

Testimony before the Committee on Banking and Financial Services regarding

The impact of Treasury's Proposed Regulation under the "EFT 99" Provisions of the Debt Collection Improvement Act of 1996

On the Poor, the Elderly and the "Unbanked"

September 25, 1997

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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. Treasury has proposed some good rules on the waiver provisions as well as the potential structure for the design of the account provided to the unbanked by Treasury. However, there is a significant possibility for a negative impact on low income elderly and disabled people throughout the U.S. which will result unless Treasury makes some changes to the implementing regulations of this new law.

Given the thoughtful and comprehensive nature of the questions posed to witnesses in this Committee hearing, we will provide most of the information in the form of answers to those questions. However, there are four crucial points we wish to emphasize on behalf of our low income clients:

- The goal of bringing the unbanked into the financial mainstream will not be achieved by these regulations. Treasury has chosen to establish a system which will push many unbanked recipients of federal payments into the arms of the unregulated, unsupervised wing of the financial services industry: the check cashers, the finance companies and other fringe bankers. This is potentially very harmful for the residents of low income communities. Treasury has chosen to do this by refusing to regulate the "voluntary" accounts established by recipients *despite the strong encouragement by Treasury to the*

unbanked to establish these accounts so that their benefits may be delivered by direct deposit.

- No waivers are allowed for persons with mental disabilities, literacy problems and language barriers. Treasury's proposal to disallow waivers for persons on the basis of mental disabilities, literacy problems, and language barriers will create serious problems for many federal recipients.
- Critical questions of cost and real access to banking services are still undetermined. The design of the account provided to the unbanked by Treasury is completely undetermined at this point; yet the attributes of the account, the cost to recipients, and the extent to which the banks providing the account will expand their presence in the low income community are all crucial issues which still must be addressed.
- There are protections against attachment and garnishment. Despite the clear protections in federal law against attachment and garnishment of Social Security, Supplemental Security Income (SSI) and Veterans' Benefits, numerous consumers do not use banks because they are afraid their limited funds will be taken by judgment creditors. Providing crystal clear prohibitions against attachment of funds in EFT accounts would bring many consumers back into the financial mainstream. Treasury's proposed regulations do not address this issue.

Answers to Chairman Leach's Questions

Question:

1. Does NCLC support the goal of "EFT 99" and EBT? Are the objectives of the new law a net plus or minus for consumers, particularly low income or other individuals who may be unbanked today? What are the drawbacks and how successfully do the proposed regulations deal with those problems?

Answer:

On behalf of our clients, and the other organizations who have signed this testimony, we all support the basic goals of EFT 99 to bring low income people into the financial mainstream, and to make the receipt of their federal payments more secure. As Secretary Rubin has noted, this is a tremendous opportunity. However, the opportunity to bring more Americans into the banking system will be squandered if Treasury proceeds with the regulations as currently proposed.

Further, these goals are not so important that they should be strived for at considerable costs to recipients. There are two forms in which the costs to recipients could be manifested:

- The out of pocket expense to the recipient from accessing their federal money. This would include monthly account fees, ATM (Automated Teller Machine) usage fees, POS (Point of Sale) usage fees (although these are currently rare in the marketplace, there is nothing prohibiting their imposition), foreign ATM fees (surcharges), and fees imposed to determine the remaining balance on the debit card, information about their account, replacement cards, and other costs associated with electronic transfers.

Treasury has effectively and appropriately addressed this concern by allowing any unbanked recipients to claim a waiver from the requirements of EFT 99 if the requirements impose a financial hardship.⁽⁶⁾

- The costs of the ancillary services sold to the recipients by fringe bankers with whom the recipients have established an EFT account.

Treasury has left the door wide open for abuses in this area, by not setting any limits on the voluntary accounts. At the same time, Treasury is announcing plans to join with the other affected federal agencies and the financial services industry to conduct a massive public education campaign to encourage unbanked recipients to sign up on their own for accounts through which to receive their federal payments.

