank accounts may be forced to take their business to CCOs. Moreover, even if they maintain a bank account, consumers may not be able to cash a

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16. While this example appears to be based on reasonable assumptions, other assumptions could change relative costs. For example, since the CFA study found that banks charged $15.11 per bounced check, the cost of using a bank would increase if the family’s account were overdrafted more frequently.

17. In 1988, the Consumer Federation of America surveyed 110 banks and 84 thrifts located primarily in the urban areas of 15 states and the District of Columbia. It found that of the 191 financial institutions responding to the survey, 71 percent would not cash government checks for nondepositors at any price. Fourteen percent would cash nondepositors’ government checks for free, and 15 percent would do so for a fee, averaging $3.88 for a $300 check. Outside of urban areas, banks are apparently more willing to cash government checks for nondepositors (U.S. GAO 1988, pp. 13-14). The study (GAO 1988, pp. 16–17) suggests that banks that refuse to cash government checks for free for nondepositors do so because banks incur costs in handling checks, they do not want to crowd their lobbies with government aid recipients who only want to cash their entitlement checks, and they fear that some fraudulent checks might be cashed for which the government would not reimburse them.
paycheck or government assistance check because the amount exceeds their account balance. Although these consumers could save money by depositing their check in a bank and waiting for it to clear, they may prefer to pay a fee to have the cash immediately.

**Evidence on CCO Use**

Surveys of who uses commercial check-cashing firms and why they choose to do so suggest that most customers are either low-income to lower-middle income workers cashing payroll checks or recipients of government transfer payments. Relative to the population as a whole, a disproportionate percentage of CCO customers are young, nonwhite, and do not have bank accounts. Limited access to banking services and the convenience of CCOs appear to be the most important factors governing their use.

This profile of CCO customers is drawn from two recent surveys. One, a survey by the Consumers Banking Association (CBA), focused on consumers cashing paychecks. A second survey, conducted by the New Jersey Department of the Public Advocate, concentrated on those cashing public assistance and social security checks. The CBA survey found that CCO customers were younger and poorer than the general population and more likely to be a racial minority. Thirty-seven percent of respondents were between the ages of 18 and 30, and 29 percent reported a household income of less than $15,000 a year. The median reported household income in the survey was $20,400 as compared with a 1985 national median family income of $28,906. While 33 percent of respondents were white, 47 percent were black and 18 percent hispanic.

The survey found that customers' reasons for using a CCO revolved around their access to bank services. Two-thirds of customers surveyed had deposit accounts at banks or other financial institutions. Only 13 percent of these customers used CCOs regularly, citing convenience and ready access to cash. In contrast, the one-third of CCO customers without bank accounts made more regular use of CCOs. For those customers, lack of funds to maintain bank minimum balances and high bank service charges were cited as the main reasons for use of CCOs.18

The study by the New Jersey Department of the Public Advocate provides a somewhat different portrait of the customer base of the check-cashing industry because it focuses on those cashing public assistance and social security checks. The Department interviewed 750 recipients of government transfer payments. In contrast to the CBA survey, 92 percent of those interviewed said that they did not have a bank account. Fifty-seven percent were cashing Aid to Families with Dependent Children (AFDC) checks. Another 20 percent were cashing social security checks, and the rest were cashing unemployment benefits, veterans assistance, or state disability checks.

In the New Jersey survey, 79 percent of

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18. There are several reasons why neither the Consumer Bankers Association's survey nor the New Jersey Department of the Public Advocate's survey is alone likely to be broadly representative of the customer base of the check-cashing industry. The Department of the Public Advocate survey limited its study to the use of CCOs by recipients of government aid programs and ignored people cashing payroll checks. In the case of the Consumer Bankers Association (CBA) survey, customers who visit a CCO during a heavy payroll period are unlikely to be representative of customers generally; that is, they are more likely to be employed and have higher education and income levels. They are probably also more likely to maintain a deposit account.

