



ACCOUNTANTS, CONSULTANTS, & BUSINESS VALUATORS

CHECK CASHING
AN INDUSTRY STUDY

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Notice & Disclaimer

In a forensic accounting setting, the purpose of an industry analysis is to allow a comparison of the subject company to its industry. This comparison is vital to assess the strengths and weaknesses of the subject company, as well as its industry and company specific risks.

The following study contains a brief, selected analysis of the specified industry. It is based upon a review of current economic statistics, articles in the financial press, reviews found in current business periodicals and information posted on numerous internet sites. It does not purport to be all-inclusive or to contain all of the information which a prospective investor or lender may require. Projections and opinions are based upon information provided by third parties. We make no representations or assurances that this information is complete or accurate. Neither Mark S. Gottlieb, CPA, PC nor any of its officers, employees, or representatives make any representation as to the accuracy of completeness of this report or its contents, nor shall any of the foregoing have any liability resulting from the use of the information contained herein or otherwise supplied.

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Industry Overview

Check-cashing organizations (CCOs) are small organizations that cash checks for a fixed fee. There are an estimated 13,000 check-cashing outlets in the U.S., cashing more than \$80 billion worth of checks annually. Some 80 to 90 percent of these are payroll checks with an average size of \$500 to \$600. The remainder are largely government benefits, income-tax-refund, and personal checks. While fees vary by state and by store, Financial Service Centers of America (FISCA), an industry trade group representing CCOs and payday lenders, estimates national annual check cashing revenues at over \$1.6 billion.

In addition to check cashing, CCOs may also provide a wide array of secondary services, the most prominent of which is the issuance of payday cash advances, or small-denomination, unsecured loans. These loans are typically due on the customer's next payday. In providing this service, CCOs compete with "payday advance centers," an offshoot of the CCO industry.

CCOs may be small, independent businesses, or large, expansive chains. Some of the largest CCOs choose to franchise their numerous outlets, while others do not. ACE Cash Express, Inc., the nation's largest check casher, claims 1,230 stores in 37 states and the District of Columbia; of these, 1,026 are company-owned and 204 are franchised. Ace Cash Express claims over \$250 million in annual revenues. Other large industry players are Cash America International, Inc. and Ezcop, Inc.

Clientele

Over 30 million people cash checks annually at CCOs, and 180 million checks are processed annually. These services are provided primarily to lower- and middle-income working individuals. CCOs do not require that a customer have an account to cash a check. Customers are typically blue- and white-collar workers involved in retail and service industries such as restaurants, hotels, auto repair, landscaping, daycare and line manufacturing. Many of these customers are also:

- Younger than the general population
- Regularly in need of financial services after normal banking hours
- Living from paycheck to paycheck

There are several reasons people use check cashers. Waiting a week or more for a check to clear the banking system is not an option for many CCO customers, as these individuals are living day-to-day with regard to finances. Also, the account balances of many people are so small after basic living expenses that little remains after the second week of the month. Further, many individuals live in a cash economy, where businesses supplying food, clothing, and other necessities view checks skeptically, and generally will not accept them. Finally, many individuals simply do not trust banks. They are reluctant to write checks for fear of bounced-check fees from these as well as merchants.



While some individuals utilizing cash-checking services hold bank accounts, most do not. According to the Federal Reserve Board's Survey of Consumer Finances, nearly 13 percent of families in the U.S. do not keep a checking account. The survey also indicated that the majority of these consumers are "un-banked" by choice. A disproportionate number of the un-banked are ethnic minorities.

These un-banked millions often must rely on alternative ways to carry out basic financial transactions, such as cashing payroll checks and paying bills. Currently, the average un-banked individual spends 10 percent of their net income on alternative financial services. Because of this, and especially due to the aforementioned payday cash advance services, CCOs are controversial service providers in the banking industries sector. They operate under significant public and legislative scrutiny.

