Exhibit No.:	______________
Issue(s):	Economic Considerations/ Pay Station Fees
Witness/Type of Exhibit:	Meisenheimer/Direct
Sponsoring Party:	Public Counsel
Case No.:	ER-2012-0345

DIRECT TESTIMONY

OF

BARBARA A. MEISENHEIMER

Submitted on Behalf of the Office of the Public Counsel

Empire District Electric Company

Revenue Requirement

CASE NO. ER-2012-0345

November 30, 2012

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of The Empire District	)	
Electric Company of Joplin, Missouri	)	
Tariffs Increasing Rates for Electric	)	**ER-2012-0345**
Service Provided to Customers in the	)	
Missouri Service Area of the Company	)	

AFFIDAVIT OF BARBARA A. MEISENHEIMER

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Barbara A. Meisenheimer, of lawful age and being first duly sworn, deposes and states:

1. My name is Barbara A. Meisenheimer. I am Chief Utility Economist for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my direct testimony.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Barbara A. Meisenheimer

Barbara A. Meisenheimer

Subscribed and sworn to me this 30th day of November 2012.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

KENDELLE R. SEIDNER
My Commission Expires
February 4, 2015
Cole County
Commission #11004782

Kendelle R Seidner

Kendelle R. Seidner
Notary Public

My Commission expires February 4, 2015.

Direct Testimony
Of
Barbara Meisenheimer

Empire District Electric

ER-2012-0345

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. Barbara A. Meisenheimer, Chief Utility Economist, Office of the Public Counsel, P. O. Box 2230, Jefferson City, Missouri 65102. I am also an adjunct instructor for William Woods University.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.

A. I hold a Bachelor of Science degree in Mathematics from the University of Missouri-Columbia (UMC) and have completed the comprehensive exams for a Ph.D. in Economics from the same institution. My two fields of study are Quantitative Economics and Industrial Organization. My outside field of study is Statistics.

I have been with the Office of the Public Counsel since January 1996. I have testified before the Missouri Public Service Commission (Commission) on economic issues and policy issues in the areas of telecommunications, gas, electric, water and sewer. In rate cases my testimony has addressed class cost of service, rate design, miscellaneous tariff issues, low-income and conservation programs and revenue requirement issues related to the development of class revenues, billing units, low-income program costs, incentive programs and fuel cost recovery.

Over the past 15 years I have also taught courses for the following institutions: University of Missouri-Columbia, William Woods University, and Lincoln University. I currently teach undergraduate and graduate level economics courses for William Woods University.

Q. HAVE YOU TESTIFIED IN PAST EMPIRE ELECTRIC RATE CASES?

A. Yes. I testified in the Company's five most recent rate cases; Case No. ER-2004-0570, Case No. ER-2006-0315, Case No. ER-2008-0093, Case No. ER-2010-0130 and Case No. ER-2011-0004.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My direct testimony addresses economic and public policy issues the Commission should consider in determining the appropriate level of revenue requirement for Empire District Electric Company (the Company). In recent years the economy has experienced slow growth, high unemployment and under-employment and only marginal wage growth. Consumers have faced frequent and substantial rate increases for electric service as well as other utility services. Empire alone filed for rate increases in both 2010 and 2011 receiving a combined increase in base rates of over $65M. Over the past several years Empire's rates have increased at a rate that far outpaced the growth of wages. Consumers are finding it increasingly difficult to make ends meet, some to the point of crisis. In this testimony I explain that the Commission can and should treat rate affordability as a key factor in determining the Company's revenue requirement. I will also address Empire's request to remove recovery of pay station related costs from base rates.

Economic and Public Policy Issues

Q. WHAT DO YOU BELIEVE SHOULD BE THE COMMISSION'S FOCUS IN RESOLVING THIS CASE?

A. In this case, Public Counsel urges the Commission to decide issues in a manner that recognizes the economic challenges faced by households in Empire's service area and reasonably minimizes the rate impact on consumers. The Commission should also focus on allowing customers greater control over their electric bills.

