Fringe Financial Services, Inner-city Banking & Community-based Solutions[1]

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Abstract
This article considers the cost of fringe financial services—including payday lenders, cheque-cashers, pawnbrokers—for individuals and an inner-city community as compared with mainstream bank services. The analysis finds that the significant costs associated with fringe banking explain a variety of community-based models that seek, in different ways, to more effectively address the financial service needs of inner-city people and neighbourhoods. The article considers four community-based financial service models at various stages of their life-cycle: Four Corners Savings Association, Cash and Save, the Fédération des Caisses Desjardins du Québec micro-loan program and the Winnipeg Financial Service Program. These models range from a full service bank for an inner-city through a specialized loan fund to a bank-fringe bank hybrid. The article outlines some key ingredients to an effective financial service model including: identifying the key financial service needs in the neighbourhood, ensuring reasonable prices and limited subsidy and involving central stakeholders in governance.

Keywords: Fringe banks, financial exclusion and poverty, community-based banking, pawnshop

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Résumé

Cet article considère le coût des services financiers du marché du crédit à court terme—prêts sur salaire, services d'encaissement de chèques, prêteurs sur gages, etc.,—pour les individus et les communautés des quartiers centraux de la ville par rapport aux services financiers de banques traditionnelles. L'analyse constate que les coûts associées aux opérations de marché du crédit à court terme expliquent une variété de modèles, axée sur la communauté, visant, de différentes façons, à adresser plus efficacement les besoins de service financiers des quartiers centraux. L'article considère quatre differents modèles soit, Four Corners Saving Association, Cash and Save, Fédération des caisses Desjardins du Québec, Micro-loan Program et le centre de services financiers de Winnipeg. Ces modèles reflètent à la fois les services offerts par une banque, les services financiers du marché du crédit à court terme et la gamme complète de services financiers offerts par une banque dans les quartiers centraux. L'article offre une série de suggestions pour un modèle efficace qui inclut une gamme de services financiers importants à un coût raisonnable et la participation des dépositaires.

Mots clés : marche de credit à court terme, exclusion financière et pauvreté, opérations de banque communautaire, prêteurs sur gages

Introduction

Financial services are a necessity for people operating in a market economy. Cashing cheques, paying bills, saving for the future and accessing credit are some of the services all Canadians need. These services help us to meet our short-term financial needs such as purchasing groceries and electricity and they help us meet our long-term financial needs such as savings or credit in the event of a financial crisis like a job loss or for a major purchase like a house. To achieve healthy financial security, people and communities need to be able to access an assortment of reasonably priced financial services. Yet there is evidence that low-income people and neighbourhoods face a limited assortment of financial services that are expensive and do not allow people to build personal savings or credit-rating. This is the result of declining numbers of mainstream bank branches—including Canadian or foreign banks, trust companies or credit unions—and rising numbers of fringe bank outlets—including pay-day lenders, cheque-cashers, pawnbrokers, rent-to-own firms, etc—in inner-city neighbourhoods. These changes in the financial system have been described as a segmentation of financial markets (Buckland and Martin, 2005; Dymski, 2003). The consequences of this segmentation for low-income people and neighbourhoods and Canadian society are problematic. It creates a two-tier financial system that hurts low-income people and inner-city neighbourhoods. The first section of this paper quantifies some of these costs for an inner-city neighbourhood in Winnipeg, a city with approximately 700,000 residents, located on the eastern edge of the Canadian prairies.

These costs, hitting low-income households and neighbourhoods the hardest, can only be mitigated through a variety of changes including public policy that regulates fringe banks[2] and *requires* banks to provide services to low-income people and neighbourhoods. This is not the subject of this paper. Here we focus on the equally important task of examining different financial service projects that are designed for low-income people and neighbourhoods. Various organizations have tried to address inner-city financial service needs. This paper explores four such models that are at various stages of their life cycle. The second section of the paper examines three models including the Fédération des Caisses Desjardins du Québec micro-loan program in Québec, the Four Corners Savings Association in Vancouver and Royal Bank's Cash and Save in Toronto. These models are instructive to understanding financial service provision for low-income people and neighbourhoods because they demonstrate the importance of innovation, they document the various types of financial services offered and they amplify the importance of key stakeholders in supporting the organizations.

Drawing on lessons from these models and from research undertaken in an inner-city neighbourhood in Winnipeg (see Buckland *et al.*, 2003), the third section of the paper describes a fourth model, a community financial service program for Winnipeg's North End. The Winnipeg model combines financial services that address short- and long-term financial service needs of low-income people.

