

Refining the Definition of the Unbanked¹

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¹ The views presented are the Authors' only and do not represent the views of the Federal Reserve Board or the Federal Reserve System as a whole.

Intro: Financial Inclusion in the US

- 4.5% of Americans are unbanked according to the FDIC Survey of Unbanked and Underbanked households (2023)
 - Higher rates of unbanked households among minorities, and lower-income, disabled, and unemployed individuals
- The unbanked in common discourse is defined as the share of individuals of banking-age population that do not have a bank account, whether or not they want one
- This approach is very different from other economic measures, such as unemployment, where we differentiate those actively looking for a job (the unemployed) from those who aren't (out of the labor force)
 - This paper: Applies the same thought process to the unbanked!

A Thought Process: Defining Populations

- The unbanked in common discourse is defined as the share of individuals of banking-age population that do not have a bank account, whether or not they want one
- Unemployment used to be defined in a similar way but evolved over time (Card 2011)
 - We now define the labor force as those that are employed and those that are unemployed and currently looking for work
 - The unemployed are those in the labor force that do not have a job but are actively looking for one
 - We define the out of the labor force population as those that do not have a job and are *not* looking for one
- This paper: Applies the same thought process to the unbanked!

Literature Review

- Studies that analyze the likelihood of being banked
Goodstein and Kutzbach, 2022; Hayashi and Minhas, 2018; Hogarth and O'Donnell, 1999; Kennickell et al., 2000; Rhyne and Greene, 2006; Rhyne and Greene, 2013; Stegman and Faris, 2005
- Studies that analyze differences within the unbanked population
Barr, 2012; Bogan and Woldfolds, 2022; Hayashi et al., 2024; Hogarth et al., 2004; Rengert and Rhine, 2016; Servon, 2017; Van der Cruijssen et al., 2021

FDIC Survey of Unbanked and Underbanked Households

1. Establish whether the individual has a bank account (Q B20 in 2021 or equivalent question from previous surveys): *Do you (IF OTHERS AGE \geq 15 FILL: or anyone else in your household) have a checking or savings account now?*
2. Infer whether an individual would want a bank account:
 - Use question UB50 in 2021 and 2019 (**interest** in a bank account)
How interested are you (IF OTHERS AGE \geq 15 FILL: or anyone in your household) in having a bank account?
 - Use question 7 in 2017 and earlier (**likelihood** of opening a bank account)
How likely is it that you (if OTHERS AGE \geq 15 FILL: or anyone in your household) will open a checking or savings account within the next 12 months?
3. Understand why an individual does not have a bank account (Q UB60 in 2021 or equivalent question from previous surveys): *What is the main reason why no one in your household has an account?*

Data

- We define those that would want a bank account as those that are “very interested” or “somewhat interested” in a bank account in 2021/2019 and as those that are “very likely” or “somewhat likely” to open a bank account in 2017 and earlier years
- We focus on the unbanked here, but a similar thought process can be applied to the underbanked (data here is very limited)

Banking Population Participation Rate

$$\frac{\text{Banked} + \text{Not currently banked that are interested in a bank account}}{\text{Population of banking age } (\geq 15 \text{ years})}$$