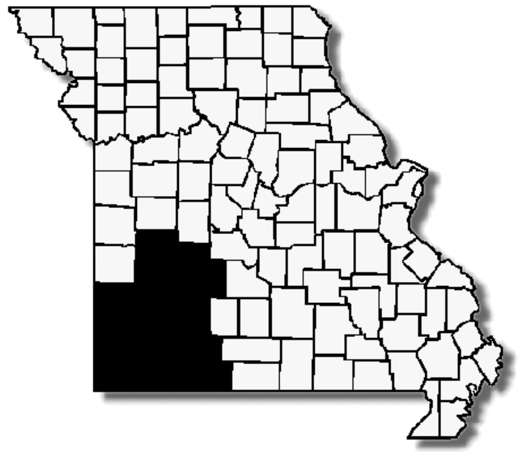
Q. SHOULD THE COMMISSION CONSIDER THE ECONOMIC CLIMATE AND FACTS SUCH AS UNEMPLOYMENT RATES AND PREVIOUS RATE INCREASES WHEN DETERMINING WHAT RATES ARE JUST AND REASONABLE?

A. Yes. It is the Commission's job to set just and reasonable rates. Public Counsel has argued and the Commission has recognized that in addition to cost of service, other relevant factors to consider in setting rates include the value of a service, the affordability of service, rate impacts, and rate continuity.

Q. PLEASE DESCRIBE EMPIRE'S ELECTRIC SERVICE AREA.

A. According to information submitted as part of the Company's minimum filing requirements, Empire serves portions of 16 counties in Southwest Missouri as illustrated in Diagram 1. The Company's service area is diverse in terms of population density and economic activity.

Diagram 1.



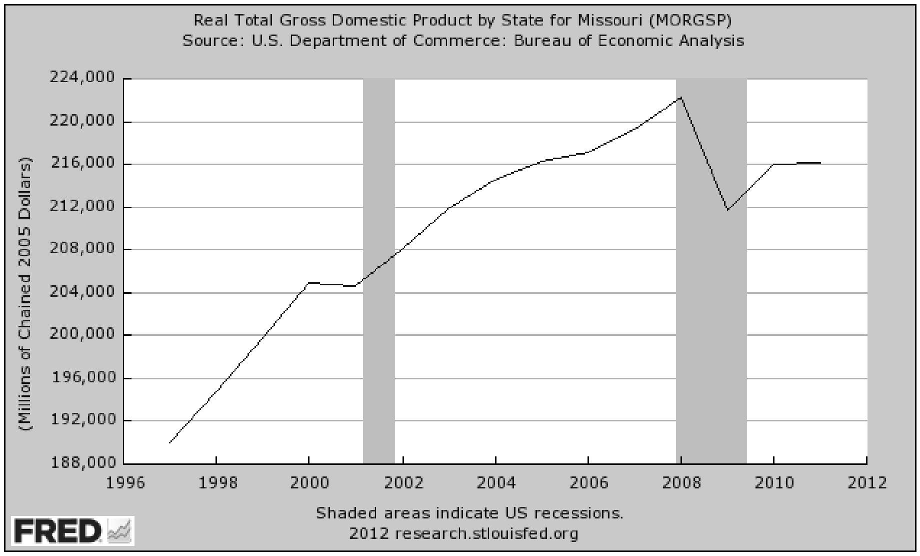
Q. WHAT ECONOMIC FACTORS HAVE AN IMPACT ON RATE AFFORDABILITY?

A. Output growth, often measured as a change in Real Gross Domestic Product, the levels of unemployment and under-employment and inflation in consumer prices all impact the general affordability of rates.

Q. PLEASE DESCRIBE THE RECENT PERFORMANCE OF OUTPUT GROWTH.

A. Real Gross Domestic Product (RGDP) measures the inflation-adjusted value of all new, final goods and services produced within a geographic area. Diagram 2 which is based on data compiled by the U.S. Department of Commerce and reported by the Saint Louis branch of the Federal Reserve, illustrates that Missouri's RGDP remains stagnant below the December 2007 level. As I will discuss later in this testimony, the reduction in output since December 2007 shown in Diagram 2 corresponds to a period of significant unemployment throughout Missouri.

Diagram 2.



Also significant is that prior to the recent recession, Missouri had experienced moderate but relatively steady growth as illustrated by the pre-December 2007 trend shown in Diagram 2. Relatively steady economic growth over time promotes confidence leading to new investment, increased employment opportunities and wage growth. It is still unclear if the recession was only a temporary shock that can be overcome or if there will be a more harmful long-term impact on Missouri households.

Q. PLEASE COMMENT ON THE RATE OF UNEMPLOYMENT IN EMPIRE'S SERVICE AREA.

A. According to the U.S. Bureau of Labor Statistics (BLS) Quarterly Census of Employment and Wages, the unemployment rate of every county served by Empire has increased substantially, in a number of cases roughly doubling between 2006 and 2011. Table 1 shown below illustrates the growth in unemployment for each of the Missouri counties containing portions of Empire's service area.