19. For additional evidence on reasons consumers may not use banks, see Canner and Maland.

20. According to the data in Appendices P through S of the study, CCOs in three New Jersey counties (Camden, Essex, and Mercer counties) cashed about 1.5 million checks in 1986, about 13 percent of which were AFDC checks. By examining 4,842 canceled AFDC checks from three counties, the Department found that 47 percent of them were cashed at banks, 32 percent were cashed at CCOs, 12 percent were cashed at local businesses, and 9 percent were cashed by friends, relatives, or landlords. Of the AFDC checks cashed at banks, 75 percent were cashed at banks that serve as depositories of county funds and are required to cash AFDC checks for nondepositors without a fee.
those interviewed stated that they never go to a bank to cash their government checks and, of these, 61 percent said they only go to CCOs. When asked why they were using a CCO to cash their government check, respondents cited lack of access to bank services and the convenience of CCOs.

Factors Behind CCO Growth

Knowledge of who uses CCOs and why is important for understanding the rapid growth in the industry during the 1980s. Changes in the economic situation of households may have led to an increased demand for check-cashing services. At the same time, regulatory changes may have increased the cost of bank services.

One factor contributing to the growth of CCOs may have been the strong growth in payroll employment following the 1982 recession. From 1983 to 1989, total civilian employment increased 16 percent (Economic Report of the President). Unlike the economic expansions of the 1960s and 1970s, however, employment growth in the 1980s was accompanied by a fall in employees' real incomes. For example, average weekly earnings of private sector, non-agricultural, industrial workers fell from $408 in 1978 to $346 in 1990. Because the customer base of CCOs is disproportionately low-wage and moderate-wage workers, lower real incomes may have contributed to the demand for CCO services.

More generally, the 1980s saw a fall in the standard of living for many low-income families. From 1979 to 1988, the mean real family income of families in the lowest income quintile fell 5.4 percent (Bradbury, p. 26). And, the number of families falling below the poverty line rose from 24.5 million in 1978 to 31.9 million in 1989 (Economic Report of the President). To the extent that poorer families

had increased difficulty in accumulating financial savings to maintain bank balances, they may have had an increased incentive to use CCOs.

The 1980s also saw changes in the cost and supply of banking services. In 1980, the federal government enacted the Depository Institutions Deregulation and Monetary Control Act. Among other things, this act began a phaseout of ceilings on the interest rates banks could pay on deposits. The Act also required the Federal Reserve System to begin charging banks for a number of services it had previously provided for free.

Another factor was a change in the attitude of bank regulators at the federal and state levels toward competition among banks. Prior to 1980, regulators often looked unfavorably on a proposed branch that would be located in a community already well-served by other bank branches. However, after 1980, in an atmosphere much more favorable to free-market competition, regulators began to consider the increased competition provided by an additional community bank to be a positive factor in approving new bank branch applications (Spong).

Following these changes, banking became a much more competitive business. Banks reacted by pricing services based on the cost of providing those services. Thus, they began to charge for accounts with high transactions volume and small balances, significantly raising the cost of using banks for many low- and moderate-income consumers (U.S. GAO). Bankers also reacted to the increased competition by closing branches in unprofitable or marginally profitable areas, which were often low-income areas, and opening branches in the more desirable, higher-income areas already served by other banks. Combined, these changes worked to make banks both

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21. Both figures are expressed in 1990 dollars.

22. For evidence on branch closings, see Obermiller and Avery.
more expensive and less convenient for many low-income and moderate-income consumers, and likely contributed to a growing demand for commercial check-cashers’ services.

Finally, the rapid growth in the check-cashing industry in the 1980s may have been stimulated by an increased awareness of the market potential of the millions of Americans who do not regularly use the banking system for their financial transactions. Beginning in the mid-1980s, journalists, academics, and policy analysts began to write about bank closings in low-income neighborhoods and the large number of households not using banks. These reports may have captured the imagination of entrepreneurs and fed the expansion of nonconventional financial institutions serving those whose needs were poorly met by banks.

Public Policy Issues

Recognizing that CCOs are playing a more important role in the U.S. financial system raises a number of public policy issues concerning CCOs and the delivery of affordable financial services to low-income households. This section considers the trade-offs in regulating CCOs and the role they could play in the financial system.

Regulation of CCOs

Bank closings in low-income communities, increases in bank fees on small deposit accounts, and the rapid growth of the check-cashing industry have made the policies of CCOs far more relevant than the policies of banks for many segments of the population.

This observation has led to suggestions that the check-cashing industry be more widely regulated. Those advocating that more states, or perhaps even the federal government, should regulate the industry point out that many check-cashing customers are relatively unsophisticated consumers, with little social or economic power. These customers might be grossly overcharged by an unscrupulous operator, some of whom may have local monopoly power. Thus, there is concern that many poor and moderate-income individuals could spend a large percentage of their limited disposable incomes for basic financial transactions.