Operations

The check cashing industry provides a wide range of services, many of which are not offered by banks or other financial institutions. These services include, but are not limited to:

- Cashing of checks: payroll, personal and government-issued
- Cashing of insurance drafts
- Money order issuance
- Wire transfers
- Utility bill payment
- Municipal services, e.g.: public transportation fares, distribution of license plates and motor vehicle titles, postage
- Public Assistance benefits and food stamp distribution
- Payday advance
- Sale of lottery tickets
- Other retail financial and transaction processing services

Smaller CCOs—generally owned and operated by local residents with 1 to 10 stores—tend to provide fewer services than larger companies. Many CCOs began expanding services rapidly following the highly profitable introduction of payday advance loans in the early 1990s.

Payday Advance Loans

Customers choose payday advance loans to cover small expenses and avoid costly bounced-check fees or late payment penalties, and other less desirable short-term credit options. A customer with an active checking account and a regular income simply: reads and signs an agreement that discloses transaction terms; writes a post-dated personal check for the advance amount plus a fee; and immediately receives the advance in the value of the check minus the fee. The customer's check is held for an agreed-upon period, usually about two



weeks. At the end of that period, either the check is deposited or the customer returns with cash to reclaim the check.

Industry analysts estimate that CCOs and payday advance locations across America extend about \$25 billion in short-term credit to millions of lower- and middle-class households annually. These households typically experience cash-flow shortfalls between paydays, and most are repeat users of payday advance loans. The extraordinary commercial success of this service grew out of robust customer demand, due to the following changing conditions in the financial services marketplace:

- Traditional financial institutions began exiting the small-denomination, short-term credit market, largely due to its high cost structure
- The cost of bounced check fees, late payment penalties and other short-term credit products soared
- Legislation was enacted providing regulations and consumer protections for payday advance customers

The payday advance loan was a service originally extended by businesses independent of CCOs, and many payday advance centers have sprung up in the last decade, aiming to take a bite out of the check cashing industry. CCOs quickly adapted, however, and have been emphasizing this branch of highly profitable services. According to the Consumer Federation of America (CFA), check cashing and payday loan outfits combined charge annual interest rates from 261 percent to 913 percent to advance cash for two weeks on post-dated personal checks.

Lending Rates and Risk

While CCOs do not make their criteria for determining prices public, rates are carefully monitored and fluctuate constantly. Most CCOs attempt to mitigate risk by way of basic loan collateral, and by high markup in check-cashing prices. Industry analysts speculate that the socialization of losses among borrowers is another basic industry risk engaged by CCOs.

Advertising

Some CCOs advertise in local media, such as newspapers, television and radio. Because CCOs provide a basic service to customers with few financial options, however, many companies spend little on advertising. Figures on advertising in the industry are not readily available, though lately advertising has been on the rise due to increased competition for services from banks and convenience stores.

Competition & Challenges

Banks and Convenience Stores — A growing number of mainstream financial institutions have begun encroaching on the traditional turf of CCOs. Many banks now serve



“high-risk” consumers through affiliates. Citigroup (the largest U.S.-based bank holding company) acquired Washington Mutual Finance in 2003, giving it 400 “subprime lending offices” in 25 states. Through its subprime flagship, CitiFinancial, Citigroup engages in subprime lending, and is now America’s largest subprime lender, with more than \$16 billion in outstanding loans.

Many banks refuse to provide financial services to the check-cashing industry, claiming corporate social responsibility. However, bank charges of \$4-8 for check-cashing services are common, which is the same as, if not more than, what many CCOs charge. In response, FISCA has lobbied extensively against bank acquisitions of lending offices, with moderate success.

The growing trend of banks owning check cashing outlets and establishing themselves in retail grocery stores has revolutionized check cashing, merging services in a once basic industry. Although the cost per transaction may be higher to consumers at such outlets, the consumer is also exposed to a greater variety of products and services than with a traditional CCO. This is seen as a distinct advantage for banks.

Interestingly, larger CCOs have enjoyed success in forming relationships with banks since the turn of the 21st century. ACE Cash Express, Inc., for example, has entered into agreements with Wells Fargo and JP Morgan Chase Bank to acquire capital for its acquisitions and other organizational activities. Smaller CCOs have had little opportunity in this regard.