Table 1.

Unemployment Rate By County

County	2006	2007	2008	2009	2010	2011	Increase 2006-2011
Barry	4.0%	4.8%	5.3%	8.4%	8.4%	8.1%	102.5%
Barton	5.2%	8.6%	9.0%	10.8%	10.9%	9.9%	90.4%
Cedar	5.1%	5.6%	6.3%	9.3%	8.4%	8.1%	58.8%
Christian	3.7%	3.8%	4.9%	8.4%	8.2%	7.5%	102.7%
Dade	4.6%	5.2%	6.1%	9.0%	9.0%	9.0%	95.7%
Dallas	5.1%	5.2%	7.3%	11.9%	11.4%	10.2%	100.0%
Greene	3.7%	4.0%	4.9%	8.5%	8.1%	7.4%	100.0%
Hickory	6.9%	7.4%	9.3%	13.7%	12.5%	12.4%	79.7%
Jasper	4.2%	4.5%	5.1%	8.3%	8.2%	7.7%	83.3%
Lawrence	3.9%	4.0%	4.7%	8.5%	8.3%	7.7%	97.4%
McDonald	3.9%	4.1%	4.7%	7.9%	8.9%	7.7%	97.4%
Newton	4.5%	4.7%	5.3%	8.2%	8.7%	7.9%	75.6%
Polk	4.4%	4.7%	5.9%	10.2%	9.6%	8.9%	102.3%
St. Clair	5.6%	6.5%	6.8%	9.9%	10.9%	10.3%	83.9%
Stone	6.6%	6.3%	7.6%	12.3%	12.5%	11.8%	78.8%
Taney	6.9%	6.7%	7.5%	12.3%	12.4%	12.1%	75.4%

Cedar County, which experienced the smallest increase, saw nearly a 59% increase in unemployment. Christian County experienced the greatest increase in unemployment - approximately doubling, increasing by nearly 103%. Statewide, unemployment grew 79% over the period 2006 to 2011.

Q. DO THE UNEMPLOYMENT STATISTICS REPORTED BY THE BLS REFLECT THE ACTUAL LEVEL OF UNDER-EMPLOYMENT?

A. No. The unemployment statistics reported by the BLS are limited in that the derivation of those statistics treats a person who works any number of hours for pay as employed. For example, a person who works only one hour for pay would be treated as employed and would not be reflected in the unemployment rate. To gauge under-employment requires consideration of additional information. Measures of workers' wages can provide additional information on the level of under-employment because they reflect changes over time in total worker compensation.

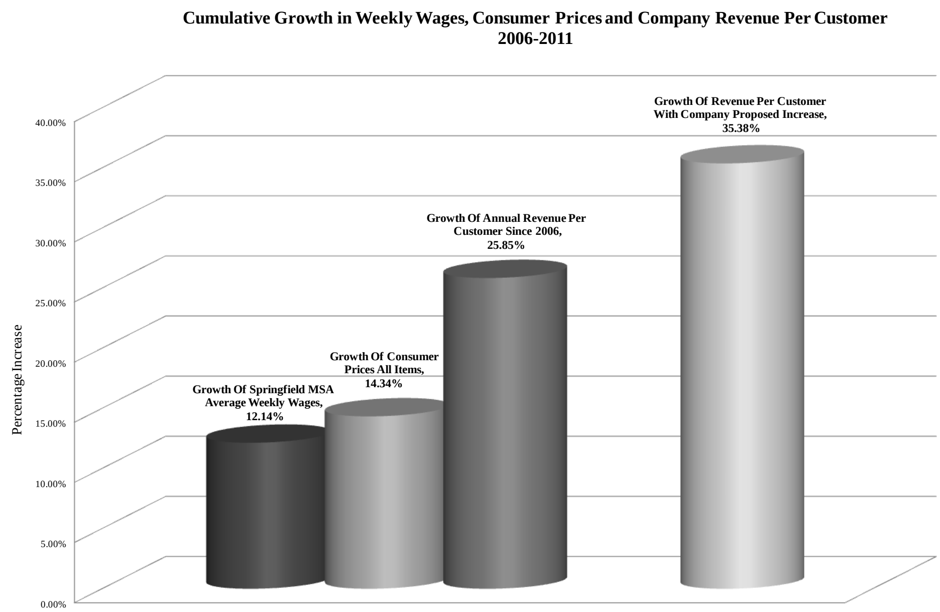
Q. PLEASE COMMENT ON HOW WAGES HAVE CHANGED.

