

Testimony before the Committee on Government Reform and Oversight
Subcommittee on Government Management, Information and Technology
regarding the

Impact of P.L. 104-134 ("EFT-99") On the Poor, the Elderly and the "Unbanked"

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Consumer Federation of America, National Coalition of Community
Reinvestment Coalitions, and Organization For A New Equality

Mr. Chairman and Members of the Committee, the National Consumer Law Center⁽¹⁾ thanks you for inviting us to testify today regarding the implications of EFT-99 to the unbanked recipients of federal payments. We offer our testimony here today on behalf of our low income clients, as well as the Consumer Federation of America,⁽³⁾ the National Community Reinvestment Coalition,⁽⁴⁾ and the Organization for A New Equality.⁽⁵⁾ This is an issue in which we are all vitally interested. There is significant potential for negative impact on low income elderly and disabled people throughout the U.S. which would result from the improper implementation of the new law.

There are numerous issues which will affect the unbanked recipients of federal benefits. One is the extent to which Treasury forces the "unbanked" to use accounts which cost them too much money to access. Another, just as important issue is *which kind of institution - regulated and insured, or unregulated* - Treasury authorizes to be the providers of the federal payments to federal payees. This issue is important, not only because of the fees which would be charged by the alternative financial providers, but because of all of the *other* services that these providers would market to the poor. A third issue is how Treasury defines the "hardship" exemption under the statute. If defined appropriately, those federal recipients who cannot find appropriately priced accounts would be allowed to continue receiving paper checks. (Criteria included in the hardship standard should also include reasonable and safe access and consideration of disabilities).

The crux of the problem here is that Treasury says that the banks don't want the accounts of the "unbanked" and that the only way to convince the banks to provide these services is to allow them to charge fees for the services. In fact, it is too early to know the answer. Treasury does not know how much it will cost to provide these accounts. Treasury does not know how much benefit the banks may derive from providing these accounts - in terms of float on the funds in the accounts, and sale of other banking services to these new customers. There is considerable confusion over the reasons why there are so many people outside the banking system in the U.S.⁽⁶⁾ The

significant discrepancies in the information currently available is a clear indication that more information should be gathered before drastic and expensive changes in the delivery system for federal payments are made.⁽⁷⁾

While banks are publically hesitating to embrace the unbanked as a new source of customers, other financial providers -- such as check cashers and finance companies -- are chafing at the bit to be allowed to dispense these services. *However, consumer and community advocates are united in their belief that allowing alternative financial providers to be the conduits for federal payments will be expensive and harmful to federal recipients and their communities.* It is the task of Treasury, and of Congress, to figure out how to deliver federal benefits to the unbanked in the United States so as to *improve* the lives of the recipients, not make them harder.

Treasury has estimated that it will save approximately one hundred million dollars per year by the electronic deposit of all federal funds.⁽⁸⁾ Most of these savings will flow from the direct deposit of federal payments into existing bank accounts. EFT-99 (as Treasury has dubbed the requirements of P.S. 104-134) offers significant opportunities to bring low income people into the mainstream banking system. Consumer and community advocates welcome this chance to facilitate the relationship between the poor and the banks. Savings efforts would be fostered and loan terms improved. Credit provided by banks is generally on much more reasonable terms than that provided by alternative financial providers - fringe bankers. However, these new relationships between banks and low income federal recipients should not cost too much; nor should they be cause of further problems in the low income community. Treasury should use some of the initial savings realized from the electronic deposits to encourage and pay for the initial establishment of truly low cost accounts for the "unbanked."

The balance of this testimony will be in four parts:

- 1) The financial burden of ATM and POS fees on low income elderly and disabled federal recipients.
- 2) The importance to *individuals and low-income communities* of ensuring that alternative financial providers are not the conduits of payments to federal recipients.
- 3) The appropriate definition for the "Hardship" exemption under the statute which would allow a waiver of the requirement for electronic deposit. "Hardship" should include those individuals who do not have access to accounts at financial institutions with a reasonable fee structure, reasonable means of access and other basic terms. "Hardship" should also include recipients' mental or physical disabilities which prevent the feasible access to their funds, as well as recipients who are unable for a variety of other reasons to use electronic banking.

4) Recommendations for Congressional action to deal with these concerns.

Part 1

The Financial Burden of ATM and POS Fees on Low Income Elderly and Disabled Federal Recipients.

There are potentially three types of fees that could be charged federal recipients of electronic payments: (1) a monthly service charge by the assigned bank; (2) a charge from the assigned bank for accessing their benefits; and (3) a surcharge fee if they go to another bank's ATM. However, this is not the limit on all of the types of fees that could be charged. As the amount of most federal payments are not in neat \$5 or \$10 increments, such that ATM machines would be able to dispense the entire monthly allotment in one withdrawal, at least some POS (point of sale) device withdrawals will also be required. Although, currently few retailers impose POS access fees, there is nothing to prohibit the imposition of such fees when POS usage becomes more widespread.