The dangers posed by voluntary accounts established through fringe bankers. We are concerned that recipients will be pressured by the public information campaign to be waged by Treasury and the Social Security Administration to establish *expensive and dangerous* electronic accounts through which they must receive their federal payments. In other words, recipients will establish accounts through check cashers and finance companies which meet the minimal requirements set out by Treasury,⁽⁷⁾ yet which leave the recipients open to serious abuses from these unregulated providers.⁽⁸⁾

We know that check cashers will seek ways to maintain and expand their market, as will finance companies and other alternative financial providers. We have already heard of one check casher in Chicago who has established accounts for recipients through a bank. The recipients receive a paper check for their federal funds at the check cashers' place of business from which the bank has already deducted \$1.90. To cash the check drawn on the check casher's own account, the recipients must then pay another \$7.90. The total cost for this service - \$9.00.

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,⁽⁹⁾ 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.⁽¹⁰⁾

By deciding not regulate the voluntary accounts, Treasury has decided to allow providers of financial services other than regulated depository institutions to be conduits of federal benefits. This result will 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,⁽¹¹⁾ generally --if not always -- without any fees being paid to access their federal money whatsoever.

Treasury has stated that to regulate these voluntary accounts would "place Treasury in the position of determining the reasonableness of prices charged by thousands of financial institutions, for a wide variety of account services, to individuals who have account relationships at institutions they have chosen voluntarily."⁽¹²⁾ This neat economic argument in favor of marketplace dynamics does indeed sound persuasive. However, it avoids the real issue. Consumer representatives have never asked that Treasury examine all the prices charged to determine reasonableness, only that it clarify that the standard of reasonableness set out in the statute actually applies to the voluntary accounts.

Representatives of the low income people who will be most effected by the EFT requirements have consistently and specifically only asked Treasury to regulate the type of institution who should be permitted to be conduits of federal funds. (See attached letter to Secretary Rubin from 21 advocacy organizations collectively representing low-income people, the elderly, the disabled, minorities and other consumers affected by EFT 99). It is our united position that *only* financial institutions -- banks, credit unions and savings associations -- should be permitted to be conduits for federal moneys. This would mean that partnering between a check casher and a bank would not be permitted. Instead Treasury's regulation prohibit federal payments deposited by Treasury into recipients' accounts at financial institutions that are effectively accessible only through fringe bankers. The recipient should

always be able to access the federal payment *in the neighborhood* through ATMs and POS devices made available by financial institutions.

This interpretation is required by the federal law mandating these regulations. Section 3332(i)(2) provides:

Regulations under this subsection shall ensure that individuals required under subsection (g) to have an account at a financial institution because of the application of subsection (f)(1)--

(A) will have access to such an account at a reasonable cost; and

(B) are given the same consumer protections with respect to the account as other account holders at the same financial institution.

The law does not differentiate between voluntary accounts and those established by Treasury. The law specifically requires that these protections apply to everyone.

Treasury's allowance 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,⁽¹³⁾ payday loans,⁽¹⁴⁾ 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.

Question:

2. In the year since the "EFT 99" legislation became law, what discussion have you had with Treasury officials and how have your views been incorporated in the proposed regulations? Which of your concerns have not been addressed?

Answer:

We have had a number of discussions with Treasury officials, in public as well as private meetings, and we very much appreciate the time that Treasury has taken with us. Many of our concerns have been addressed by Treasury. To name some of those which seem to have been specifically addressed in these regulations:

- We were very concerned that the language in the law which permitted a recipient to name an "authorized payment agent" for the purpose of receiving the recipient's federal funds would allow fringe bankers access to the federal funds. We argued that the term in the statute should be read to incorporate only the concepts of "representative payees" or other fiduciaries recognized by federal and state law as those providing assistance to recipients. Treasury has agreed with this limitation in its proposed definition of authorized payment agents. However, our concern regarding potential access to these funds by fringe bankers is still very real, as Treasury has allowed them to partner with financial institutions for the delivery of federal funds in the voluntary accounts, and may yet allow these partnerships even in the accounts to be established by Treasury.
- We were concerned that liberal waivers be allowed. Treasury has addressed these, with a few exceptions regarding waivers for persons with mental disabilities, literacy and English fluency problems. This issue is detailed below in response to Question 5.
- We are concerned that the attributes and the costs of the accounts established by Treasury be open for public comment. Treasury has indicated that it will allow some comment on their proposed parameters of these accounts before they allow competitive bidding.