A. Based on data obtained from the US Bureau of Labor Statistics, between 2006 and 2011 for counties served by Empire, the cumulative growth in average weekly wages ranged from an increase of about 6.02% in St. Clair County to an increase of 21.43% in Polk County. The un-weighted cumulative average weekly wages for all counties containing portions of Empire's electric service area grew about 12.14% over the period 2006-2011, which is similar to Missouri workers' cumulative average weekly wages growth of 11.62%.

Q. HOW DOES THE GROWTH IN WAGES COMPARE TO THE GROWTH IN COMPANY REVENUE?

A. Over the period 2006-2011, cumulative average weekly wages grew less than half as much as the 25.85% growth in Empire's current revenue per customer, and less than one third of the 35.38% growth in revenue Empire could receive if its $30.7M proposed increase in this case is granted. Diagram 3, shown below, illustrates these comparisons. The diagram illustrates that Empire's growth rate of revenue per customer is far outpacing the average growth in workers' wages and overall consumer prices.

Diagram 3.



Q. HOW DO RATE INCREASES THAT OUTPACE WAGE INCREASES IMPACT CONSUMERS?

A. As electric bills claim an even larger share of wages, many consumers find it more difficult to make ends meet. Some customers might have to work extra hours or two jobs. Some customers might have to make a choice between paying utility bills and buying food and medicine.

Q. DO EMPIRE'S CUSTOMERS ALSO FACE THE RISK OF UNANTICIPATED RATE INCREASES FOR ELECTRIC SERVICE?

A. Yes. In addition to substantial base rate increases, Empire customers face the risk of upward volatility in their electric bills due to potential rate increases that can occur between rate cases. The Fuel Adjustment Clause (FAC) is a surcharge through which the Company can adjust the collection of fuel and purchased power costs separate from all the other costs of doing business. Empire sought and received authority for the FAC in response to the Company's perception that it was under-recovering fuel related costs. The result of the FAC mechanism has been to shift the risk of higher fuel costs to consumers resulting in the potential for unanticipated bill increases.

Q. PLEASE COMMENT ON OTHER RECENT RATE INCREASES THAT HAVE IMPACTED EMPIRE'S SERVICE AREA.

A. From 2006 to 2011, customers of investor-owned utilities in portions of Empire's service area have faced significant increases. In rate cases, Empire increased companywide electric rates three times for a total of almost $107M and increased natural gas distribution rates by about $2.6M. In addition, Empire sought and received approval for rate mechanisms that has collected millions of dollars in additional electric fuel cost recovery outside of the normal rate case proceedings. The Company's submission in response to the minimum filing requirements estimates that the current FAC collects an additional $8.6M annually. Prior to the FAC, Empire was allowed to collect over $8M annually in additional revenue, incremental to base rates, through an Interim Energy Charge. Missouri American Water increased companywide water rates four times for a total of over $133M. Missouri Gas Energy increased natural gas distribution rates twice for a total of about $43.4M. Missouri Gas Utility increased natural gas distribution rates over $300K.

Q. HAVE CONSUMERS PREVIOUSLY EXPRESSED CONCERNS ABOUT THEIR ABILITY TO AFFORD UTILITY RATE INCREASES AND THE FAIRNESS OF RATES?

A. Yes. Although the public hearings associated with this case are scheduled to occur after the date of this testimony, customers testifying in recent public hearings for other utilities and customers submitting comments to the Commission have regularly voiced frustration and concern about the burden of additional rate increases given the state of the economy. Based on the economic conditions in Empire's service area counties described in this testimony, I anticipate that consumers in Empire's service area are facing similar rate affordability issues as customers of other utilities. From a consumer perspective, Empire has received significant concessions including regular rate increases and reduced risk as a result of the IEC and FAC which work to enhance the profit of shareholders. In the current case the Commission should focus on ensuring rate affordability and fairness for consumers.