1) Inner-city Neighbourhoods and Banking

Based on a 1996 survey it is estimated that 3 percent of Canadian adults and 8 percent of Canadian adults with annual household income less than $25,000 do not have bank accounts (Task Force, 1998).[3] Moreover, there is evidence that low-income Canadians are disproportionately dependent for their financial services on fringe banks. While data for Canadian fringe bank clients are limited, one study found that Canadian pawnshop clients come from a lower-income group (Lott and Grant, 2002). US studies generally show that fringe bank clients are from a low-income or lower-middle income, working-class background (Caskey, 1994; Temkin and Sawyer, 2004).[4] In a study of fringe bank clients in Winnipeg's North End, it was found that the majority of selected respondents were low income (between $10,000 and $20,000) and, out of all types of financial services, they were the most likely to use pawnshop loans, rent-to-own services, and cheque-cashing services (Buckland *et al.*, 2003).

One argument for the growth in fringe banks is that mainstream banks have closed inner-city branches, leaving a void in low-income neighbourhoods. However, a recent study in the US found that proximity to mainstream bank is not a significant factor determining whether a person is unbanked (usually defined as a person without a checking or savings deposit account) (Barr, 2004; Temkin and Sawyer, 2004). Nevertheless, there is evidence that fringe banks such as pawnshops, cheque-cashers and rent-to-own firms locate primarily in low-income neighbourhoods. Temkin and Sawyer (2004) also found that fringe banks are disproportionately located, and tend to cluster in, low-income and minority neighbourhoods. In our research in Winnipeg's North End, we found an inverse relationship between the number of bank branches and fringe bank outlets over the last 24 years (Buckland *et al.*, 2003). In the last twenty years, there has been major decline in mainstream bank branches and rise in fringe banks in the North End. In 1980, there were 20 bank and credit union branches in the North End and only one fringe bank, a pawnshop. By 2003, the numbers had almost reversed: 19 fringe bank outlets and 5 mainstream banks and credit unions branches.

Winnipeg's North End

Winnipeg's North End, with a population of 36,425 people in thirteen neighbourhoods, is a relatively disadvantaged area. This is particularly the case in the southern portions centred around Selkirk Avenue and Salter Street. This disadvantage is reflected in a variety of factors. For instance, average income for North End households in 2001 was 64 percent of the Winnipeg average (City of Winnipeg, 2001). The incidence of low income and unemployment is about double that for Winnipeg as a whole.

a) Banking and the Leaky Bucket Local Economy

One of the reasons given for an inner-city neighbourhood remaining poor is that income and wealth generated by area residents is not reinvested locally, but is largely spent elsewhere. A healthy local economy would generate income and wealth that would then be partly reinvested in the local economy. For instance, individuals would spend part of their income on goods and services supplied in the neighbourhood, generating jobs and income for local shops and service companies. Individuals might also deposit their savings in a local credit union which, in turn, might earmark part of those deposits for investment in the local economy. In these ways, a healthy economy is strengthened by recycling income and assets locally.[5] On the other hand, an inner-city economy has been likened to a rusty or leaky bucket (Fairbairn *et al.*, 1991). Wealth is generated and income is received by neighbourhood individuals, but since there are limited economic goods and services produced or available locally, the majority of this wealth leaks away. Those shops and service providers that do operate in low-income neighbourhoods often employ few local people, charge high prices and may export profits to a head office outside of the local economy. The result of these leakages is that the neighbourhood stays poor.

Fringe financial services compound the leakages from the inner-city. This is the result of several processes. Using the leaky bucket metaphor, income enters the inner-city through labour income, business income and government transfers. If the neighbourhood is dominated by fringe banks rather than mainstream banks, individuals and businesses are dependent on fringe banks locally and mainstream banks outside the neighbourhood. Clients face two important obstacles when relying on fringe banks. First, the cost of services is much higher than mainstream bank services (Buckland *et al.*, 2003). Cashing one cheque can cost more than the monthly fee for a deposit account. Loans of various forms (pawn, rent-to-own, pay-day, etc.) can involve an annualized interest rate from 250 to 1000 percent. Add to this the problems of misleading advertising, aggressive collection practices and exponential increases in costs if the client requests an extension or roll-over of the loan. We found roll-overs common in some Winnipeg pawnshops and studies have found rollovers common among pay-day lenders (Stegman, 2003). Once the loan is rolled-over, additional charges lead to the annualized interest rate rising drastically. An associated problem for fringe bank clients is that fringe financial services do not provide a means for the client to improve their financial security through building their savings and establishing a credit rating.[6] As charges mount, the likelihood of repayment declines and the consumer might fall into a growing cycle of debt. Also, with the decline in the availability of mainstream banks in the North End, consumers increasingly have only one option for their formal financial services: fringe banks. Yet fringe banks do not provide deposit accounts and they do not provide a means to develop a positive credit rating. Once again, the result is that the client can become stuck within the fringe banking system.