Indeed, evidence supports the concern that some check-cashing firms levy relatively high fees. For example, the survey by the Consumer Federation of America (1989) found that 11 percent of the firms charge 3 percent or more for cashing government entitlement checks. In New Jersey, for example, check-cashers are limited by law to charging 1.0 percent on in-state checks and 1.5 percent on out-of-state checks. Of 662 customers there who reported the amount of the check they cashed and the amount of fee they paid, 49 percent were charged more than the legal maximum (New Jersey Department of the Public Advocate, p. 29). On average, check-cashers overcharged by about 44 percent of the ceiling rate, and in some cases the excess charge was substantial. To cite two examples from the report: a Hispanic woman who could not speak English was charged $25 for cashing a $268 social security check, and another woman was charged $16 for cashing her $525 AFDC check.

23. For example, the U.S. GAO (1988, p. 19) estimated that about 16 million American families did not have banking accounts of any type in 1985. Also see the articles by Canner and Maland, Gross, Zamba, Lueck, Obermiller, and Bartlett.

24. In a survey, by the author, of 42 check-cashing outlets across several states, a few charged 5 to 6 percent to cash government and payroll checks. When asked why competition would not drive firms that charge more out of business, check-cashers said many of their customers just want their money as fast as possible and pay no attention to a difference of a few percentage points in the fee charged. In addition, customer transportation costs may limit competition among check-cashing outlets.
Interestingly, in its response to the study by the Department of the Public Advocate, the New Jersey Department of Banking, which oversees check-cashing outlets, reported that it had received only one check-cashing complaint over two years (GAO, p. 9). It appears, therefore, that the vast majority of people who were charged more than the legal maximum in New Jersey did not complain to the oversight agency, perhaps because they were unaware of the overcharge, felt a complaint would be ineffective, or did not know how to file an official complaint or felt that the effort was greater than the cost of the overcharge. 25

Those who favor limits on check-cashing fees need to be aware of possible consequences, however. Mandating very low check-cashing fees could kill the industry and hurt the low- and moderate-income people who have no realistic alternatives for cashing their checks. Prior to 1989, for example, Delaware limited check-cashing outlets to charging a fee of 0.5 percent of the face value of the check or $0.25, whichever was greater. In 1989, the state raised the limit to 1.0 percent or $4.00, whichever is greater, noting that no CCOs were operating in the state under the old law.

On the other hand, it is clear that CCOs can flourish in urban areas when the ceiling rate is around 1.0 to 2.0 percent. 26 In New York, for example, the ceiling rate is 0.9 percent or $0.50, whichever is greater. Yet over 400 check-cashing outlets operate in the state. Illinois, which permits check-cashers to charge up to 1.2 percent of the face value of the check plus $0.90, has more CCOs per capita than any other state. 27

The evidence suggests, therefore, that if regulation of CCOs is deemed desirable, states can set limits on check-cashing fees to protect consumers against the highest charges and yet permit the industry to flourish. The evidence from New Jersey also suggests, however, that the state must devote resources to enforcing compliance with the statute. In New York and Illinois, where the state banking departments conduct annual on-site surveys of CCOs, firms do not appear to charge more than the legal maximum. Presumably, annual license fees from CCOs can provide the states with the revenue to cover the costs of monitoring the industry and enforcing state legislation.

The Role of CCOs in the Financial System

The 1980s have seen increased emphasis on the access lower-income households have to affordable basic financial services.Legislatively, this concern has been expressed in congressional hearings or proposals to force banks to cash government entitlement checks for free and to offer “basic,” or “life-line,” bank accounts (U.S. Senate, U.S. House 1989). 28 Such accounts would permit a consumer to

25. The New Jersey Department of Banking told the New Jersey Department of the Public Advocate (p. 68) in 1987 that it relied on the “honor system” to assure compliance with state limits on check-cashing fees. A 1991 telephone survey, by the author, indicated that check-cashing firms in the state are now complying with the law, perhaps because the Department of Banking increased the resources it devoted to enforcement after the report by the Department of the Public Advocate.