Convenience stores are another source of competition for CCOs. For example, 7-Eleven has enjoyed recent success with cash checking services. In its pilot program, the store offered check cashing membership enrollment, with much success. 7-11 promotes this service through advertising, in-store signs and special events, all of these aimed at consumers who regularly patronize CCOs.

In response to stiff competition from convenience stores, many CCOs have begun co-branding with their newest competitors. Mainstream co-branding techniques have allowed for a proliferation of this strategy, and have promoted consolidation within the industry. Attractive logos and signage, uncluttered visual impact zones, and most of all, the desire of convenience stores and CCOs to expand market reach, have fueled this trend.

Direct Deposit — Direct deposit poses a major threat to the check cashing industry. CCOs have experienced a dramatic decrease in their government benefit check cashing business as states have opted for Electronic Benefit Transfer (EBT) accounts and direct deposits. The issuing of public assistance, disability, and other government checks on paper has all but ceased in some parts of the U.S. This saves the government a substantial amount of money without addressing the need of low-income customers for real banking services. Government estimates state that if all the remaining “Social Security and SSI beneficiaries who currently receive a check signed up for direct deposit, it would save the government \$5 million a



month.” Direct deposit also saves the private sector a considerable amount; estimated annual savings for a company with 100 employees are \$5,796.

Direct deposit provides customers with immediate access to funds, eliminating any wait for a check to clear, and thereby eliminating the primary service of CCOs. As direct deposit has become prevalent, some CCOs and banks have contracted with counties to receive the direct deposit of government assistance checks. Corus Bank in Chicago has developed a program in conjunction with check cashers to handle the electronic receipt of government benefit checks, charging recipients \$6.50 a month to access these funds. Los Angeles County has also initiated a program wherein public assistance benefits are no longer issued by check but must be collected at the local CCO.

Government Involvement

To the check cashing industry’s credit, many associations within the industry have a history of considering and instating regulatory controls. FISCA has created a national code of conduct specifying ethical standards for the industry, and currently boasts over 3,500 charter members. The CCANY (Check Cashing Association of New York) proposes and enacts legislation and legislative activities affecting the check cashing industry.

Regarding payday loans, it should be noted that many states have laws on the books capping interest on short-term loans at certain APR, usually from 20 percent to 50 percent. New York, New Jersey and several other states have laws on the books that ban payday loaning all together, limiting the scope of services for many CCOs. The practice of importing interest rates from other states under the National Bank Act, however, makes it difficult for states to enforce laws banning payday lending, or mitigating its ill effects.

The Treasury Department has proposed that CCOs, along with sellers of money orders and traveler’s checks, money transmitters, and currency exchange firms, be required to register with a particular agency. This follows with the requirements of certain states that all CCOs attain licensure. While most of the check cashing industry supports new regulations, many believe that some of the new proposals are too stringent. Currently, only eighteen states regulate check cashers and only twelve set limits on the fees the check cashing businesses are allowed to charge for services.

Industry Outlook

The outlook for the check cashing industry is positive with respect to continued growth. The greatest growth is expected to come from the suburban market, though this should vary by county and by state. Growth will be achieved through a continuation of marketing via a variety of advertising vehicles, and CCOs are expected to continue beyond simple marketing, embracing the concept and value of branding. Consolidation should follow.



Whereas ten years ago the delineation between banks, CCOs and other financial service providers was very distinct, the lines between them have grown blurry and will continue to fade. The eagerness of grocers and large chain stores like Wal-mart to enter into the check cashing industry should galvanize competition even further, emphasizing the new model of multiple services within CCOs. Because the industry has proven itself adaptable regarding legislation and the changing roles of banks and other competitors, industry growth should continue in order to meet the rising demands of a population dependent on its services.

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Every client obtains the personal involvement of a team of experienced professionals. Engagements are carefully planned and reviewed to ensure that they proceed in a timely and professional manner.