Finally, as fringe banks replace mainstream banks, less savings is generated locally, likely reducing credit available for local business and consumer loans. The existence of local mainstream banks, and particularly credit unions, would improve the probability of local credit availability for businesses and consumers. Additionally, profits and salaries generated by mainstream banks leave the locale and in some cases profits accrue to foreign shareholders. Credit unions are more active in the local economy. Profits are shared with local members through patronage allocations and, as a provincially mandated institution, credit unions are required to lend and invest strictly within the province. Profits generated by small fringe banks like pawnshops might stay in the neighborhood, but we found that a few individuals from outside the neighborhood controlled several pawnshops. Profits and salaries from larger fringe banks are more likely to leave the neighborhood. For instance, National Money Mart Company is a Canadian subsidiary of the US Dollar Financial Group. In 2003, Money Mart remitted approximately $89 million ($US 67 million) to its US parent, Dollar Financial Group (Lawford, 2004). If that profit was earned evenly over its 300 Canadian outlets, that would amount to $297,000 per outlet. With one outlet in the heart of the lower-income part of the North End, that constitutes a significant leakage that goes to the US.

The remainder of this section seeks to estimate the value of income lost to consumers through reliance on fringe banks in comparison to mainstream banks. Take for instance cheque-cashing. We found that the average fee for a $500 cheque is $16.79. Cashing two such cheques each month for one year would cost a total of $402.96, amounting to 1.11 percent of the average household income of the North End. Cashing cheques through a low-fee account at a bank would cost a total of $44.28. Next, consider a pay-day loan client. Take an average two-week loan of $200 at an average annualized interest rate of 550 percent. The cost to the client for the loan is almost $46. If the client takes out seven pay-day loans per year (as per Stegman, 2003), the total annual cost is $321, or 0.88 percent of the average North End household annual income. If that person was able to use a credit card for equivalent size and number of transactions the cost would be less than $1.67 per transaction and $11.67 per year, saving almost $310 each year. Finally, if a person engaged in an average $60 pawning transaction seven times per year at an average annualized interest rate of 300 percent, this would cost $15 per transaction and $105 in fees per year, 0.29 percent of the average income of North End household. Using a credit card would cost the client no more than a $1 transaction fee for an annual cost of $7, saving $98. A fringe bank client using all three of these services at the above-stated rates would pay an annual total of $829, representing 2.28 percent of a North End household's annual income. A mainstream bank client would face a total annual cost for the three types of services of $63, amounting to 0.17 percent of the average household income.

There are six pay-day lenders, three cheque-cashers and nine pawnshops in the North End. If we assume that the fringe banks only service area residents and that the volume of transactions for cheque-cashing and pay-day lending outlets are similar to outlets in the US, we can estimate the cost of the services to North End consumers:

- Assuming that each pay-day lending outlet extends 2,810 loans per year[7] means a total of 16,860 pay-day loans from the six outlets in the North End. The average cost per loan to the consumer is almost $46 (described above), for a total cost to consumers of $774,155.
- If we assume that each cheque-cashing outlet cashes 1,200 cheques each per month[8] then in one year the three North End outlets cash 43,200 cheques. Assuming the same average face value of the cheque ($500) and fees ($16.79 per cheque), this amounts to an annual cost of $725,328.
- Data collected for Winnipeg indicates that the average monthly number of loans per pawnshop is 273, so for the nine North End pawnshops that amounts to 29,484 pawn loans per year. Assuming the average cost of each loan is $15, this means the annual cost of North End pawn loans is $442,260.

Fringe bank services are more costly than mainstream bank services. The total annual cost of these three types of fringe bank operations—pay-day lending, cheque-cashing and pawnbroking—to consumers in the North End is estimated to be $1,941,743, or 0.38 percent of North End income. If these consumers used mainstream bank services instead, the costs would have been only a fraction (11 percent) of this, annually $216,992 or 0.04 percent of North End total income. And as mentioned previously, fringe banks do not offer deposit accounts or credit-building programs, meaning that clients are less able to contribute to local investment and they cannot easily shift into mainstream banks. Finally, profits generated by foreign-owned fringe banks such as Money Mart may be partly repatriated to the parent corporation. These factors have aggravated the leaky bucket that maintains low average income in the North End. One way to plug the leaks is to design a new model that more effectively meets the financial service needs of low-income people and communities. The next two sections examine different models from across Canada and a proposed model for Winnipeg.