Q. HOW CAN THE COMMISSION PROMOTE RATES THAT ARE FAIR AND AFFORDABLE?

A. The Commission can promote rate affordability by carefully scrutinizing the claimed expenses underlying Empire's request for a rate increase. Expenses including operations and maintenance expenses, labor expenses and administrative and general expenses make up the largest driver of revenue requirement. The rate of return is another key factor in determining the Company's revenue requirement and ultimately customer rates. In determining the return on investment, the Commission typically recognizes that there is a range of rates of return that can allow a utility the opportunity to earn a reasonable return on investment. To promote affordability the Commission should adopt a rate of return at the bottom of the reasonable range. As

I will discuss in future rate design testimony, the structure of rates is also important in promoting rate affordability. By minimizing mandatory fixed charges, the Commission can promote affordability by providing customers a better ability to manage their electric bills by controlling usage.

Pay Station Related Costs

Q. IN DIRECT TESTIMONY EMPIRE WITNESS BRENT BAKER DESCRIBED EMPIRE'S REQUEST TO REMOVE RECOVERY OF PAY STATION RELATED COSTS FROM BASE RATES. IS THERE ADDITIONAL INFORMATION THAT THE COMMISSION SHOULD CONSIDER IN EVALUATING THE MERIT OF REMOVING PAY STATION COST RECOVERY FROM BASE RATES?

A. Yes. While Public Counsel is still evaluating the proposal, there is additional information that should be considered and addressed prior to any decision on the issue. For example, a key consideration is that the availability of local pay stations may be of great benefit to customers and in particular of great benefit to customers most at risk of late payment and disconnection. On the other hand, Public Counsel does recognize that differing forms of payment impose different costs and the cost of arranging for local pay-stations likely exceeds the cost of accepting mailed or electronic payments. Ultimately, the Commission will need to determine if the benefits of greater accessibility outweigh arguments that cost differences justify transitioning to a third-party fee based system.

Q. IS THERE EVIDENCE THAT CUSTOMERS MOST VULNERABLE IN TERMS OF LATE PAYMENT AND DISCONNECT ARE ALSO LESS LIKELY TO HAVE THE FLEXIBILITY OF PAYING BY CHECK OR DEBIT CARD AND THEREFORE MAY DISPROPORTIONATELY RELY ON PAY-STATIONS?

A. Yes. A recent report prepared by the Federal Deposit Insurance Corporation (FDIC) suggests that low-income consumers, young consumers, women-headed households and minority groups are more likely to be unbanked or underbanked. The Executive summary from the report entitled "The 2011 FDIC National Survey of Unbanked and Underbanked Households" is included as Attachment BAM Direct-1. Based on my experience, the consumer groups identified as exhibiting a relatively high rate of being unbanked or underbanked align closely with groups at greater risk of late payment and disconnection.

Q. WHAT DO YOU VIEW AS A RISK OF SHIFTING COST RECOVERY FROM BASE RATES TO THIRD PARTY FEES?

A. Public Counsel is greatly concerned that in some cases, offering bill payment transiting services has been used by predatory lenders as way to target and to market to low-income and credit challenged consumers. Shifting responsibility for cost recovery from base rates to third-party recovery might create an incentive for consumers to use predatory providers for bill payment transiting services rather than using a utility designated pay-station if the fees for using a pay-station are allowed to exceed the cost for transiting services provided by non-authorized third parties such as payday lenders. Currently, Empire has partnered with dozens of entities including banking institutions, local government agencies and businesses throughout its service area to establish a local place where customers can go to pay their Empire Electric bill without having to comparison shop for the lowest fee. A list of local pay-stations is available on the Company website. As part of my review in preparation of this testimony I checked to verify that none of the entities listed on the Company's website appear on the State's list of registered payday lenders. I was however able to verify that there is at least one payday lender offering bill payment transiting services for Empire Electric bills. The payday lender charges $1.50 per bill for 3 day transiting service and $2.50 per bill for next day transiting service.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

2011 FDIC National Survey of Unbanked and Underbanked Households

Executive Summary

Federal Deposit Insurance Corporation

FDIC

September 2012

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Members of the FDIC Unbanked/Underbanked Survey Study Group

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I. Executive Summary

The FDIC is committed to ensuring that all Americans have access to safe, secure, and affordable banking services. Public confidence in the banking system derives in part from how effectively banks serve the needs of the nation's diverse population. To assess the inclusiveness of the banking system, and in response to a statutory mandate, the FDIC conducts biennial surveys of households to estimate the proportion of households that do not fully participate in the banking system.[1] This report presents the results of the 2011 FDIC National Survey of Unbanked and Underbanked Households.