In addition to the concerns which have been partially addressed, as described above, Treasury has not addressed our stated concerns in the following area:

- Treasury has failed to provide any protections from attachment or garnishment in EFT accounts. This remains a very serious concern for many low income federal recipients. (See discussion in response to Question 4.)

Question:

3. What type of institutional and network infrastructure is necessary to provide "unbanked" recipients with low cost access to EBT? What is an appropriate role for financial institutions and other money services businesses?

Answer:

We have not said that banks should be required to provide accounts to the unbanked. We have not said that banks should be required to subsidize the accounts of low income people. What we *have* said is that it should not cost low income recipients money to receive their federal funds. If affordable accounts cannot be designed that meet the needs of the unbanked, then either Treasury should use some of the substantial savings to be experienced by the Government from EFT 99 to subsidize these accounts or low income recipients should be exempted from the requirement of electronic transfer. We do not disapprove of the approach that Treasury has taken to this issue at this juncture. Treasury is waiting to see what the market will develop, and how low income recipients will respond. We are very concerned, however, that Treasury might drive many recipients into voluntary, yet unaffordable accounts. Recipients might be led to believe that unless they sign up for the only accounts that are made available to them -- which might be only those provided through the local check casher or finance company -- they will lose their federal benefits. The public information campaign which is planned to start imminently should be carefully designed to avoid this result.

Regarding the appropriate role that other money services businesses should have in the delivery system for federal payments, the answer is only as retail outlets at which POS devices or ATMs are placed. 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,⁽¹⁵⁾ finance companies, and others--should not be provided a government boost to their business by serving as contractors with financial institutions for the delivery of federal payments. Commercial banks, savings banks, and credit unions 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.⁽¹⁶⁾ 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.

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⁽¹⁷⁾ accounts will remedy the financial aspect of this issue. However, 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 prohibited 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 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.

Question:

4. What are the most compelling reasons and the most successful methods for persuading federal beneficiaries to establish their own bank accounts and

participate in direct deposit before January 1, 1999? To what extent are federal agencies, financial institutions, and other organizations making that case to the unbanked?

Answer:

We have heard one overwhelming concern from low income recipients of federal payments, and their legal services attorneys: *The reason that many low income recipients do not have bank accounts is their fear of losing their limited funds to judgment creditors.* Low income elderly and disabled people are particularly vulnerable because of their inability to pay all of their doctor or hospital bills. They deliberately avoid keeping their money in bank accounts to ensure that the bank does not allow their funds to be attached by creditors.

Treasury could go a considerable distance in convincing many recipients of federal payments to feel comfortable in doing business with a bank, if they would assure recipients that their funds would be safe from the claims of creditors.

Although many federal payments are protected by law from attachment and the claims of judgment creditors, banks routinely fail to abide by these restrictions. The provision on Social Security is typical of these protections:

(a) The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.⁽¹⁸⁾

There are similar provisions in the governing statutes for SSI benefits⁽¹⁹⁾ and Veteran's benefits.⁽²⁰⁾ However, the only remedy available for a recipient whose funds have been wrongly attached is to file a lawsuit against the financial institution. That does little good for the recipient who is living month to month and in dire need of the funds that were wrongly attached. As a result, cautious recipients simply do not allow their funds to be kept in a bank account.

We have notified Treasury of our concerns in this regard and requested that they issue a regulation that flatly prohibits the attachment or garnishment of any funds in an account into which the covered federal funds have been deposited. However, the proposed regulations are completely silent on this point.

Question:

5. By law, the Treasury Department is authorized to grant waivers of the EFT requirements under certain circumstances. What is your position on the

waiver criteria proposed in the regulations?

Answer:

The scheme proposed by Treasury of using one of four separate standards or tests to determine whether a waiver should be granted to permit the continued receipt of payment by check rather than EFT is good, in so far as it goes. However, Treasury has defined the hardship standard much too narrowly in terms of its enumerated barriers and, without further alterations, many recipients of direct federal benefits may be forced into a situation that requires them to surrender a level of independence they otherwise had in the check based environment.