Further, because of the interest income that banks can make on the federal payment held in the accounts, it would make business sense for institutions to encourage *more* withdrawals during the month, rather than fewer - thus rewarding recipients for leaving some funds in the account (and encouraging recipients in their savings' efforts). Also, it is likely that the unbanked will recognize the safety and convenience of leaving funds in the accounts, for gradual withdrawal as need arises during the month. So, it is not unreasonable to imagine a scenario in which the following, seemingly reasonable, incremental fees would be charged to a federal recipient in one of these accounts:⁽⁹⁾

Monthly service charge by the assigned bank -- \$3.50

Charge from the assigned bank for accessing benefits (\$1.00 x 3)⁽¹⁰⁾ -- 3.00

Surcharge fee for use of *another* bank's ATM (\$1.50 x 2)⁽¹¹⁾ -- 3.00

POS fees (\$1.50 x 3) -- 4.50

TOTAL monthly expenditure accessing federal payments -- \$14.00

Now, consider the burden this amount imposes on an elderly or disabled individual⁽¹²⁾ subsisting entirely on Supplemental Security Income (SSI).⁽¹³⁾ Currently the federal payment to an SSI recipient living alone is \$484 a month.⁽¹⁴⁾ This means that this low income federal recipient would spend 2.9% of their income every month just accessing the federal payment to which they are by law entitled. The burden could easily be more, as the

incremental fees used in this example are each fairly low.

Some may say that these charges are not excessive when compared to the amounts that many of the unbanked currently pay to have their federal payments cashed. Indeed if the unbanked recipient is now using a check cashier on a regular basis, it is likely that a single transaction of cashing the federal check would be in excess of these \$14 monthly fees.⁽¹⁵⁾ And, it must be recognized that the individual who uses the ATM card to withdraw funds in increments during the month enjoys additional safety and convenience features that are not available when a check cashier is used. However, it is *not* reasonable to assume that all unbanked recipients of federal payments use check cashers to cash their federal checks. It is much more likely that the majority of these unbanked use one of the following *no cost* alternatives:

- cash their check at a bank at which they do not have an account;
- cash their check at a grocery store or other neighborhood store;
- deposit their check in a relative's account;
- have a relative cash their check for them.

In fact, a recent Treasury survey on the characteristics of Federal Benefit Check Recipients,⁽¹⁶⁾ found that 58% of federal benefit recipients without a bank account nonetheless have their federal checks cashed at a bank, 25% use a grocery store or other retailer for check cashing purposes, and a mere 8% of unbanked federal recipients regularly used check cashing outlets.⁽¹⁷⁾

The impact of the *combination* of numerous fees imposed to access electronically deposited federal payments on low income recipients will be equivalent to a reduction of their federal entitlement. Those in poverty will suffer. This potential financial burden on America's poorest underscores the importance of Congress and Treasury' ensuring that the actual fees charged - if any - are appropriate and truly necessary.

Part 2

The Importance to Individuals and Low and Moderate Income Communities of Ensuring That Alternative Financial Providers Are Not the Conduits of Payments to Federal Recipients.

Treasury is contemplating allowing providers of financial services other than regulated depository institutions to be conduits of federal benefits. Such a result would be terrible for low income recipients of federal payments and their communities. If alternative providers of financial services are permitted to be conduits of federal payments, that would constitute the federal government's blessing of grossly abusive practices against low-income and elderly people. Moreover, it would actually force the unbanked into relationships with these unregulated financial providers that to date they

have generally been able to avoid. As the Treasury's own study indicates, the overwhelming majority of the unbanked federal recipients cash their federal checks at banks or stores,⁽¹⁸⁾ generally --if not always -- without any fees being paid to access their federal money whatsoever.

Treasury could allow alternative providers of financial services to be the conduits in two ways: 1) The term "authorized agent"⁽¹⁹⁾ in the statute could be interpreted to allow an alternative financial provider to be designated the recipient of federal payments instead of a financial institution (defined by Treasury to be a bank, savings institution or credit union)⁽²⁰⁾; or 2) Treasury could permit financial institutions to contract with alternative providers as its delivery mechanism for EFT payments to the otherwise "unbanked."

Fringe bankers, such as check cashers, finance companies, and others, do business in the low income community because of the large profits that they can make. Expensive services, extraordinarily high fees, and abusive transaction terms are standard business practices for these alternative providers. They have succeeded because of the vacuum created by the absence of banks from these communities. These fringe bankers make no reinvestment of their substantial profits back into the communities. They charge as much for financial services as the regulatory structure - or lack of regulation - allows. And the low income residents of the community gain little benefit other than the specific service provided from their presence. If this non-regulated industry - which continues without CRA obligations - is allowed to be the conduit of federal payments, the financial problems in the low income communities will not only continue to be ignored, they will be exacerbated.

Treasury's use of alternative financial providers as conduits for the federal payments will be the U.S. imprimatur on the unregulated activities of these alternative providers. The government will be saying, in effect, that the federally insured and regulated banking system is only for those who can afford it. The poor would be required by the government to use alternative, unregulated providers with none of the benefits and protections furnished to consumers in the financial mainstream. Such a result should not be the consequence of this legislation.

Consumer and community advocates fear the use of alternative financial providers as conduits largely because of the *other* services that will undoubtedly be sold to the recipients. If recipients must go through the doors of the fringe bankers at least one time each month, it is very likely that they will fall prey to the expensive -- and unregulated -- other financial products of these fringe bankers, such as check cashing,⁽²¹⁾ payday loans,⁽²²⁾ high cost home equity loans, even rent-to-own transactions. While recipients may always be able to opt for these services if they care to, they should not be required to go through the doors of these alternative providers every single month in order to obtain their federal entitlement.