2) Comparison of Some Community-Based Financial Service Models in Canada

The absence of mainstream financial services and the growth of fringe financial services in some communities have prompted the development of various organizations and programs to meet some or all of the financial service needs of people in various communities. While some of the initiatives seek to offer the same services as fringe financial outlets at less usurious rates, other initiatives incorporate a broader set of financial services for low-income people and communities to plug the leaky economy. This section highlights three different programs: the Cash and Save in Toronto, the Four Corners Savings Association in Vancouver and the Fédération des Caisses Desjardins du Québec micro-loan program.[9] The first two programs are single locations operating in inner-city neighbourhoods. The final program is offered through participating *Caisses Populaires* in the province of Québec.

a) The Cash and Save, Toronto

The Cash and Save, a subsidiary of the Royal Bank of Canada, was established in the Parkdale neighbourhood in Toronto in 2002 in response to a community-identified service void. The conceptual roots for the initiative originated through local relationships established by a community banker and continued to consult with a community reference group that is made up of various neighbourhood representatives who act as the local "eyes and ears" for the branch. Services offered include bill payments, money orders, money transfers, and cheque-cashing (free for government issues and the greater of $4.00 or 1.25% of the cheque value for other cheques). Service fees charged at Cash and Save are greater than would be charged at most banks or credit unions, but less than at most fringe banks. For that reason their services do plug some leaks in the local economy. But other identified needs such as access to credit or deposit accounts have not been met. Although there is a mechanism by which a client can open a deposit account at a Royal Bank branch, we were told that no one has utilised this option. Cash and Save is expected to realize a profit, although less than a typical bank branch.

The size and familiarity of an institution such as the Royal Bank is significant as it lends financial stability, financial and managerial expertise, and credibility to Cash and Save. However, from a community reinvestment perspective, realised profits for the Cash and Save consist of resources extracted from a low-income community and transferred to middle or high-income individual shareholders. The Cash and Save branch could be closed despite breaking-even if it achieves profits below levels set by global competitiveness and shareholder accountability concerns. The privately owned, for-profit model limits the scope and nature of services to those that are profitable as opposed to those that will have the greatest impact and benefit to the community and its members. However, if this model is profitable, it may be the most sustainable as it will not be vulnerable to termination of external subsidy or to political changes in the public sector.

b) Four Corners Community Savings, Vancouver

The Four Corners Community Savings was opened in 1996 by the provincial government to address the unmet financial service needs of Vancouver's Downtown Eastside. Four Corners provided deposit accounts with no minimum balance requirement, term deposits, cheque-cashing, money orders, utility bill payments, electronic deposit of cheques, and no charges on automatic teller machine (ATM) transactions.

However, Four Corners closed it doors in the spring of 2004. It was unable to draw large accounts, as accounts were not insured for more than $2 million. This limited its ability to make loans, an important source of revenue. As well, the bank attempted to provide high per-unit cost transactions for no fees. The bank's initial $10 million base capital, provided by the provincial government, had been eroded to near the required minimum of $5 million. A new provincial government in 2002 terminated lending functions of the bank and introduced user fees in an attempt to make Four Corners viable, but these changes only led to decreased use of banking services. Attempts to secure tripartite funding failed, although the federal government did agree to fund building renovations aimed at attracting non-profit organizations as tenants to share overhead costs, and the city bought the building and charged little to no rent to Four Corners.

Four Corners sought to integrate meeting short-term and long-term community financial needs through services such as cheque-cashing and by employing local individuals, providing financial counselling, encouraging savings, and integrating community organisations such as job kiosks and community information displays into their service network. An innovative identification mechanism, where the client received personal photo identification that Four Corners kept a record of in their database, contributed to smoother delivery of services for both clients and the bank. The client was able to exercise transactions without identification, since the information with the client's photo was available in the computer system.

Four Corners also increased the safety of the community (Bancroft Planning and Research Associates, 2000). Fewer cheques were lost or stolen because they could be electronically deposited directly into clients' accounts. Additionally, access to money orders and deposit accounts noticeably reduced the number of assaults and thefts in this neighbourhood, as individuals carried less cash. All of these benefits reduced related costs to the taxpayers (health care, policing and cheque replacement), as well as the social benefits provided by access to banking. Arguably, these benefits should be seen as part of the bank's return on investment. In these ways, Four Corners plugged many economic and social holes in the local community.

However, it appears that Four Corners was conceived out of a vision to serve the poor and not careful attention to its revenues. As a program of the provincial government, the bank was vulnerable to the political will of provincial leaders. Overlooking economic realities for the sake of meeting community needs placed the bank in a precarious position from which it did not recover.

c) Fédération des Caisses Desjardins du Québec (Desjardins) Micro-loan Program, Québec

Fédération des Caisses Desjardins du Québec consists of 671 *Caisses Populaires* (akin to credit unions) across the province and a federated central organization consisting of 5.16 million members with assets of $85.3 billion (Fédération des Caisses Desjardins du Québec, 2003). *Caisses Populaires* are federated together in the Fédération des Caisses Populaires du Québec. The federation has implemented a pilot project that seeks to provide small consumer loans to members who would not otherwise qualify for loans and to engage these members in financial planning. The federation allocates a minimum of $33,000 and a maximum of $66,000 to a fund, which must be matched by the *Caisse Populaire* involved. The salaries of credit agents were paid by the government of Québec during the first year and it split this cost with each local *Caisse Populaire* in the second year. The federation is seeking to establish a foundation that would finance these salaries in the future.