Specifically, Treasury ignores the legislative history on the hardship exemption in the Act by excluding from the enumeration of qualifying barriers:

- mental,
- educational, or
- language problems

Under the proposed regulations, none of these conditions would be just cause for the granting of a waiver from the EFT requirement. Only physical handicap, geographic barrier, or financial hardship for the unbanked, would qualify as a hardship criteria. The rationale offered by Treasury for this decision in the preamble to the proposed regulations evidences a lack of true understanding or compassion for the populations that would be affected.

Mental Disability. Treasury simply states that waivers would not be required for persons with a mental disability because those who have a mental disability that makes them incapable of managing their own funds have a representative payee appointed for them by the applicable program agency and such payee would presumably be able to handle an EFT payment arrangement unless he/she individually met one of the other exemption criteria. There are several very important considerations that Treasury leaves out of its overly simplistic justification. First, there are a very large number of recipients with mental impairments who are quite capable of managing their own funds in a check based system and who, absent a transition to an electronic delivery system, could function independently without the need of turning their finances over to a representative payee. Some of these recipients may simply be unable to remember a PIN; others may have a limited ability to think conceptually and, while they can count out money to make purchases or even write checks to pay bills, cannot deal with abstract benefits they cannot see and feel. It is simply unconscionable to say that, because the government wants to save some money, such individuals should now have to put someone else in charge of their funds and give up that level of control over their own lives.

The second consideration that Treasury ignores is that there is already a great difficulty in finding persons or entities willing to serve as representative payees for those government benefit recipients who are truly incapable of managing their own funds. SSA officials over the years have acknowledged this problem and there has been a concerted effort to identify entities willing to serve in this capacity. In some parts of the country there is a thriving business of individuals and agencies that sell their services to be a representative payee to persons who can not otherwise find someone. By forcing even more people into a situation where they will have to have a representative payee in order to receive their government benefits, Treasury will in effect be supporting the growth of this industry that takes money out of the pockets of some of our neediest citizens without any tangible benefit to the program recipients.

A final consideration ignored by Treasury's justification for its position is the possible risk of loss of benefits to recipients if they are forced into a representative payee situation, especially in those cases where the representative is someone with whom the recipient does not otherwise have a relationship, such as the pay for service arrangements discussed above. While Congress has made clear that recipients of direct federal payments in an EFT environment are fully covered under the Reg E protections, the Reg E limitations on consumer liability for losses that are associated with the use of a valid card and PIN do not apply if those benefits are accessed by a representative payee who misappropriates the funds for his/her own use. Thus, there would be no protection for recipients who felt compelled to pay some stranger to serve as their representative payee so that they could get their government benefits only to find that such person wiped out their accounts and moved on.

Limited Literacy Skills and English Fluency. Treasury's proposed rule also does not envision permitting a hardship waiver on the basis of educational level, limited literacy skills, or lack of fluency in English. Here Treasury argues first that these factors do not pose any barriers unique to an EFT delivery mechanism as opposed to a check system. Such an assertion is again simply untrue. Many persons who fall within one of these categories can in fact operate in a paper based environment sometimes alone and sometimes with the help of friends and family, even if they cannot read or write or are not fluent in English. It does not take an ability to read or write to sign a check with an "X" or an ability to read English to sign your name on the back of a check. It does on the other hand require an ability to read English or one of the other limited languages that may be available on a POS or ATM screen to negotiate an electronic debit of funds, and it is those who are not literate and/or fluent in English that are most likely to end up with an electronic debit only account because they will not otherwise have a relationship with a bank and therefore will not even be able to avail themselves of teller assistance when they cannot negotiate the ATM.