Treasury's use of "authorized agents" as alternative conduits of federal payments should be limited to those individuals and entities who have a fiduciary duty to the recipient. The words "other authorized agents" in the new law are only intended to apply to the types of recognized surrogates that are currently used as intermediaries for the receipt of benefits through the various federal programs, when the actual recipient cannot, for some reason, be the original designee of the federal payment. For example, the Social Security Act uses the term "representative payee," various Veterans programs use the term "fiduciary agent;" and other federal payees may use guardians or attorneys in fact. The new statute simply uses the term "other authorized agent" as a pseudonym for all of these terms, as it would have been illogical to attempt to separately identify every type of individual agent currently used under both federal and state law as an intermediary for the receipt of federal payments. However, the consistent aspect among all of the types of agents currently recognized by state or federal law is the fiduciary duty that is owed to the recipient. *Treasury should not go beyond this by allowing agents to be conduits of federal payments who do not have a fiduciary duty to the recipients.*

Very Limited Regulation on Check Cashers. Check cashers are NOT the appropriate alternative to banks to provide access to federal payments for the "unbanked." In only eleven states, plus the District of Columbia, are there even limits on the amounts that check cashers can charge to cash government checks. Examples of caps on check cashing fees in the few states that have limits are:

California: 3 to 3.5% for government and payroll checks, depending upon identification.

Connecticut: 1% for state welfare checks, 2% for others.

Delaware: 2% or \$4, whichever is larger, for all checks.

D.C.: 1% or 50 cents whichever is greater.

Georgia: The larger of \$5 or 3% for welfare checks, 5% for payroll checks, and 10% for personal checks.

Illinois: 1.4% to 1.85% plus an additional 90-cent-per-check charge.

Indiana: \$5.00 or 10% of the face amount of the check, whichever is greater.

Minnesota: 2.5% of welfare checks over \$500 (5% for the first check), 3% of other government and payroll checks (6% for the first check); no limit on personal checks (but rates must be filed and "reasonable").

New Jersey: 1% on New Jersey checks, 1.5% on others, or \$.50, whichever is larger.

New York: 1.1% of the face amount or \$.60, whichever is larger.

Ohio: 3% on government checks.

Rhode Island: The larger of \$5 or 3% for welfare checks, 5% for payroll checks.

While some of these fee ceilings may themselves seem high, in the rest of the 38 states, there are no limits whatsoever on these fringe bankers.

For once, let us learn from experience. The experience in the low-income communities around the nation is that fringe bankers have developed sophisticated and ingenious techniques for taking money from the poor. Fringe bankers--check cashers, finance companies, and others--should not be provided a government boost to their business by serving either as "other authorized agents," or contractors with financial institutions for the delivery of federal payments. Commercial banks, savings banks, credit unions, and possibly the U.S. Postal Service, should be the only designees for receipt of electronic transfers of federal payments.

"Fringe banking" is an entire industry devoted to doing business in the low-income community, which has proliferated largely as a result of the deregulation of interest rates and loan terms in many states since the 1980's. Lawyers who represent poor people can document--in almost every state--high cost lending, both illegal under state usury laws, as well as legal under a deregulated environment. Many of these providers constantly push the envelope in terms of the legality of their practices--they keep charging the exorbitant fees until made to stop. All too often, the abusive practices are not technically illegal, but exceed the bounds of common decency.⁽²³⁾ Establishing any one of the purveyors of this high cost credit as the conduit of federal payments sanctions and stimulates these types of transactions. The federal government should be in the business of discouraging high cost lending, not providing the means to facilitate it.

Substantive limitations on fees and terms governing the contracts between the recipients of federal payments and the authorized agents would NOT provide sufficient protections from the problems that would be created by allowing fringe bankers to be authorized agents. The federal payment would simply ensure that the recipient becomes a captive customer of that fringe banker, without even the present opportunities to go elsewhere if treated unfairly. Fringe bankers, generally speaking, should not be supported by the federal government. Appendix A provides examples of some of the abusive charges made by fringe bankers.

Justifications for Fringe Bankers - Not Sufficient. Some Treasury staff have said that check cashers and money transmitters should be considered for three reasons: 1) they seem to be the financial providers of choice to many of the unbanked; 2) they may offer services (such as electronic payment of bills) to many low income people that may not otherwise be accessible; and 3) they have a wide array of outlets in the community already which should be deployed to provide residents more access. Even if these statements were true -- although Treasury's own research calls them into serious doubt -- they are nevertheless not sufficient justification for making the fringe bankers "authorized agents" for the receipt of federal funds.

There are several reasons that some low income people choose to use check cashers rather than banks. Very often, low income people cannot afford to use banks: they cannot afford the fees or minimum balances required for accounts. Presumably the proper design of Direct Deposit Too⁽²⁴⁾ accounts will remedy the financial aspect of this issue. However, as noted previously many low income people do not use banks even when affordable accounts are offered because of privacy concerns, fears of having their funds attached by creditors, or just because banks are not as comfortable to them as the local check casher or retailer who provides free or low cost check cashing services to its customers. Reassurances of privacy and of the anti-attachment prohibitions for Social Security funds should address the first two aspects of this concern. The last aspect - the level of comfort - can be addressed by simply allowing check cashers to continue providing their services in the community as they do currently.

We do not propose that fringe bankers be prohibiting from providing any access to federal money, just not the *sole* access for any federal recipient. Nothing requires that check cashers could not establish ATM or POS devices on their premises and sell recipients all of the products and services that are now currently offered. The key distinctions between this and allowing alternative financial providers to be "authorized agents" or contractors with financial institutions for the delivery of federal electronic payments are:

- 1) If recipients can only receive their federal payments through "financial institutions" as currently defined by Treasury, they will be pulled into the mainstream banking system, and thus provided savings' opportunities as well as alternative (and less expensive) sources for credit.
- 2) Recipients who must have a bank account, but who nevertheless choose to access their money through a check cashier or a money transmitter, will still have the choice every month of where to obtain their funds-- they would not have to go to the check cashers to receive their federal payments.
- 3) The banks receiving the federal payments will have a greater source of funds as a basis for community reinvestment back into the low income community, whereas the check cashier has no such obligation.