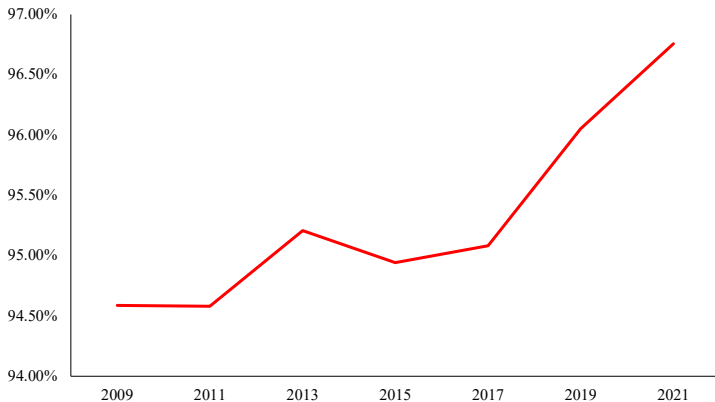


Figure: Banking Population Participation Rate

Redefined Unbanked Rate

Not currently banked that are interested in a bank account
Banking population

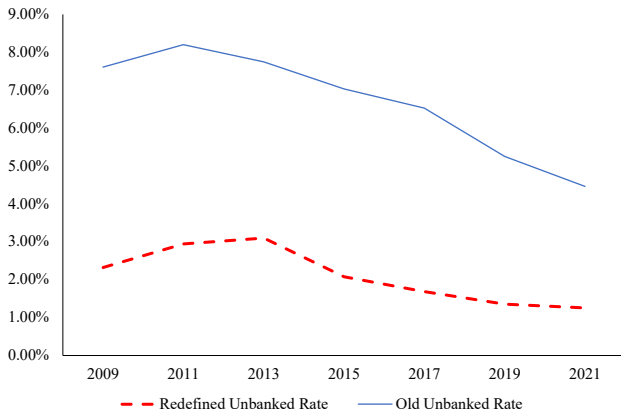


Figure: The Unbanked Rate

Out of Banking Population

Not currently banked that are **not** interested in a bank account
Population of banking age (≥ 15 years)

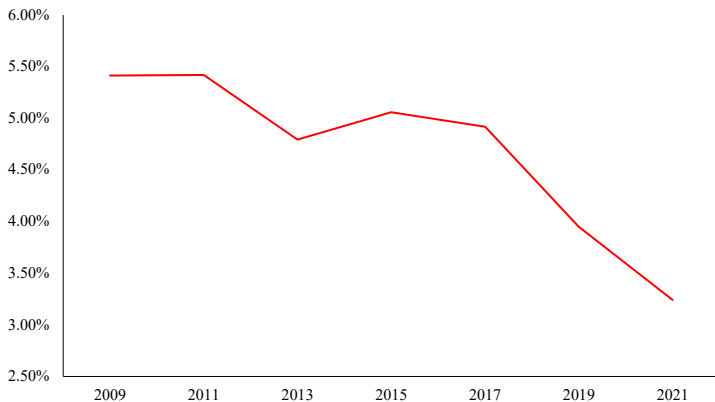


Figure: The Out of Banking Population Rate

Some Equalities

Banking Population =

Banked + Not currently banked that are interested in a bank account

Banking Population + Out of Banking Population = Population of Banking Age

Banking Population Participation Rate + Out of Banking Population Rate = 100%

Main Reasons for Not Being Banked in the FDIC Survey

- Question UB55 in 2021 or equivalent question from previous surveys asks households to specify what reasons play a role in them not having a checking or savings account
- Question UB60 in 2021 or equivalent question from previous surveys then asks the households to specify the main reason that they do not have a bank account out of those selected in UB55: *What is the main reason why no one in your household has an account?*
- Respondents to the FDIC survey have the option to not indicate a reason or report that their reason is not listed
 - To accurately compare data across years, we calculate the shares of individuals reporting a particular reason out of all the respondents that chose a reason from the listed ones

Main Reasons for Not Being Banked in the FDIC Survey

The specific reasons listed and asked have changed over time:

- In 2011: *Previously had an account but the bank closed it; **Can't open an account due to ID, credit, or banking history problems**; Banks do not have convenient hours or locations; **Bank account fees or minimum balance requirements are too high**; Banks do not offer the needed products or services; **Don't like dealing with and/or don't trust banks**; Do not have enough money; Do not know how to open or manage an account; Do not need or want an account*
- In 2021: *Bank locations are inconvenient; **Bank account fees are too high**; Bank account fees are too unpredictable; Banks do not offer products and services you need; **Don't trust banks**; **Don't have enough money to meet minimum balance requirements**; Avoiding a bank gives more privacy; **Don't have the personal identification required to open an account**; **Cannot open an account due to problems with past banking or credit history***