The FDIC partnered with the US Census Bureau to conduct this survey in June 2011, collecting responses from nearly 45,000 households. The FDIC used survey responses to categorize households' banking status as unbanked, underbanked, or fully banked. Unbanked households are those that lack any kind of deposit account at an insured depository institution. Underbanked households hold a bank account, but also rely on alternative financial services (AFS) providers.[2] Fully banked households are those that have a bank account of any kind and have not recently relied on any of the AFS included in the survey.[3]

Key Findings

More than one in four households (28.3 percent) are either unbanked or underbanked, conducting some or all of their financial transactions outside of the mainstream banking system. Many of these households rely on AFS providers, while others use cash or other financial arrangements.

- **8.2 percent of US households are unbanked. This represents 1 in 12 households in the nation, or nearly 10 million in total. Approximately 17 million adults live in unbanked households.[4]**
- **The proportion of unbanked households increased slightly since the first survey. The estimated 0.6 percentage point increase represents an additional 821,000 unbanked households.[5]**
- **20.1 percent of US households are underbanked. This represents one in five households, or 24 million households with 51 million adults.[6] The 2011 underbanked rate in 2011 is higher than the 2009 rate of 18.2 percent, although the proportions are not directly comparable because of differences in the two surveys.[7]**
- **29.3 percent of households do not have a savings account, while about 10 percent do not have a checking account. About two-thirds of households have both checking and savings accounts.**
- **One-quarter of households have used at least one AFS product in the last year, and almost one in ten households have used two or more types of AFS products. In all, 12 percent of households used AFS products in the last 30 days, including four in ten unbanked and underbanked households.**

[1] Section 7 of the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (Pub. L. 109–173) calls for the FDIC to conduct ongoing surveys, "on efforts by insured depository institutions to bring those individuals and families who have rarely, if ever, held a checking account, a savings account or other type of transaction or check cashing account at an insured depository institution ['unbanked'] into the conventional finance system." Section 7 further instructs the FDIC to consider several factors when conducting the surveys, including estimating the size and worth of the unbanked market in the United States and identifying the primary issues that prevent unbanked individuals from establishing conventional accounts.

[2] For the purposes of this report, households are identified as "unbanked" if they answered "no" to the question, "Do you or does anyone in your household currently have a checking or savings account?" Underbanked households are defined as those households that have a checking and/or a savings account and had used non-bank money orders, non-bank check cashing services, non-bank remittances, payday loans, rent-to-own services, pawn shops, or refund anticipation loans (RALs) in the past 12 months.

[3] Fully banked households may have used AFS more than a year ago or may currently use types of AFS not included in this survey. Based on the banking status classification used in this report, fully banked households are the most engaged in the financial mainstream. However, there are still opportunities to improve the quality and sustainability of banking relationships for some of the fully banked households (e.g., expanding the use of savings accounts or bank credit products).

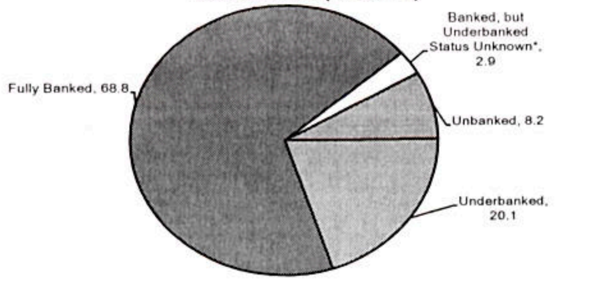
[4] In addition, unbanked adults may also reside in other households. Adults are defined as persons aged 16 and older. This is a lower-bound estimate of the number of unbanked adults in the United States because it is based on the assumption that all adults residing in a "banked" household are banked. A banked household may contain one or more unbanked adults; these unbanked adults residing in banked households are not included in the 17.6 million adults number cited in this report.

[5] All reported differences resulting from direct comparisons described in the text are statistically significant at the 10 percent level, unless otherwise noted.

[6] This is an upper-bound estimate of the total number of underbanked adults in the United States because it is based on the assumption that all adults residing in an underbanked household are underbanked. However, an underbanked household may contain one or more adults who are not underbanked.

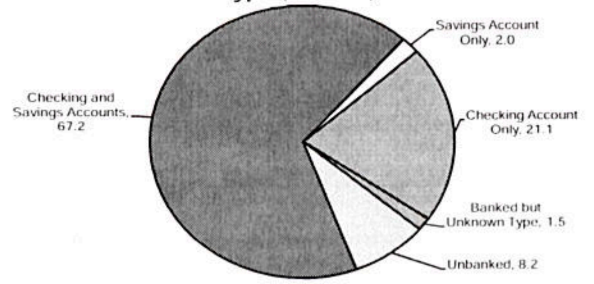
[7] Revisions made to the 2011 survey instrument led to changes in the definition of an underbanked household. Specifically, the inclusion of questions regarding households' use of non-bank remittances in 2011 and changes to the questions regarding the time frames during which households used AFS make it impossible to directly compare underbanked estimates across years.