Access should not be the criteria to allow alternative financial providers to be the conduits of federal payments. Social service agencies in the community can quite easily facilitate access. The agencies can help recipients initially establish accounts with various banks that have electronic equipment or branches in the community. The social service workers can help recipients determine which accounts best serve their individual needs by interpreting the features and the costs of the available choices. Further, the workers can help recipients learn about accessing funds electronically by conducting trainings, providing reading materials on the new law and its requirements, and helping recipients master the use of personal identification numbers (PINs), ATMs and POS devices. Finally, the social service agencies can help recipients use banks' customer assistance telephone lines to answer questions about withdrawals, charges, and other issues.

The Use of Default Banks Provides Treasury With Tremendous Leverage To Expand Services in Low Income Communities. What happens to all the payments to federal recipients who fail to tell their federal payer into which bank their deposits should be placed? It is unlikely that paper checks will still be sent. Instead, the funds will be transferred electronically to some bank. The recipients will then have to obtain their funds from that bank, either electronically or through a teller. Treasury will have the choice of using either a federal Electronic Benefits Transfer system -- one bank nationwide, with minimal services, and minimal access -- or a series of default banks in each state or region.

If Treasury chooses to go the route of using default banks, the leverage available is immense. Consider the potential amount of money involved in just one state, that would flow through the default bank, that is not now being deposited in that bank. On a state by state basis, the monthly deposits will be increased by hundreds of millions of dollars.⁽²⁵⁾ The float on this money, even if it is all withdrawn within a few days of deposit by the Treasury, will be substantial. It therefore seems reasonable to assume that many banks will recognize the profit potential of being a default bank for all of the unbanked recipients in the state or region and that there will be competition for this opportunity on a national, state, or local level.

Treasury can use the leverage provided by the competition between financial institutions to be the default bank to ensure that additional ATM and POS devices are available at reasonable access points throughout the low income communities. Treasury can also use the combination of these many relatively small accounts to provide economies of scale. In this way, the combination of many accounts should keep the monthly and transaction fees to a minimum, while still providing the financial institution with a healthy profit for engaging in this new business. Additionally, the default banks will have a ready source of new customers to whom to market all of their other products and services.

Part 3

The "Hardship" Exemption Allowing a Waiver of the Electronic Deposit Requirement.

- As advocates of low-income consumers, we basically agree that electronic transfers are a more efficient and safer method of receiving payments than the paper based system. However, the additional advantages of the electronic system quickly evaporate if recipients have higher costs, unanticipated risks, and/or greater potential losses. Assuming that financial institutions respond to this opportunity to market their business to an entire new segment of the communities, there are a range of options that could be pursued. Banks could aggressively market existing low cost checking or savings accounts. They could create all electronic accounts, as are contemplated under "Direct Deposit Too", with access only through use of an ATM card. Or, wholly new types of accounts and combinations of attributes might be designed.

We hope as much as Treasury that the banking community will recognize the huge potential for new customers in EFT-99, and begin the process of designing new accounts which would meet the needs of the unbanked, while providing fertile new markets for a variety of banking services. However, we are less sanguine regarding this actually happening. First, this has not happened to date.⁽²⁶⁾ Although the federal government and the unbanked have a new reason for needing the banking community to respond, the banks may not react as desired by marketing services to this population, as they clearly have not done to date. Further, many of the larger banks have already recognized the tremendous money making potential in this market and have created non-banking subsidiaries to provide services which are priced considerably more expensively than the same services provided to their own customers. A number of finance companies and check cashers are subsidiaries of banks.⁽²⁷⁾ In many cases, the ultimate ownership of the fringe banker does not seem to change its standard practices.

If consumer advocates are overly pessimistic, we will be thrilled to find ourselves wrong. However, if we are correct, then it will fall back to the federal government to either (1) reduce its expectations for the pervasive use of electronic transfers (because too many of the unbanked will remain unbanked, and thus not have electronic transfers realistically available to them); (2) provide some incentives to banks for providing these electronic transfer services to the unbanked; or (3) compromise the standards of the accounts to be furnished to the unbanked, and require this population to be serviced in a manner which does not adequately protect them from abuses. Option 3 should be avoided at all costs, as whether or not one believes that it is the government's responsibility to protect the neediest of its citizens from harm, everyone should agree that it is NOT in the government's purview to advance that harm upon the neediest of its citizens. Requiring the unbanked to use fringe bankers to access their federal payments, or requiring them to use accounts at financial institutions which do not include certain minimum

standards would *create* new opportunities for the neediest segment of the federal payee population to be harmed. This is an unacceptable choice.

Essential protections for electronic transfers include a myriad of considerations. We propose that the minimum attributes of a required electronic account for the receipt of federal payments meet these criteria. Any federal payee who cannot find an account at an insured, depository institution should be considered to have a hardship under the statute, such that their federal payment would continue to be made by paper check.⁽²⁸⁾ After all, although as a policy matter we can all agree that receipt of payments electronically is generally better for all concerned, that will not apply to each individual. This is the basic rationale behind the statute's exception to the requirement for electronic transfers in cases of hardship. When high costs, excessive risks and/or difficulties in accessing the payment are involved for a particular individual the electronic option may be far worse than the paper system.