Treasury's next argument is that whatever problems EFT may pose for these segments of the population are merely a "short-lived" "transitional hurdle" that it asserts will be overcome by targeted educational programs. Since, to the best of our knowledge, Treasury has no plans to offer any in-person training on how to use debit card technology or on how to shop around for low cost bank accounts that will permit direct deposit it is unclear how they plan to "educate" this population to get them through the transition. The printed materials they appear to be relying on most heavily for their educational campaign will be of little use to those who cannot read the materials, nor is there any indication that they will be made available in anything other than a very limited number of languages. Public service announcements, the other major vehicle Treasury plans to employ, are unlikely to provide much in the way of substantive information. It is certainly unrealistic for Treasury to count on already over-extended and under-funded community based organizations to take on the role of educating and training those among the 10 million unbanked recipients of direct federal benefits who are out there who will need such assistance because of their educational or language problems.

Finally, it is not enough to note, as Treasury does in the preamble to the proposed regulations, that in some areas ATMs and POS terminals offer language options other than English as this does nothing to answer the question of whether on-screen messages in the appropriate language are in fact available to those who need them where and when they need them. The obvious answer to this question is no if your primary language is something other than Spanish or English and that is not something that the onset of EFT '99 is likely to change.

In light of all of the above, there is simply no justification for excluding these populations from the ability to seek a hardship waiver on the grounds that an EFT system will impose a burden upon them that could be avoided if they could elect check receipt as an option.

Question:

6. What risks to consumers may be associated with use of a federal electronic benefit card? What steps should be taken to ameliorate these problems?

Answer:

There are a number of concerns, as well as steps that can be taken to address these:

- *POS fee structure.* POS fees must be limited or prohibited altogether. Several states have implemented, or are contemplating, EBT projects in which retailers are permitted to charge as much as \$1 per POS cash back or cash withdrawal transaction. This POS transaction charge is

more than four times the average per transaction cost merchants incur for processing a transaction. Thus, merchants have in effect been authorized to make a profit at the expense of recipients who have to use their equipment.

- **Transaction Limitations.** Any restrictions on the number or type of transactions or dollar amounts of transactions must be reasonable. Actual experience with EBT has shown that, after becoming familiar and comfortable with the new system, the average recipient tends to make between three and four ATM withdrawals per month. Many recipients will need to draw down the bulk of their cash benefits at one time to pay their monthly bills. Accordingly, no restrictions should be placed on transactions unless experience shows that recipients are using the transaction capabilities in a way that makes the cost prohibitively expensive. In addition, if such restrictions are imposed, recipients should be allowed unlimited free transactions for the initial months of their participation so that they can gain confidence that they have ready access to their benefits in an EFT environment. Currently some ATMs only allow withdrawals in \$10 or \$20 increments. Recipients obviously need access to their change, because their benefits are generally not in these neat denominations. They should not have to wait for the next transfer of funds to access their own money.
- **PIN Selection.** Recipients feel very strongly about the importance of permitting self-selection of the PIN. In pilots where the PINs have been assigned, there have been complaints that recipients can't remember the PIN or that they write it down on the card.
- **Card Replacement.** It is critical that any electronic delivery system have established procedures for promptly responding to recipient requests for a replacement of either the plastic debit 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 be the only way that recipients can access the benefits they need to pay their bills and provide for the bare necessities. Accordingly, a simple procedure for requesting and promptly obtaining a replacement card and/or PIN not only must be in place but a clear explanation of the steps a recipient must take to initiate this process must be included in both the oral and written information provided to EFTT recipients.
- **Security.** The isolated location of ATMs that are appendages to the outside of buildings or inside the vestibule of banks, especially in high crime areas, makes one an easy target for muggers. Efforts must be made to deploy unmanned terminals inside stores (including some,

such as convenience stores, that have extended hours) and malls, or in other well lit, heavy traffic areas.

- Backup Systems. There must be a way of making sure there are backup systems for handling computer glitches and system breakdowns.

Question:

7. What is your view of the use of a single card for both federal and state benefits and how would you assess the success of recent federal-state pilot programs testing that concept?