Figure 1.1 2011 Banking Status of US Households (Percent)



Notes: Percentages are based on 120.4 million US households. Percentages may not sum to 100 because of rounding.
* These households are banked, but there is not enough information to determine if they are underbanked.

Figure 1.2 2011 US Households by Account Type (Percent)



Notes: Percentages are based on 120.4 million US households. Percentages may not sum to 100 because of rounding.

Unbanked and Underbanked Households

Unbanked and underbanked households are not homogeneous populations. On the contrary, these groups have diverse demographic characteristics, past banking experiences, reasons for not holding an account, and future banking plans.

The highest unbanked and underbanked rates are found among non-Asian minorities, lower-income households, younger households, and unemployed households.[8] Close to half of all households in these groups are unbanked or underbanked compared to slightly more than one-quarter of all households. Relative to 2009, the estimated unbanked rates in 2011 are essentially unchanged for most groups.[9]

Table 1.1 Banking Status for Select Demographic Groups

Select Demographic Groups	Percent Unbanked	Percent Underbanked	Percent Fully Banked
All households	8.2	20.1	68.8
Blacks	21.4	33.9	41.6
Foreign-born non-citizens	22.2	28.9	45.8
Households experiencing unemployment	22.5	28.0	47.5
Lower-income households (less than $15,000)	28.2	21.6	47.6
Unmarried female family households*	19.1	29.5	48.4
Hispanics	20.1	28.6	48.7
Households with householders under age 24	17.4	31.0	49.7

* The Census Bureau classifies households into different household types. For example, a family household is a household that includes two or more people related by birth, marriage, or adoption and residing together, along with any unrelated people who may be residing there. Single mothers are an example of female family households. For more detail, refer to the Technical Note (Appendix E).

Comparing the demographic composition of unbanked, underbanked, and fully banked households shows stark differences between these groups. The same demographic groups are generally overrepresented among both unbanked and underbanked households. However, on many measures, such as employment and income, underbanked households are more similar to fully banked households than to unbanked households.

Among unbanked households, slightly more than half have never had a bank account. Relatively high proportions of Hispanic (14.7 percent) and foreign-born noncitizen households (18.9 percent) have never had an account.

The most common reasons why households report they do not have bank accounts are that they feel they do not have enough money for an account, or they do not need or want one. Households that have previously had an account are less likely to report that they do not need or want an account relative to those that have never had one.

Certain segments of the unbanked population are more inclined to open an account. While most unbanked households report that they are not likely to open an account in the future, one-third (33.9 percent) report they are "very likely" or "somewhat likely" to do so. Among unbanked households more likely to want to open a bank account in the future are those that were previously banked or that became unbanked within the last year, as well as those individuals who are younger, unemployed, have some college education, or are in family households headed by an unmarried woman. The likelihood of opening a bank account also increases with AFS use and with the use of a payroll card or a prepaid debit card.

[8] The demographic characteristics of a household, such as race, age, education, and employment, are taken to be those of the owner or renter of the home (i.e., "householder"), unless the characteristic is one defined at the household level, such as income or household type. For convenience, some abbreviated language will be used to refer to the demographic characteristics of households. For example, the term "black household" refers to a household for which the householder has been identified as black. Note that other members of a household could have different characteristics from those of the householder. For instance, an unemployed household is defined as a household whose householder is unemployed, but other household members could be employed and earning income. The income measures included in this report reflect the income earned by all household members and not only the householder.

[9] Reported differences between groups described in the text do not account for other geographic or demographic factors that may also contribute to the disparities.

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Use of Alternative Financial Services and Prepaid Debit Cards

About 25 percent of households, including all underbanked households and 64.9 percent of unbanked households, have used AFS in the last year. The use of both transaction and credit AFS became more widespread between 2009 and 2011, with higher proportions of households reporting having used either product.

AFS transaction products (i.e., non-bank money orders, non-bank check cashing, and non-bank remittances) are considerably more widely used than AFS credit products (i.e., payday loans, pawn shops, rent-to-own stores, and refund anticipation loans). In the last year, 23.3 percent of households used transaction AFS and 6.0 percent used AFS credit product.