- Limits on monthly fees. Many recipients of federal benefit payments, and especially those who are currently unbanked, live at or below the federal poverty guidelines. For example, one of the criteria for *receipt* of SSI payments is meeting an income eligibility test. Very few of these precious dollars should be required to be spent on fees for the mandated electronic account.

At a maximum, allowable fees should be the lesser of 1% of the monthly payment or \$3.00.

- Reasonable access to cash withdrawals. Many people budget on a weekly basis, so they should be permitted to withdraw needed cash on a weekly basis. Moreover, it is to the institution's financial benefit to encourage the recipient to leave some portion of the payment in the account, as the account is not interest bearing and the institution benefits from the float.

Reasonable access to cash withdrawals should include no fewer than four free ATM withdrawals at the financial institution at which the account is held per month, plus a reasonable number of ATM balance inquiries. In the absence of ATM availability, the same general rules should apply to teller withdrawals.

- Limits on fees for access to cash. Currently many financial institutions charge as much as \$2.50 to users of their ATMs who are not customers. Recipients of direct federal benefits who have these limited electronic accounts should not be charged any more than the actual costs to the financial institution for processing the transaction.

Recipients who use the ATMs at the financial institution where they have an account, on a more frequent basis than four times a month, should be

charged no more than the actual cost of the transaction to the financial institution.

- Prohibition on fees for point of sale transactions involving a purchase. Both the merchant and the bank gain when payments are made electronically when a sale of goods or services has taken place. The merchant receives payment immediately, without the cost of having to count the cash, the worry of having to collect on a check, or the expense of the merchants' discount when a credit card is used. The bank similarly benefits. Further, the bank benefits because it has the use of the recipient's money until the last possible moment. The recipient of electronically dispensed federal payments should thus not be charged for electronically paying for goods, when by doing so it benefits everyone else in the transaction.

No fees or surcharges should be permitted for POS transactions involving the purchase of goods or services.

- Other access and consumer protections issues should also be assured. Appendix B of this testimony sets out these other consumer protection issues in more detail.

Part 4

Recommendations for Congressional Action

Congress should amend P. L. 104-134 in three ways:

- 1) Delay the implementation of the section of the law which requires electronic deposit of federal payments to the "unbanked" to enable Treasury to determine the actual costs and benefits to financial institutions derived from providing direct deposit accounts to the unbanked recipients of federal payments.
- 2) Authorize Treasury to employ various means, including the use of some of the savings derived from electronic deposits of federal funds to recipients *with* bank accounts, to motivate financial institutions to provide the "unbanked" with direct deposit accounts.
- 3) Ensure that only financial institutions with CRA obligations to the low income communities, or credit unions, be the authorized conduits for federal electronic payments.

Appendix A

Examples of Fringe Banking Charges

Establishing formal relationships between the recipient of federal funds and fringe bankers, which are not easily discarded, is a dangerous support for the activities of these fringe bankers. Limits on the fees and the terms charged by the fringe bankers for the transfer of funds will not adequately protect consumers. Even now, some fringe bankers provide free check cashing as a means of enticing customers into their stores. Even rent-to-own dealers are recognizing that check cashing provides a captive audience for its overpriced services.⁽²⁹⁾ The free check cashing is simply a loss leader for the overwhelmingly profitable rent to own transactions that follow. The rental of the living room suite or a TV at a rental purchase store is likely to cost the consumer an equivalent interest rate of well over 100%.⁽³⁰⁾ One federal appellate court recently found "the public interest overwhelmingly favors enjoining these contracts."⁽³¹⁾ Unfortunately for consumers, in most of the other 49 states equivalent judicial decisions are not immediately likely. Is this a relationship that the federal government should be fostering by allowing this type of financial services provider to be a conduit for federal payments?

- "Check cashing fees range from 1% of the check to a very high 21% of the face amount of the check."⁽³²⁾ There are only a handful of states that regulate the rates imposed by check cashers. Allowable regulated fees are as high as 10% on personal checks (Georgia). However, even in the few states where there are limits on check cashier's fees, these restrictions are routinely ignored. In a study by the New Jersey Public Advocate's Office on check cashing charges, 652 customers were surveyed. 49% of these customers were found to have been charged more than the maximum legal rate--on average 44% over the legal rate.⁽³³⁾
- The check cashers' fees are not just exorbitant on small checks. Consider one case in which \$1,100 was charged on a lump sum Social Security check for \$11,000. The check cashier had deceptively told the recipient that cashing the check would have been more expensive at a bank.⁽³⁴⁾
- In South Carolina, where until recently small loan rates were completely deregulated, 100% was a typical posted interest rate charged for small loans. Now, with some statutory limits, 56%-60% is a typical charge for loans between \$300 and \$400. Higher rates, even for costlier loans, are not uncommon. For example, 85% on a \$1000 loan with a 1 year term was recently made to one low-income consumer.
- Check cashers are also making big bucks on people who have checking accounts. "PayDay" Loans are the newest scheme. Lower income wage earners, military personnel and welfare recipients are all typical customers.⁽³⁵⁾ According to the Virginia Attorney General the following describes a typical loan transaction:

Consumer customer visits Payday, completes application and writes a present or post-dated check to Payday for \$100. Payday provides customer with \$83 in cash that day and agrees to hold customer's check until an agreed upon future date, generally corresponding with the consumer customer's payday. On the agreed upon future date, Payday deposits and presents the consumer's check for payment. During this process the consumer customer's check typically is held for a period of between five to fifteen days." The effective annual percentage rate actually charged on these PayDay loans ranges from 498% to 1,495% if the check is held for only five days.