Each loan fund is established by one or several local *Caisses Populaires* in partnership with a financial consulting agency. This agency is considered to be a key element of the loan fund as they screen out individuals not capable of participating and they also deliver the educational component of the process that empowers clients, increases their financial management skills, and increases the loan repayment levels. Out of 488 financial consultations, 259 loans have been granted for an approval rating of 51%. A total of $131,279 has been lent out through 85 participating *Caisses Populaires* for an average loan size of $527. The repayment rate is 92%. More than 2/3 of the clients had incomes of less than $10,000 and 90% had incomes of less than $15,000. The top reasons for the loans in order of frequency were: appliance purchases, utility bill payment, furniture purchases, rent payments, debt consolidation, and the purchase of employment related tools. Loan interest is capped at 5%, but only one *Caisse Populaire* has chosen to charge any interest at all.

Through this program, reasonably priced loans are being provided to low-income households. This provides them a source of credit to meet life-cycle and emergency needs. The lower-priced loan also reduces the cost to the household, raising their disposable income. Finally, by integrating the micro-loan program with existing *Caisses Populaires*, the client can draw on other financial services available including deposit accounts and building their credit rating. To the extent that the micro-loan fund clients and the participating *Caisses Populaires* are located in an inner-city, this model may also plug some of the leaks in the inner-city economy.

As evidenced by the disinclination to charge interest, the perspective guiding the loan fund is not profit-oriented. The lack of loan interest charges coupled with an 8% default rate will mean that the fund will require permanent subsidisation, which is only possible due to the size and strength of the federation and the partnerships under which the loan fund is administered. This administrative, financial, and stabilizing capacity is important for the delivery of the loan fund. The *Caisse Populaire* has well-established procedures and technology for administrating financial transactions such as loans.

d) The Three Models

These models demonstrate the benefits of, and the need for further financial service model innovation.[10] Affordable financial services have not emerged from the private or public sector and the capacity required to deliver these services is beyond most community non-profit organizations. Cash and Save represents a market-based response, but it has no long-term goal of individual or the neighbourhood transformation in its mandate. Four Corners represents a government intervention, but it failed to become viable. Desjardins has creatively designed a model that does meet both short and long-term needs. Since it is a pilot project, however, it is not clear how effective this model will be in terms of transformative service provision and ability to cover its costs.

Various organizations including credit unions/*Caisses Populaires*, government, community organizations and banks are seeking to plug the financial service gap through a variety of different models. These models range from the full-service bank for the poor (Four Corners) through the specialized loan fund for low-income people (Desjardins) to a cross between a bank and a fringe bank (Cash and Save). Each model offers lessons about addressing financial service needs of low-income people. While Four Corners Savings Association provided a full set of financial services, it was not itself financially viable or able to maintain an external subsidy. The Cash and Save provides a model that may be more financially viable, but with only basic financial services the benefit to the community is limited. The Desjardins micro-loan program provides a specialized service lodged within participating local *Caisses Populaires*. This model is attractive in that it meets a critical need of low-income people and it is embedded within a local *Caisse Populaire* that can provide the full range of financial services. In this way this model addresses both short-term and long-term financial service needs.

The Four Corners, Desjardins and Cash and Save models also demonstrate that effectively addressing financial service needs of low-income people and neighbourhoods will involve a number of stakeholders. Involving key stakeholders can strengthen the capacity of the model, but it also has the ability to expose the initiative to vulnerabilities. Collaborating with various organizations and government can provide the model with diverse capacities, expertise, opportunities, several locations, and spreads the responsibility and risk for the model's success to more than one lone entity. However, excessive direct or indirect dependency on government funding can render a model vulnerable to funding alterations or termination. Four Corners would not have emerged had it not been for the leadership role taken by the provincial government. But this, together with perpetual operating deficits, contributed to the termination of the model with the election of a new government that was not interested in subsidizing financial services for the public. Having a mainstream bank or credit union with financial strength and capacity (as in the case of the Royal Bank and Desjardins), might be preferable. However, such an approach may not return the profit demanded by bank shareholders. Credit unions, with concern for community as a stated guiding principle, should be more ideologically disposed to playing such a role.