The relationship between household banking status and AFS use is complex. A non-trivial share of unbanked households (29.5 percent) do not use any of the AFS providers asked about in the survey, suggesting they rely primarily on cash. However, overall, unbanked households are more active AFS users than underbanked households. Unbanked households are more likely to use multiple products and to have used AFS, particularly transaction products, more recently and more frequently than underbanked households. The use of AFS credit products does not differ markedly between unbanked and underbanked households, except for payday lending, which typically requires a bank account, making it more prevalent among the underbanked.

Unbanked and underbanked households value the convenience of transaction AFS and perceive AFS credit to be easier to obtain than bank credit. The most common reason households use transaction AFS is convenience, while the main reason households use AFS credit products is because they are easier or faster to obtain than bank credit. The main reason many unbanked households use AFS providers for transaction services is because they do not have a bank account. Among underbanked households, the ability to get money faster and the perceived lower cost of non-bank money orders were also common reasons for using AFS providers.

Although not considered AFS in this survey, prepaid debit cards continue to be more widely used among the unbanked and underbanked than among fully banked households. With one in ten households reporting use of a prepaid debit card, overall use of the product appears to be relatively stable from 2009. However, the proportion of unbanked households that have used a prepaid debit card climbed from 12.2 percent to 17.8 percent in 2011, with no significant change among the underbanked.

Implications

The survey results presented in this report suggest four lessons for policymakers, financial institutions, and other stakeholders working to improve access to financial services.

1. Understanding the characteristics of different segments of the unbanked and underbanked populations might increase the efficacy of economic inclusion strategies. Different subgroups among unbanked and underbanked households have different characteristics and varying levels of demand for banking services. Understanding these differences could lead to the development of products and strategies that more effectively engage these households. For example, economic inclusion strategies that target unbanked Hispanic households might consider that this group includes two distinct segments with starkly different financial services behavior. One substantial segment (29.6 percent) of this group does not use any financial services from bank or non-bank providers, while another uses AFS more actively than any other ethnic or racial group: 51.8 percent of unbanked Hispanics used AFS in the last 30 days, including almost a quarter (22.5 percent) who used two or more AFS in that period. In contrast, among other unbanked segments, only about 43 percent of white or black households used AFS in the last 30 days and about 14 percent used two or more in that time frame.

In many cases, underbanked households, and particularly unbanked households, face challenging economic circumstances, such as unemployment. Understanding these families' varying situations could help drive collaborative efforts between financial institutions and public and private entities that serve other needs of this population (e.g., employment or social services agencies).

2. Having a bank account does not guarantee long-term participation in the banking system. Households can and do cycle in and out the banking system over time. For example, nearly half of unbanked households had an account in the past, and nearly half (48.2 percent) of these report that they are likely to join the banking system again in the future. Also, almost a quarter of fully banked households have used AFS in the past and could have been considered underbanked at that time. Economic inclusion efforts require not only banking the unbanked, but also retaining and better engaging current bank customers to prevent them from becoming unbanked or underbanked. The offering of low-cost deposit accounts with transparent fee structures could play an important role in this effort.

3. Households with banking experience appear to have more positive perceptions of having an account and rely less on AFS. Unbanked households that previously had a

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relationship with a financial institution are more likely to see value in having a bank account than unbanked households without this relationship. Previously banked households are more likely to want to open an account in the future and less likely to say that the main reason they are unbanked is because they "do not want or need an account."

In addition, survey results show that households that have an account, particularly a checking account, tend to use transaction AFS less actively than those that do not have a checking account. On average, unbanked households are more active transaction AFS users than the underbanked. Even among underbanked households, those that only have a savings account are more active transaction AFS users than underbanked households that have a checking account.

4. Financial institutions interested in pursuing the market opportunity that AFS users present might need to more clearly demonstrate the value in having a bank account to AFS users who perceive non-bank financial services to be more convenient, faster, less expensive, or to present lower barriers to qualification. For example, banks might find it useful to promote mobile technology to increase convenience, thereby addressing the most commonly reported reason households use non-bank check cashers. In addition, for the notable share of unbanked and underbanked consumers who cited speed as a reason for using non-bank check cashing, efforts toward expediting the availability of deposited funds might make deposit accounts more appealing. Making affordable small-dollar loans available with streamlined but solid underwriting could help attract consumers who currently rely on credit AFS.