Main Reasons for Not Being Banked

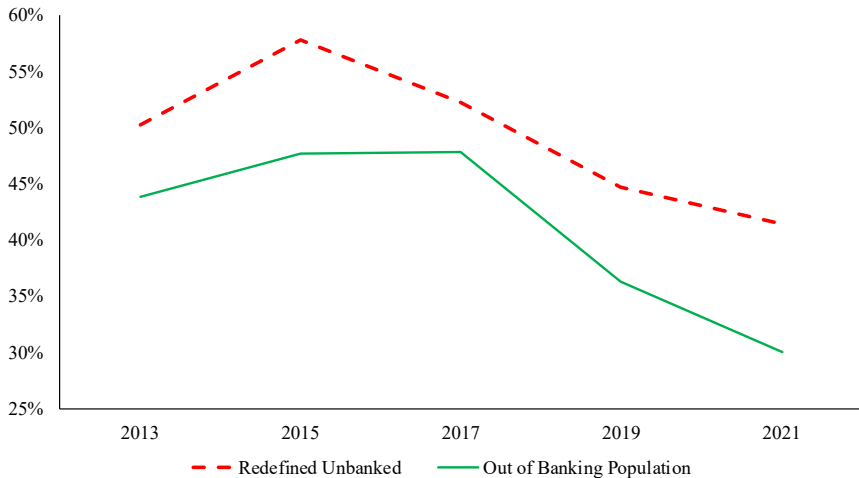


Figure: Main Reason: Minimum Balance Requirements

Main Reasons for Not Being Banked

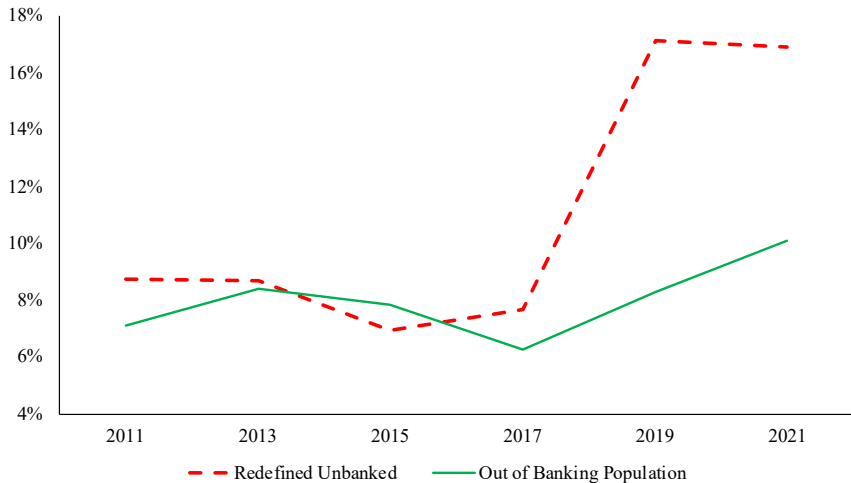


Figure: Main Reason: ID, Credit, or Banking History Problems

Main Reasons for Not Being Banked



Figure: Main Reason: Lack of Trust in Banks

Discussion

- The unbanked as defined here tend to consistently report reasons associated with financial constraints, such as minimum balance requirements, and past credit and banking history problems
 - Some of these problems may be associated with the widespread use of *ChexSystems*, which makes it more difficult for an individual that was subject to an involuntary account closure to open a new account
- The out of banking population reports issues of trust increasingly more—the majority of them reports lack of trust in the financial system as a reason not to be banked
 - Privacy concerns are often mentioned together with trust, but not always
 - Interest in bank account inversely related to reported trust in financial system