3) The Winnipeg North End Community Financial Service Model

For the last two years a group of community organizations have undertaken research into the need, the design and the feasibility of a community financial service program for the North End. Preliminary research identified access to a mainstream bank as a problem for many North End residents and it identified the need for reasonably priced financial services for this neighborhood (Buckland *et al.*, 2003). The next step of the research was to undertake a feasibility assessment of a community financial service program. The feasibility assessment identified and examined the costs of a variety of financial services. This section documents the underlying assumptions about this model and provides details about its operations.

a) Defining the Task

Designing a community-based model for providing alternative financial service in the North End of Winnipeg is a challenge. The objective was to design something that was new, and that incorporated the learning from both local respondents and the review of other models. Based on an analysis of these sources, a number of things become clear. Firstly, neighborhood residents stated unequivocally that they did not want any form of ghettoized banking, but wanted to become valued customers or members of a recognized financial institution. Secondly, the basic services under discussion cannot be sustained solely through interest charges or service fees paid by low-income clients. Thirdly, any stakeholder (public or private sector) willing to subsidize these services would need to be able to cap or manage the subsidy level. Fourthly, models that rely on building stand-alone subsidized branches either severely constrain available products or founder on a lack of earned revenue.

The micro-loan program implemented by the Desjardins has significant merit as do the inner-city locations and more varied services of the Cash and Save and Four Corners. To address the financial service needs of low-income people and the North End economy, elements of all three models are used. The North End model will combine a micro-loan fund with some other necessary financial services based in a physical North End outlet.

The design for a North End model flowed from a set of basic assumptions. It was important to meet the short-term, immediate needs in the community, but to incorporate an approach that included stepped services, where people could progress over time towards a relationship with a mainstream financial institution. Services should be affordable, but price should bear some relationship to cost. This also serves as a structural incentive for clients to progress through the steps. If this progression culminates in clients using unsubsidized services, the subsidies may then be applied to a new set of clients in turn. It should be noted that the model is designed to meet the needs of a particular client group. It seeks to offer alternatives to low-income people who have essentially sound character and a willingness to learn new skills in order to improve their situation. It is not likely to meet the needs of the homeless or other highly marginalized populations as effectively.

The overall strategy was to create a community financial service program that would operate as a community non-profit and be the source of the soft and heavily subsidized service. One or more financial institutions would be asked to provide customized financial services to clients in the middle steps of the progression. Ultimately, these clients will become regular customers of the financial institution, and can be served using existing financial products from the bank or credit union.

b) Entry Level Service

The model starts the client relationship by offering an alternative to a pawnshop loan, assisting the low-income client in meeting an immediate need by offering access to a micro-loan. The loan of $40-$100 would be offered for terms of 30-90 days and is intended to replace the necessity for a pawnshop transaction. The goal of the loan program is to provide the loan at an annualized interest rate below the criminal rate of interest (60 percent per year), but above competitive rates associated with credit cards (18-25 percent per year). This pricing is well below the cost of pawning, yet since it is above that of a typical credit card, clients would be motivated to move towards conventional credit as it becomes available. Micro-loans will only be offered to clients who meet two criteria. The first is that they are referred to the program by members of a network of local community service organizations, who will be asked to provide a character reference for the borrower. The second criterion is that the person is either unbanked or has a minimal relationship with a bank[11].

A condition of the micro-loan will be the purchase of a low-cost personal photo identification card. Lack of affordable identification is a major motivating factor in the use of cheque-cashers (Buckland *et al.*, 2003). A photo identification card can likely be provided for $6 to $8, and there are some indications that local businesses and financial institutions will recognize this form of identification if properly introduced. Issuing the identification and the micro-loan will occur as a local credit file is created for the client. This local credit file will track the record of the client in repaying the micro-loans. This localized credit history will be used to determine eligibility for subsequent micro-loans, and whether the client is a candidate for moving forward in the progression of stepped services. The creation of the credit file, along with the micro-loan and the identification, create an opportunity to initiate a discussion with the client about their overall financial situation and where they are currently getting financial services.

c) Becoming Banked

If the client demonstrates the ability to repay the micro-loans successfully, they will be encouraged to open an account at a participating financial institution. Program staff will be able to demonstrate the true costs of using cheque-cashers and other fringe bankers as compared to the monthly service charges associated with a bank account. Most financial institutions have a basic chequing account with service fees that will be significantly cheaper, provided that the account is used correctly. Providing the client with the correct type of account and ensuring comprehension of the fee structure are critical elements of this process.

One of the key factors in the decision to use fringe financial services on the part of low-income customers is the immediate availability of cash for a cheque (Buckland *et al.* 2003). Financial institutions normally place a 5-day hold on cheques and will not release cash until the cheque has cleared. This was seen as a major impediment to bringing the unbanked into mainstream banking. To address this, the community financial service model proposes to have participating financial institutions set up special accounts. These special accounts will be a modification to existing financial products of the institutions. The proposed modifications are twofold: the account will allow up to $400 to be withdrawn during the five-day hold period, and the accounts will be monitored daily by the financial institution to look for signs that indicate the client is struggling with the account. If a concern arises the financial institution will be authorized to contact the community financial service program staff for assistance in taking preventative steps. Special accounts will carry normal service charges, preparing the client for the reality of mainstream banking.