Answer:

Their possible advantages to the government and the recipients of combining all government benefits to which a household may be entitled on a single debit card are fairly self-evident, for example, convenience, and the need to remember only one PIN. However, there are some potential concerns with such an approach that need to be addressed. The first concern is that combining all benefits on one card increases the amount of the loss a recipient could suffer if the account is fraudulently accessed or the recipient is coerced into making a forced transaction. Moreover, confusion and a possible loss of rights may result due to the different procedures that must be followed for reporting such problems depending on the types of benefits combined on the single card. Federal benefits are covered by the protections of the Electronic Funds Transfer Act; state administered benefits are not.

A second, related, concern is that such a system could enable other household members to access benefits that are intended for the exclusive needs of a single household member. For example, there are households that contain members who currently receive some benefits that are for the entire household's use and other benefits that are restricted to particular members of the household. One example of this situation would be a multi-generational family in which the grandmother receives social security benefits and the entire family qualifies for food stamp benefits as a single food stamp assistance unit. In such instances, we believe that the household head (the grandmother in this example) should be given various options, either one card issued to her with all the household benefits on it, one card issued to her with all the benefits accessible from it and a second card issued to her adult child that permits access to the food stamp benefits only, or one card to her for the social security benefits and a second card to the adult child for the food stamp benefits.

The final concern in this area relates to the issue of transaction limits. The more cash benefit programs that are combined on a single card, the more egregious the imposition of restrictive transaction limits becomes.

With respect to your question about the "recent federal-state pilot program" testing the concept of combining federal and state benefits on a single card, there is no data yet available on the impact of this approach. Alabama first made this option available to recipients when it began piloting EBT in April of this year, with Missouri following in June and Georgia in July. As these states bring their state EBT projects up, recipients in the affected areas are advised that if they are also receiving their direct federal benefits by check they can choose to have those benefits combined into their EBT account. Our information is that to date only a very small number of recipients of both federal and state benefits have actually chosen this option and we have no information on the experiences of those who have. Why the numbers are so small is another open question at this time. We do not know whether it is due to poor outreach concerning this option, whether it is because EBT is still so new in these areas that recipients are not ready yet to experiment with adding additional benefits, whether it is because of the costs associated with receiving their direct federal benefits in this manner, or because of limitations on where they would be able to actually access their federal benefits to pay their bills, or some combination of these and other factors.

Conclusion.

Treasury's stated goal of bringing "into the mainstream of the financial system those millions of Americans who receive Federal payments and who currently do not use the financial services to receive funds, make payments, save, borrow or invest" will not be achieved unless substantial changes are made to the proposed regulations. We hope this Committee will exert its influence and convince Treasury to address these concerns appropriately.

Appendix A

Letter to Secretary Rubin

June 18, 1997

Secretary Robert E. Rubin
Department of the Treasury
15th and Pennsylvania Avenue
Washington, D.C. 20220

Dear Secretary Rubin:

The undersigned advocacy organizations collectively represent low-income people, the elderly, the disabled, minorities and other consumers who will be significantly affected by the implementation of EFT 99. This joint letter is to urge you to use the statutory requirement for electronic transfer of federal payments to improve the lives of America's most vulnerable citizens by bringing them into the banking system. You have the opportunity through the appropriate implementation of P.L. 104-134 to make a significant

difference. The *wrong* decision by Treasury at this juncture may ease the transition to an electronic payment system for the U.S. Government, but it will do so at the cost of its citizens.

If done right, Mr. Secretary, EFT 99 will significantly foster the relationship between the unbanked federal recipients and the regulated, insured mainstream banking system. As you have recognized, bolstering banking relationships facilitates savings efforts, and increases the opportunities for other financial transactions between consumers and banks. The banks benefit from the new business. Consumers benefit from the lower cost and less abusive terms banks provide as compared to the unregulated alternative financial providers.