- In Illinois, finance companies have also abused the deregulation of small loan interest rates. In one case⁽³⁶⁾ consumers were charged between 283% and 557% on loans in the range of \$1000. Lender's employees typically met customers as they left their places of employment; threats of violence were implicit throughout the dealings.⁽³⁷⁾

Some may argue that these examples are extreme, and not characteristic of the fringe banking industry. We, who work with lawyers representing low-income consumers on a daily basis, attest that these few examples are not isolated incidents. How many examples would it take to prove a pattern of abusive behavior by too many fringe-bankers throughout the United States?

Others may argue that there is nothing inherently wrong with these charges, as everyone has choices and the consumers of these fringe bankers are simply inappropriately exercising their freedom of choice. That may or may not be. But the issue here is not whether to allow these industries to continue to thrive, but whether the federal government should place its imprimatur on these activities by establishing those responsible as the conduit for the access to the federal payments by many low-income consumers.

Appendix B

Additional Consumer Protection Issues Related to EFT-99 Accounts

- Reasonable access to information about the balance left in the account. Providing monthly statements--as otherwise required to consumers under the EFTA--is a relatively expensive service which might reasonably be waived for recipients of Direct Deposit Too accounts. However, that leaves the necessity that recipients be entitled to find out, on a reasonable basis, the remaining balance on their accounts, as well as the reason, the timing and the amount of fees imposed. It seems reasonable to require that every ATM transaction include the provision of a receipt which indicates the imposition of fees, to the extent applicable, and the remaining balance in the account. To the extent that further information is necessary, or

recipients wish to find out any of this information at other times, they should be able to call a toll free number, provide appropriate identifying information and obtain their account information. Whether or not this telephone service is available, recipients should be able to obtain a transaction history upon request at minimal or no cost.

At a minimum, all receipts from ATM transactions should include information about the remaining balance and fees; at least two monthly ATM balance inquiries should be allowed for free, and others should be charged no more than the actual cost to the bank for providing the information; and a transaction history should be available free upon request or whenever there is a dispute.

- Application of the consumer protections (such as disclosure of rights, protections from loss from unauthorized transfers, error resolution, etc.) which are provided by the Electronic Funds Transfer Act ("EFTA," also referred to as "Reg E"). There should be no dispute about this issue. Indeed, as the federal government will benefit from the provision of electronic accounts to federal payees, it is the federal government which should bear the risks of loss when the application of EFTA poses an additional cost to the financial institution that it is unwilling to bear.

The EFTA should unconditionally apply to all Direct Deposit Too and federally established EBT accounts.

- Electronic access to benefits that is within a reasonable distance to the recipient's home must be provided. Access based on distance is generally a subjective matter. In a rural area, requiring an ATM or POS within a mile from the recipient's home seems to be unrealistic and perhaps unnecessary. However, given the expense (both financial and emotional for some recipients) of urban transportation, as well as the degree of physical handicap for many elderly or disabled recipients, access to benefits that is even a mile away may be too far. The standard thus should remain subjective.

Recipients should be permitted to avoid the requirements of electronic transfers if benefit access is not reasonably accessible from their homes.

- The ATM card or device must be accepted by a reasonable number of merchants in the neighborhood and surrounding area. There are currently a number of ATM networks--Cirrus, Honor, etc.--most of which are reasonably accessible at merchants in the geographical area in which the banks offering them are located. However, some networks are more popular in some areas than others, and are thus less accessible in the "foreign" areas. If access to cash benefits through ATMs is limited before fees are imposed, it is important that POS access be reasonable. This means that there must be a sufficient

number of stores which both accept the type of ATM network device provided in the geographic vicinity in which the federal payee lives and permit the use of the card for cash back and withdrawals as well as purchases.

The ATM card or device must be accepted by a reasonable number of merchants in the neighborhood and surrounding area who permit both free cash back with purchase transactions and reasonably priced cash withdrawal options.

- ATMs and POS devices must be accessible to handicapped people. Many recipients of direct federal benefit payments are eligible for such payments on the basis of a physical or mental handicap. Their handicap may cause them to be unable to participate in an electronic banking environment unless the equipment is specially modified to accommodate any handicapping condition they have, such as braille PIN pads, wheelchair accessible ATMs, etc.

Unless Treasury is prepared to monitor compliance, merely requiring system compliance with the Americans with Disabilities Act is not sufficient. Leaving it up to the aggrieved individual to somehow find a way to manage while independently pursuing an ADA claim is an unreasonable expectation for government benefit recipients who are both poor and disabled.

Systems that do not meet the special needs of handicapped recipients of government payments must not be considered adequate for requiring electronic transfers for these federal payees.

- Recipients with limited reading skills or no English literacy at all also have special needs. ATM and POS on-screen messages must meet the needs of those with limited English proficiency or who are non-English speaking.

Systems that do not meet the special needs of those who are non-English speaking or have limited English proficiency must not be considered adequate for requiring electronic transfers for these federal payees.

- Training for new electronic transfer recipients. Many of the 10 million unbanked recipients of federal payments may have never had a relationship with a financial institution or used a credit or debit card before signing up for the receipt of their federal benefits electronically in 1999. In recognition of this, there should be an opportunity for anyone who desires some personal training on how to use an ATM for a balance inquiry or withdrawal to receive some minimal level of assistance from the financial institution. This should be in addition to any written training material that may be provided. The failure to accommodate such requests for assistance could well keep some who

might otherwise be willing to establish an electronic funds transfer arrangement from doing so.