The modifications required by the special accounts represent both extra cost and extra risk to the financial institutions. By capping the volume of these special accounts, and by spreading them among several financial institutions, the cost and risk can be contained within acceptable levels. One possibility is for the community financial service program to create a fund to indemnify financial institutions against losses incurred on the special accounts.

d) Access to Services

It will also be important for the model to ensure that once people have secured an account, that they have reasonable access to that account. This access will be secured by four elements: introducing an additional deposit-taking ATM to the North End, providing clients with access to direct deposit and debit technology, providing clients with training/support in telephone and on-line banking, and by having participating financial institutions provide outreach through an on-site presence at the community financial service program. Each of these elements is discussed below.

Research showed several ATM locations within the North End, but the majority of these are the 'white label' ATMs that carry additional surcharges and do not have deposit-taking capability. The proposed model suggests that the non-profit community financial service program will make the capital purchase of the ATM equipment with funds from a charitable foundation. The ATM will then be leased to a participating financial institution for $1 per year, with the institution covering the operating and servicing costs. This arrangement will lower the break-even point for the ATM significantly, to the point where it is expected to be profit-neutral for the financial institution. In addition to ATM access, clients will receive debit cards, and wherever possible, be encouraged to receive their pay-cheques or income transfers through direct deposit. The client will also receive training and support in the use of telephone and internet banking. While it is true that many low-income clients may not have a phone, and most lack internet at home, local community service organizations provide both telephones and internet terminals in their outreach offices for community use. Community service organizations are confident that clients will quickly learn how to use these technologies, provided there is some up-front training. While not all clients will want to use these tools, it offers another means to improve access to banking services in the absence of physical bank branches.

While providing financial service hardware like ATMs significantly improves access to banking services, it lacks the human interaction that is sometimes necessary. To this end, the model proposes that participating financial institutions commit to provide three hours per week of staff time for outreach at the community financial service program location. This presence is not intended to conduct transactions that could just as easily be done through an ATM, but to provide clients with the opportunity to ask questions and learn about new products from a financial institution representative. This representative could take applications for new accounts, provide product information, answer questions, and make appointments for clients to come down to the appropriate branch. This is seen as a crucial step in having the client connect directly with the institution, and to eventually receiving mainstream financial services. It is recognized that this is an additional cost to the financial institution, but one that is manageable. The financial institution can also view this as a long-term customer development strategy.

e) Defining Roles of Key Stakeholders

The model for a community financial service program in the North End of Winnipeg is predicated on defining appropriate and manageable roles for all the stakeholders. These include clients, community organizations, financial institutions, government and charitable foundations. The non-profit program is seen as an intermediary to coordinate these roles and deliver support services that allow clients to progress through the various steps.

The role of the client is twofold: they are both a recipient of social/educational services and a consumer of the financial services. The client is expected to be motivated to change and willing to accept responsibility as various barriers are removed or minimized. The stepped services are based on merit—clients advance as they succeed. This feature recognizes that not all low-income people are currently in a position to learn new skills or revise future plans. Those clients that are will receive opportunities to join the mainstream of financial services.

Community organizations are asked to play a role that identifies clients who would benefit from the community financial service program, and to screen those that are not currently able to meet the minimum requirements. The organizations also play a role in providing points of access to banking services. The model is based on the strength of the relationship between the organizations and the clients they refer. It also assumes that these clients will move beyond dependence on these organizations and will eventually manage their financial affairs independently.

Financial institutions are recognized in their dual role: they are private sector businesses with a bottom line, but they are also the owners of a financial services infrastructure that resembles a public utility. In the latter sense, there is a moral obligation to provide reasonable access to this infrastructure, as people who cannot currently access it are being economically punished. The model strives to combine an expectation of wider access with recognition that extraordinary costs need to be contained.

The model distinguishes between the 'concrete' financial services infrastructure that is provided by the financial sector and 'soft' services that are not provided by banks but that are necessary to attract unbanked people into a relationship. These soft services include fair-priced basic financial services, accessible information about services and opportunities to build one's financial management skills and credit-rating. The role for government is to help subsidize the costs of these softer services. These subsidies are not universal, but are linked to participant skill development that will reduce the long-term cost of financial services to the low-income client. To the extent that many of the low-income clients receive income transfers from government, government has a responsibility to ensure that low-income individuals receive maximum benefit from these funds, and that the impact is not dissipated by the exorbitant fees charged by fringe banks. Moreover, the programs will assist low-income people to achieve better financial security, making them better taxpayers in the long run. At the same time, the model recognized the political reality that the public sector has to be able to contain subsidy costs.