Movements in the Banking Population

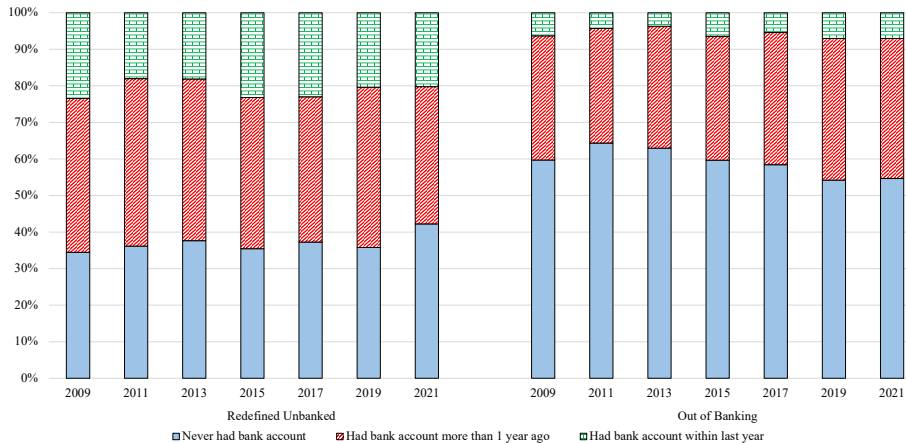


Figure: Previously Banked: Unbanked vs. Out of Banking Population

Improving Measures

- All available data is a repeated cross-section → panel data would allow us to follow individuals' choices over time and their response to policies
- Questions aimed at identifying whether an individual is actively trying to be banked would improve our statistics → “interest” and “likelihood” are subjective, and some of the reasons specified may be based on beliefs or constraints applicable to a specific point in time
- Questions aimed at understanding the reasons underlying the increasing mistrust toward banks is crucial to design policies effectively
 - *RAND California Survey of Household Finance* provides additional details on why a sample of Californians are unbanked

Why Do We Care?

- Not all people without a bank account actually want to have one
 - Policymakers care about financial inclusion but failure to internalize these preferences might not lead to optimal policy design
- Individuals without a bank account that report a higher interest in having one (the unbanked, 1.3%) tend to cite finances or past credit/banking history problems as reasons for not being banked
 - Focused policies on these aspects may be fairly successful
- Individuals without a bank account that report low or no interest in having one (the out of banking population, 3.2%) tend to cite lack of trust in banks as a reason for not being banked
 - The seemingly-growing lack of trust in the financial system suggests that a more structural intervention may be needed, with the goal of understanding and tackling the sources of this lack of trust
 - Domestic and international efforts often focus on creating banking products that feature the characteristics of alternative products used by this population (think: crypto and privacy), but a mistrust toward banks may make these individuals less interested in any products within the traditional banking system

The Underbanked

- A similar thought process could be applied to the definition of the underbanked
 - The FDIC defines an underbanked household as one that has a bank account but also uses nonbank financial products or services (independently of how often these are used): Money orders, check cashing, international remittances, rent-to-own services, payday loans, pawn shop loans, tax refund anticipation loans, and auto title loans
 - These questions may capture fully-banked individuals that happened to use a nonbank service (even just once) for other reasons—for example, you might need a post office money order to renew an international passport, even if you have all other banking services available and you prefer them
- If we look at how the labor literature defines the underemployed, they define this population as those part-time workers that would like to work more than part-time but are unable to work more

The Underbanked

- Under the new definition, the idea would be to clearly separate out those in the banking population that:
 - Actively seek and would want another service (say, a loan) **but**
 - Cannot obtain that service at a bank and therefore need to rely on nonbank services

- With the current data, this estimate would be relying on a number of assumptions
 - We would have to determine which nonbank services are better representative of that population (thoughts: payday loans, pawn shop loans, tax refund anticipation loans, and auto title loans)
 - We would have to assume that this population would seek and prefer an equivalent banking service but cannot obtain it
 - Takeaway is that more data collection efforts would be extremely useful here

Conclusion

Comments welcome on everything!

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