The author called several other state consumer advocate agencies and state banking departments to find out if there had been complaints against check-cashing outlets. In no state was this the case. However, in unregulated states, it was often difficult to locate anyone in a state agency who knew where one would go to file such a complaint or how it would be classified by the consumer advocacy agency.

26. If outlets are to cash very small checks or personal checks, a higher fee may need to be permitted in these cases.

27. Other states should not automatically assume they can adopt the New York or Illinois ceilings on check-cashing fees without adversely affecting the industry. Both of these states use check-cashing outlets to distribute welfare payments, which brings additional business to the outlets. Also, in both states, check-cashing outlets are almost exclusively found in the dense urban areas. States with less concentrated populations may find check-cashing firms cannot function profitably with a 1.0 percent ceiling.

28. Some policy analysts have also suggested reviving the U.S. postal savings system to ensure all communities have convenient access to a deposit-taking financial institution. In fact, perhaps a major reason check-cashing outlets do not exist in Europe is because most European countries have postal savings systems with giro accounts.
conduct a limited range of basic financial transactions for a very small fee or no fee. Regulators and community activists have also used the Community Reinvestment Act and other means to bring pressure on banks to keep branches open in low-income areas and to improve banking services in these communities.29

However, the possible cost or effectiveness of these proposals has also caused concern. For example, if banks are forced to provide these services without sufficient compensation, the burden might not be shared equally among banks. Indeed, banks with existing branches in low-income areas could be most affected. Moreover, imposing such policies on banks but not their competitors could place banks at a competitive disadvantage and, perhaps, lead to an acceleration of bank branch closings.

Recognition of the growing importance of CCOs, however, suggests that they might play a role in providing basic financial services to low-income households. CCOs specialize in delivering a narrow range of payments services. With experience, they have learned which financial services are most in demand by lower-income households and have learned to minimize the cost of providing these services. CCOs already compete for locations that are most convenient for the low-income and moderate-income households that make up their customer base.

By viewing CCOs as an integral part of the financial system, federal, state, and local governments may be able to work with them to ensure that they deliver affordable basic payments services. Indeed, a number of states already appear to be taking this approach, using CCOs in the distribution of public benefits and services. For example, residents of New York City and Chicago can elect to receive their AFDC payments or food stamps through local CCOs. In New York, the state pays the CCO to distribute AFDC benefits in cash. In Illinois, the CCOs handle the distribution of AFDC checks for free, but if the recipients cash their checks at the CCO, they pay the regulated state fee. And, in Illinois, many CCOs have the right to handle automobile registrations and title transfers.

The suggestion that CCOs be used as delivery points for government services is linked with the view that they be more widely regulated. This is true for two reasons. First, in a state where CCO fees and services are regulated, the industry is likely to have a better public image and therefore is more likely to be trusted for distributing public services. Second, because permitting CCOs to distribute AFDC payments, handle automobile registrations, or provide other public functions is profitable for CCOs, such opportunities can be traded for lower ceilings on the fees CCOs levy for basic financial services.

Realistically, however, advocating broader regulation and reliance on CCOs for the delivery of basic financial services does not require abandoning efforts to improve the accessibility of banks for lower-income households. While CCOs provide some basic payment services, they are not substitutes for banks. CCOs do not take deposits, so residents of a community serviced only by CCOs would not have a safe and convenient outlet for their savings. And, CCOs also do not make loans, so the economic development of a community served only by CCOs may suffer.

Summary

This article has surveyed the role check-cashing outlets play in the financial system. CCOs

29. See the 1986 policy statement on basic banking by The Federal Financial Institutions Examination Council in Canner and Maland. In 1989, federal financial institution regulators made provision of basic banking services a part of a bank's CRA rating.
provide basic financial transaction services to many low-income and moderate-income households. And, measured by the number of outlets, COOs may be the most rapidly growing segment of the financial system. Households that consistently use COOs appear to devote a larger fraction of their incomes on average to pay for financial transactions than do families that rely on banks. Some use of COOs appears to be voluntary. Consumers may turn to them rather than to banks because COOs have a more convenient location or longer hours of operation. However, some consumers may turn to COOs because they cannot afford to meet minimum balance requirements at banks.

For many moderate-income and low-income households in urban areas, a COO may be the most important financial institution in their daily lives. This observation has led an increasing number of states to regulate COOs and suggests that COOs might be employed in the delivery of basic financial services and government benefits.

References


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