Charitable foundations are asked to play a familiar role as funders of this effort to relieve poverty. This particular intervention, while clearly a poverty reduction strategy, is also developmental in nature. It speaks to the view among progressive charities, which anticipates that building capacity in the individual will be a sounder long-term investment in poverty reduction. This model ties nicely in with the growing interest among charities in asset-building programs.[12]

4) Conclusion

The changing face of financial services for low-income people and neighbourhoods threatens to aggravate poverty, thereby reinforcing the income inequality that led to the segmentation of the markets in the first place. Low-income people and communities are less likely than middle-income people and communities to be banked and are more likely to use fringe banks. By draining more income from the inner-city, fringe banks add more leaks to an already leaky bucket economy.

The three models considered in section two demonstrate the wide variation used to address this problem. Four Corners had the most transformative services for the clients but Desjardins micro-loan program isn't far behind if clients are able to access other *Caisse Populaire* services. Cash and Save is least transformative. On the other hand, Cash and Save appears to hold out the greatest hope for financial viability while Desjardins and (the now defunct) Four Corners are less so. In all cases the models demonstrate the need for several stakeholders to be involved: clients, banks, community and government as the most prominent among them.

The Winnipeg model seeks to achieve relevance to the North End's uniqueness while drawing lessons from these experiences. Offering micro-loans and special accounts, among other services, this model seeks to help financially excluded people connect with the banking system. The organizations that catalyzed the research into financial service models for the poor in Winnipeg have completed a detailed business plan with direct support from Canadian Imperial Bank of Commerce and Assiniboine Credit Union. The operations will need to be subsidized. If the results of this model are that more people become banked, then this subsidy could be justified economically and socially (not to mention politically). The Winnipeg model draws on community, government, charities and private sector support. It suggests that there is a collective responsibility to plug the financial service leaks, and that some supports are required to overcome existing barriers. By sharing costs and restricting volumes, the model has been designed to be sustainable, as opposed to self-funding.

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Notes

1 Data for this study were collected in 2002-2003. Since that time in Vancouver's Downtown Eastside, Four Corners Savings Association has been closed (and a new centre, Pigeon Park Savings has opened), the micro-loan program of Fédération des Caisses Desjardins du Québec has expanded, and, as this article goes to press, the Winnipeg Community Financial Service Program is set to open its doors in September 2006.

2 Regulation of fringe banks is a provincial responsibility but few provinces have fringe

bank legislation. Section 347 of Criminal Code of Canada that prohibits interest rates in excess of 60 percent has not been used to regulate fringe banks.

3 This is likely an underestimate given the survey methods that depended on telephone interviews & low-income households are more likely than others to not have a telephone. VISA International (2004) estimates that 15 percent of Canadians do not have a bank account. 8.4 million families or 22 percent of low-income households in US are unbanked (Barr, 2004, p. 133).

4 Evidence from the US suggests that pay-day loan consumers come from a "modest" or working-class background (Elliehausen and Lawrence, 2001, p. iv).

5 We recognize the limitations of the leaky bucket metaphor particularly with reference to neighbourhoods in the urban context. Because a wealthy local economy such as a rich suburb is integrated into the national and international economy through such factors as employment, investment and trade the geographic locale is of limited importance to the neighbourhood's wealth. In fact, some "leakages," for example the export of savings from a neighbourhood to a bank may generate more wealth for that neighbourhood if it receives a higher return than what is locally available. Also, exporting income to purchase goods and services outside the neighbourhood may be balanced with importing income through a well-paid job outside the neighbourhood.

6 In our research we found that some pay-day lenders claim that timely repayment of their loans will help build one's credit worthiness. To the contrary, one banking industry insider stated that mainstream banks see repaying pay-day loans as a negative factor in rating credit worthiness.

7 This is the average number of pay-day loans per outlet from a recent study of pay-day lenders in North Carolina (Stegman, 2003).

8 The average number of cheques cashed in typical cheque-casher in the US (Caskey, 2001).

9 For a more extensive review and analysis of these programs, as well as several other models, please refer to the full research report (Buckland *et al.*, 2003).

10 An important aspect of innovation relates to new electronic technologies. New electronic technologies include electronic kiosks offering bill payment service, cheque-cashing, money orders and transfers, internet access and automatic teller machine functions. Other developments include the 'chip' card and the 'smart' card. The chip card might replace the 'swipe' card, and it would carry account information on the card itself. The smart card would have deposits transferred to it and would have payments transferred from it. Point of purchase machines may make it possible to make bank account deposits at retail outlets.

11 A minimal relationship with a bank might occur if welfare cheques (Employment and Income Assistance in Manitoba) are received through direct deposit, but this income is immediately withdrawn and the account is used for no other purpose.

12 Asset-building programs such as the Learn$ave pilot program in Canada assist low-income persons with matched savings to accumulate assets such as education and business investment.

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