There are many important considerations involved in choosing a financial service provider including the quality of the business relationship. Since most of our engagements entail great emotion and significant financial consequences, we are sensitive to these issues and make every effort to treat our clients with the highest degree of care and respect.

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We are frequently appointed as a neutral expert by the court. This honor is not taken lightly, or without the burden to perform at each stage of the engagement.

We welcome the opportunity to be of service to you.

BUSINESS VALUATION SERVICES

How much is that business worth? The answer to this question may have a variety of consequences. Businesses are frequently valued in divorce cases, business disputes, tax matters, and a variety of other legal and business contexts.

Our expertise in accounting, taxation and economics provides our clients with business strategies and solutions that work. There is no cookie-cutter approach here. Our clients depend on our comprehensive knowledge of valuation theory; our ability to focus on industry specific valuation drivers; and to understand the financial performance of the subject company.

Regardless of your need, when the valuation of business is an issue, we can provide an independent, knowledgeable, and credible valuation to withstand the scrutiny of the taxing authority, the courts, and others.

We regularly provided valuation services for the following situations:

- Allocation of Purchase Price
- Bankruptcy and Reorganization
- Buy-Sell Agreements
- Charitable Gift Planning
- Divorce
- Economic Damage Calculations
- Gift and Estate Tax Planning
- Insurance Claims
- Mergers and Acquisitions
- Pursuing and/or Defending Litigation
- Shareholder Disputes...and more

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While we are often retained to prepare a full written report, we also prepare modified reports for business transactions and litigation matters.

For matrimonial matters we also perform the Enhanced Earnings Capacity Calculation of an individual's license, degree, or specialized training.

LITIGATION SUPPORT

When faced with a myriad of challenges in preparing a case, you may need to address financial, tax, and accounting issues. Proper guidance in these areas is critical to presenting your point of view. We can help you identify these issues and enhance your ability to use them in a prudent and strategic manner.

From sorting through cumbersome data, to analyzing significant financial and tax ramifications, our efforts will enable you to organize and quantify pertinent financial information. Litigation support from an experienced firm is not only important, but often essential to the service you provide your clients.

Input from MSG CPA's allows attorneys and their clients to address issues before they become obstacles and to present them in a clear, organized and accurate manner. If necessary, we also provide expert witness testimony.

Our efforts before trial are often as important as during the trial itself. We often assist in the discovery process by developing document requests, helping prepare interrogatories, conduct interviews, assist in pre-trial depositions, and review and critique opposing counsel's financial expert reports.

FORENSIC ACCOUNTING INVESTIGATIONS

Mark Twain once said, "There are two times when you should not speculate-when you can afford it, and when you can't."

The goal of a forensic engagement is to prepare an analysis to eliminate the need to speculate. We roll up our sleeves and dig a deep to disclose the less obvious. Taking on the roles of forensic auditors and investigators, we decipher and uncover those transactions and personnel activities that may have intentionally or unintentionally adversely affected an individual, business or organization.

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In divorce cases, attorneys commonly turn to us to provide forensic accounting services. These services assist in identifying missing assets, transfers of funds, underreporting of sales & income, and search for dissipation of marital assets.

In other matters, we follow and investigate the trail of those suspected of committing fraud and other criminal acts; such as discovering hidden assets, fraudulent conveyances, embezzlement, etc.

The role of our forensic team varies by project, circumstance and purpose. These matters may include investigating business transactions, tax investigations, economic crime investigations, civil litigation support, specialized audits, and even terrorist investigations.

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There may be times when you are presented with a set of books or records that make no sense at all. There may also be instances when no records exist. These circumstances often require the reconstruction of a business's or individual's accounting records.

Record reconstruction may be required to prepare financial statements, tax returns, court exhibits, or insurance reimbursement. The need for record reconstruction sometimes stems from tragedy, but is more often an indication of neglect, or of more serious concerns.

Depending upon the engagement, record reconstruction may be used to facilitate other forensic work, such as, bank deposit analysis, receipts and expenditure analysis, or net worth reconstruction. A complex undertaking, record reconstruction is just one of the many areas of expertise maintained by our firm.