In addition to providing written materials, financial institutions offering Direct Deposit Too or federally established EBT accounts should be required to provide in-person training upon request.

- Opportunity for new electronic transfer recipients to choose their own PINs (personal identification numbers). Our strong preference would be for all electronic delivery systems to use PIN self-selection as the norm to reduce the likelihood of the individual's needing to write the number down and carry it with him or her in order to remember it. We recognize however that PIN assignment is more likely to be the norm. In such cases, individuals must be notified at the time of card issuance of the procedures to follow if they would prefer to change their PIN to a self-selected number. Moreover, there must be a simple process to effectuate such a change that does not delay the individuals' access to their federal payments.

Direct Deposit Too and federally established EBT accounts must provide for a simple and quick means for recipients with an assigned PIN to change to a number of their own choosing.

- Reasonable procedures for PIN replacement and card replacement. It is critical that any electronic system for delivering federal payments have established procedures for promptly responding to recipient requests for a replacement of either the ATM card or the PIN. The need to get a replacement card or PIN could arise for any number of reasons, including the loss of the card, damage to the card or the magnetic strip on the card, failure to remember the assigned PIN, or recipient concern that the card and/or PIN has been compromised. Use of the card and PIN may well be the only way that federal payees can access the benefits they need to pay their bills and provide for the bare necessities.

Simple procedures for requesting and promptly obtaining a replacement card and/or PIN must be in place and a clear explanation of the steps an individual must take to initiate this process must be included in the informational materials provided about the account.

1. The National Consumer Law Center is a nonprofit organization specializing in consumer credit issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys around the country, representing low-income and elderly individuals, who request our assistance with the analysis of credit transactions to determine appropriate claims and defenses their clients might have.⁽²⁾

2. The National Consumer Law Center, Inc. (NCLC) is a nonprofit Massachusetts corporation founded in 1969 at Boston College School of Law and dedicated to the interests of low-income consumers. NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government and private attorneys across the country. *Cost of Credit* (NCLC 1995), *Truth in Lending* (NCLC 1996) and *Unfair and Deceptive Acts and Practices* (NCLC 1991), three of twelve practice treatises published and annually supplemented by NCLC, and our newsletter, *NCLC Reports Consumer Credit & Usury Ed.*, describe the law currently applicable to all types of consumer loan transactions. - - -

3. The Consumer Federation of America is a nonprofit association of some 250 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

4. The National Community Reinvestment Coalition (NCRC) is the nation's largest CRA (Community Reinvestment Act) membership organization. The goal of NCRC is to increase fair and equal access to credit, capital and banking services. NCRC, representing over 615 national, regional and local community organizations seeks to support and provide tools to build community and individual net worth.

5. The Organization for a New Equality (O.N.E.) is a multi-racial organization whose top priority is expanding economic opportunity to people who have historically been excluded from the economic mainstream. Established in 1985 by the Reverend Dr. Charles R. Stith as a non-profit organization, O.N.E. is working to develop and implement new economic strategies to promote equal opportunity and encourage change.

6. Data from the 1995 Survey of Consumer Finances, (which involved interviews of 4,299 families from all income brackets) found that 15 percent reported that they did not have a checking account. The following reasons were provided by these families for not having a checking account:

- 27% said they did not write enough checks to make one worthwhile;
- 20.5% said they did not have enough money;
- Nearly 29% reported that they did not like to deal with banks; and
- Just under 10% each gave as their reason either high minimum balance requirements, an inability to manage or balance an account, or bank service charges they deemed to be too high.

Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances. Federal Reserve Bulletin, Vol. 83, No. 1, Jan. 1997 at 7.

On the other hand, a recently completed study involving a much smaller sample of unbanked direct *federal benefit recipients* found:

- 47% said they did not have enough money to have an account;
- 21% said they had no need for an account; and
- 6% said that bank fees were too high.
- Much smaller percentages cited concerns about bounced checks, overuse of ATM's, bad credit histories, distrust of banks, privacy, or having their assets frozen in the event of a legal judgment.

Department of the Treasury Financial Management Service, *Mandatory EFT Demographic Study, Executive Summary*, April 22, 1997 at 3-4.

7. In fact, the Office of the Comptroller of the Currency has recognized the need to determine why so many households in the U.S. do not participate in the financial mainstream. The OCC has recently embarked upon a research effort to answer this question.

8. "At a minimum the Government will save 28 cents per check on postage, printing supplies, and paper; and avoid check costs of 28 million for every one hundred million payments converted to EFT." *EFT-99 Facts*, prepared by the Department of the Treasury, Financial Management Service.

9. The ATM related fees are reasonable examples based upon various proposals that have been discussed. The POS fees are just guesswork on NCLC's part, based on experience with the onset and growth of ATM fees.

10. This assumes three separate withdrawals, each with a charge \$1.

11. The fees from the home bank and the surcharges from use of another bank's ATM are likely to be imposed for the same transaction.

12. The Treasury study found that SSI check recipients are far more likely to not have a bank account (58%). Department of the Treasury Financial Management Service, *Mandatory EFT Demographic Study, Executive Summary*, April 22, 1997 at 3.

13. One also needs to assume for this example that this individual lives in one of the majority of states that does not provide additional state benefits to SSI recipients.