There are a number of specific decisions we urge Treasury to make in implementing rules for EFT 99:

- **Only federally regulated and insured, depository institutions should be permitted to be the conduits for federal payments.** This would *not* mean that recipients could not access their funds through an ATM or POS device at an alternative financial provider such as a money transmitter or a finance company -- just that they would never be *required* to go to that alternative provider to access their money. Nor would it prevent recipients from transferring the funds on their own to a non-insured mutual funds account.
- **Recipients who do not voluntarily participate in the electronic transfer program must be provided *individual accounts at insured, depository institutions, which are affordable, reasonably accessible, include basic consumer protections and provide access to essential banking services.*** These accounts must provide least-cost access to their federal entitlement; encourage savings; and foster financial relationships between the unbanked federal recipients and the mainstream financial institutions. When selecting institutions to provide these services, Treasury should give weight to the geographic coverage that the competing institutions offer.
- **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. The consistent aspect among all of the types of intermediaries currently recognized in federal law is the fiduciary duty that is owed to the recipient. *Treasury should not deviate from this important principle by allowing agents to be conduits of federal payments who do not have a fiduciary duty to the recipients.*

Fringe bankers, such as check cashers, finance companies, and others doing business in low and moderate income communities have succeeded because of the vacuum created by the absence of banks from these communities. These fringe bankers do not reinvest their substantial profits back into the communities. The residents of these communities gain little benefit other than the specific service provided by the fringe bankers. If Treasury allows this non-regulated industry -- which continues without obligations to the community -- to operate as either "authorized agents, " or subcontractors with banks for the purpose of receiving federal payments, the financial problems in the communities will not only continue to be ignored, but they would 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.

We urge you to exercise your authority to ensure the proper resolution of these issues. We would like to meet with you at the earliest possible date to discuss our concerns in more detail. Thank you for your attention.

Sincerely,

ACORN

AFL-CIO

American Association for Retired Persons

American Federation of State, County and Municipal Employees

Center for Community Change

Consumer Action

Consumer Federation of America

Greenlining Institute

International Brotherhood of Teamsters

Jesuit Conference USA, National Office of Jesuit Social Ministries

National Alliance to End Homelessness

National Community Reinvestment Coalition

National Consumer Law Center

National Peoples' Action

NETWORK: A Catholic Social Justice Lobby

Organization for A New Equality

Surface Transportation Policy Project

21st Century Group

Woodstock Institute

United Auto Workers U.S. PIRG

Appendix B

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.⁽²¹⁾ 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%.⁽²²⁾ One federal appellate court recently found "the public interest overwhelmingly favors enjoining these contracts."⁽²³⁾ 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."⁽²⁴⁾ 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.⁽²⁵⁾
- 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.⁽²⁶⁾
- 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.⁽²⁷⁾ 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⁽²⁸⁾ 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.⁽²⁹⁾

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.

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. Proposed Rule 31 C.F.R. ♦208.4(b) (1997).

7. These minimal requirements are only 1) that the funds must be deposited into a financial institution 2) in the name of the recipient. There is no requirement that the recipient actually be able to withdraw the federal funds directly from the financial institution.

8. For additional information about the current practices of check cashers and pay day lenders, see Consumer Federation of America, *The High Cost of "Banking" at the Corner Check Casher: Check Cashing Outlet Fees and Pay Day Loans*. August, 1997.

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

10. *Id.* at 4.

11. *Id.*

12. 62 Federal Register, Number 179, page 48723.

13. 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.

14. 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.

15. 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 fourteen states 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.

Florida: 5% with ID or 6% without, or \$5 whichever is greater for personal checks and money orders; 3% with ID, 4% without or \$5 for state benefits or Social Security checks, 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.

North Carolina: 3% or \$5 whichever is greater for government checks; 10% or \$5 whichever is greater for personal checks; 10% or \$5 whichever is greater for all other checks. (Eff. 10/1/97)

Ohio: 3% on government checks.

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

Tennessee: 3% or \$2 whichever is greater for state public assistance or federal social security checks, 10% or \$5 whichever is greater of personal checks or money orders. (Eff. 10/1/97).

While some of these fee ceilings may themselves seem high, in the rest of the 36 states, there are no limits whatsoever on these fringe bankers.

16. 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).

17. Treasury's use of "default" banks to receive all the direct deposits for all non-exempt 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.

18. 42 U.S.C. ♦407(a).

19. 42 U.S.C. ♦1383.

20. 38 U.S.C. ♦5301.

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

22. 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).

23. *Id.* at 654.

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

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

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

27. 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).

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

29. 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.