14. This is the current SSI monthly payment for an individual living independently and completely self-supporting. Someone living in another's household and receiving meals and other sustenance receives a payment of

\$322.67. Couples living independently receive \$363 each. (Information provided by Social Security Administration, May 20, 1997.)

15. See information in Part 2 on fees of regulated and unregulated check cashers in different states.

16. Department of the Treasury Financial Management Service, *Mandatory EFT Demographic Study, Executive Summary*, April 22, 1997.

17. *Id.* at 4.

18. *Id.*

19. The amendment to 31 U.S.C. §3332 requires recipients of federal funds after January 1, 1999 to "(1) designate 1 or more financial institutions or other *authorized agents* to which such payments shall be made; and

"(2) provide to the federal agency that makes or authorizes the payment information necessary for the recipient to receive electronic funds transfer payment through each institution or agent designated under paragraph (1)." (emphasis added).

20. " Financial institution means any bank, savings bank, savings and loan association, credit union, or similar institution." 31 C.F.R. §208.2(e).

21. According to a recent study of fringe banking in Milwaukee: "Customers pay far more for services provided by a check cashing business than they pay for the same services at a conventional bank. Fees for cashing payroll checks nationwide generally range between one percent and three percent of the face value of the check. For personal checks the range was generally between 1.7 percent and 20 percent, averaging around 8 percent. In some instances, however, fees and interest rates have been reported as high as 2000 percent. A study by the New York Office of the Public Advocate found that a check cashing customer with an annual income of \$17,000 will pay almost \$250 a year at a check cashing business for services that would cost \$60 at a bank. The Federal Reserve Bank of Kansas City reported that a family with a \$24,000 annual income using a check cashing business will spend almost \$400 in fees for services that would cost under \$110 at a bank." (Citations omitted). Squires and O'Connor, *Fringe Banking in Milwaukee: The Rise of Check Cashing Businesses and the Emergence of Two-Tiered Banking System*. (1997) at 5,6.

22. Payday loans are generally provided by check cashers who agree to cash a post-dated personal check with the understanding that it will not be deposited until the customer's next payday. "Customers can receive \$50 for a check written in the amount of \$60 and dated 14 days after the cash is

provided. ... The effective annual interest rate for this loan is 1,092 percent." Ibid, at 11, 12.

23. The legal standard applicable to judge these transactions thus becomes one of "unconscionability." Unconscionability generally refers to a transaction "which is so one sided that only one under delusion would make it and only one unfair and dishonest would accept it." See, Cobb v. Monarch Finance Company, 913 F.Supp 1164, 1179 (N.D.Ill. 1995).

24. Treasury's use of "default" banks to receive all the direct deposits for all recipients who fail to designate a financial institution will provide a significant opportunity for Treasury to ensure that there are adequate ATMs and POS devices throughout the low income community accessible at little or no cost to these Direct Deposit recipients.

25. As the average Social Security payment is approximately \$700 a month, it is reasonable to assume that the average payment to the unbanked might be slightly lower, say \$500 a month. 10 million (unbanked) times \$500, equals \$5 billion of new deposits a month. Roughly, dividing that by 50 (states) yields additional deposits on a state level of about \$100 million a month.

26. Competition does not work in the traditional sense in the low income community. While competition was deemed to provide adequate protections for consumers, for the poor it has been a dismal failure. Generally, reverse competition has prevailed - the more expensive providers have prospered in low income and minority communities. In fact deregulation of interest rates and credit terms has caused far more harm than good for poor people. Deregulation of basic loan terms has only allowed high cost lenders to charge more to people who do not have the means to obtain better deals.

27. Indeed in some cases, the first business was the finance company, which then created the holding company and associated national bank as the structure to avoid the imposition of state usury statutes.

28. If too many of the "unbanked" continue to meet this hardship definition, then it behooves the federal government to consider incentives to financial institutions to create accounts which meet these minimum standards.

29. See Rental Dealer News (August 1993), at 11-12.

30. A recent 8th Circuit case found that the 46%-746% interest rates charged by rent to own dealers was ample justification for a permanent injunction against dealers operating in the state of Minnesota in standard modes. Fogie v. THORN Americas, Inc. 95 F.3d 645, 653 (8th Cir. 1996).

31. *Id.* at 654.

32. Consumers Union, *The Thin Red Line* (1993).

33. John P. Caskey, *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor* (Russell Sage Foundation 1994).

34. *In Re Wernly*, 91 B.R. 702 (Bankr. E.D. Pa. 1988).

35. This quote is from the complaint filed by the Virginia Attorney General in the case of Commonwealth of Virginia, ex rel. Mary Sue Terry, Attorney General v. Bar D Financial Services, Inc. (d/b/a Payday).

36. *Brown and Cooper v. C.I.L. Inc.*, January 28, 1996, 1996 U.S. Dist. LEXIS 4917.

37. For an example of a case in which a court found that a series of transactions may have been "unconscionable," or "not inconsistent with an absence of meaningful choice," see, *Cobb v. Monarch Finance Company*, 913 F.Supp 1164, 1179 (N.D.Ill. 1995). In this case, the consumer entered into a total of ten separate loans from three finance companies: (1) four loans, each with a principle of \$690, and annual percentage rate (APR) of 101%; (2) five loans, each with a principle of \$700, an APR of 96.43%; and (3) one in the amount of \$500, an APR of 57.22%. All loans created a similar payment mechanism. A bank account was created on behalf of the consumer, to which an allotted portion of her paycheck was electronically and directly deposited. The allotment was then immediately transferred from the consumer's account to the finance company account.