CHAPTER ONE

A Pathway to Empowerment: EFT'99

Millions of low-income, "bankless" Americans may soon become part of the financial mainstream, thanks to the recent amendment of an obscure law, advances in banking technology, and proposals to use supplemental savings programs to strengthen social security. If all goes according to plan, in coming years federal benefit recipients will join millions of private sector and federal workers and 90 percent of all federal retirees, in the system best known as *direct deposit.* In other words, they will receive their benefits through electronic funds transfer (EFT), rather than by paper check.

For as many as 10 million of these federal benefit recipients, the move to direct deposit will require opening bank accounts—perhaps for the first time in their lives—to receive their benefits electronically.[1] Like about 13 percent of U.S. families in general[2] and about 75 percent of families on welfare,[3] these recipients are often forced to pay extra for even the most basic financial services such as cashing checks and paying bills because they have no relationship with mainstream banking institutions. Without accounts, they also have a difficult time establishing credit histories and are denied many of the incentives to save for the future that middle- and upper-class Americans take for granted.

By promoting electronic delivery of benefits, the federal government's EFT'99 campaign and related efforts by state welfare and food stamp programs could change all this. By themselves, these campaigns can help provide inexpensive basic financial services to those who need them most. But if partnered with major financial education and savings initiatives like President Clinton's proposal to establish universal savings accounts (USAs) for working people,[4] these campaigns could become even more: a critical link in the nation's transition from entitlement programs to policies that promote work, self-sufficiency, and wealth accumulation. Direct deposit may be a matter of convenience for most people, but it could be the first step toward greater financial independence for millions of low-income Americans.

Upheaval in the Financial Services Industry

EFT'99 comes at a time when access to financial services for low-income families has become increasingly problematic. The interplay of many factors—among them the deregulation of interest rate ceilings in the 1980s, new technology, and growing competition from nondepository institutions—has led to a significant decline in the number of financial institutions in the United States and has driven banks to charge for services that they formerly subsidized with cheap, regulated deposits. "After fluctuating between 13,000 and 15,000 since the 1930s, a wave of bank failures and mergers caused the number of commercial banks insured by the FDIC to decline from 14,434 in 1980 to 12,343 in 1990 to 9,143 in 1997."[5] Many economic studies predict further shrinkage in the number of banks by the year 2000 by anywhere from 2,000 to 6,000 institutions.[6]

At the same time, the banking industry is restructuring to focus on higher-income markets. The recent wave of mergers and closings has sparked a small wave of new banks established by bankers who have been laid off or chose to leave their former positions. However, most of these new players are focusing on serving affluent professional or middle market businesses, or both.[7] In 1998, 216 new banks were chartered, up from just 53 three years before.[8] While the total number of bank branch offices has increased by 29 percent during the last twenty years, nearly all of this growth has occurred in middle-income areas. In contrast, the number of branch facilities declined by 21 percent in low-income neighborhoods.[9] Between 1978 and 1995, for example, Brooklyn lost around 14 percent of its bank branches and the Bronx about 20 percent; a disproportionate share of closings occurred in the poorest neighborhoods.[10] A recent Deloitte & Touche study predicted that competition could force banks to close nearly half their branches over the next decade. With more branches being opened in affluent areas, the inevitable implication of this study is that low-income neighborhoods will continue to lose banking offices in significant numbers.[11]

Growing competition with nonbanks such as money market funds and mutual funds, along with technological advances, have also been important factors in both the recent wave of mergers and consolidations that has swept the financial services industry and in the move to fee-based banking. Between August 1997 and April 1998, the five largest bank mergers of all time took place, causing the *Economist* to observe, "If there's a buzzword in banking right now, it's 'big.' The industry's future, goes an old mantra that is back in fashion, will belong to the super league of behemoths, with fingers in banking, broking, and insurance, that is emerging from the current wave of financial mergers. Some small banks may survive as niche operators. Middling ones, on the other hand, must either find partners or expect to be driven out of business."[12]

The growing competition with nonbanks has driven banks to charge for services that they used to subsidize.[13] In the twenty-first century, banks will meet their bottom lines more by charging fees for specific services than by living off the interest spread between taking deposits and making loans. This trend, which has important implications for lower-income consumers, is already discernible. For example, Wells Fargo, which recently merged with Norwest Bank, now gives checking account customers three free calls into its automated-voice-response telephone lines and then charges 50 cents for each additional call. To speak to an agent to shift funds or ask questions, customers are charged $1.50 per call.[14] "Some banks—mostly large, billion-dollar institutions—have even begun charging customers to close their accounts."[15] Two of the nation's giants—Charlotte-based NationsBank / Bank of America and First Union National Bank—charge a $10 fee if a checking account is closed within 180 days of opening.[16] By October 1997, some 35 percent of the total revenue for U.S. banks came from fees, the *Economist* noted. This was almost double the proportion in 1980.[17] In short, "at best, mega-mergers mean more ATMs, better technology for faster transactions, and computerized service and branches across the country. At worst, banks could close neighborhood branches and increase fees on everything from dealing with tellers to penalties for late payments."[18]

The Shrinking Community Reinvestment Act

The upheaval in the financial services industry has important implications for individual low-income customers who are being charged more for basic services and low-income communities, traditionally denied access to credit and capital needed for healthy development.

Federally regulated financial institutions are required to meet community credit needs under the Community Reinvestment Act (CRA).[19] Proponents of the act, which was passed in 1977, argued that "banks and other depositories were taking deposits from inner-city and other less affluent neighborhoods, while lending mostly in other areas and frequently overlooking qualified loan applications in the process."[20] According to Brookings Institution economist and banking scholar Robert Litan and his colleague Jonathan Rauch, providing for local community credit needs is a reasonable requirement in exchange for the special federal protections that banks receive: "This mandate was not imposed out of the blue: banks and thrifts, as the proponents noted (again with justice), enjoy federal charters, granted on the basis of a showing of need in a particular community, as well as recourse to a federal safety net in the form of deposit insurance. It was not illogical, therefore, to examine such institutions' community service records when considering whether to grant applications to merge with or acquire another institution, open or relocate a branch, seek a charter, obtain deposit insurance, or otherwise expand in ways requiring normal regulatory approvals."[21]

With respect to how well local community needs are being met, it is no small matter that when CRA took effect, roughly two-thirds of Americans' long-term savings were in CRA-covered institutions.[22] Today, less than 30 percent are, and this migration from the conventional banking system to mutual funds, money market accounts, and other savings vehicles outside CRA continues unabated. Technology will accelerate this phenomenon. Community advocates want Congress to extend community reinvestment requirements to nonbanks that control the vast majority of America's investable capital; however, they lack significant political support. This issue is part of the political debate surrounding financial modernization and looms large as the regulations that will govern the nation's transition to EFT are finalized by the Treasury.

Part of this debate involves disagreement over how federal regulators should define the assessment area—the geographic area within which the agencies evaluate an institution's CRA performance—for banks and thrifts that use alternative product delivery systems like the

Internet, rather than the traditional brick-and-mortar branch structure.[23] According to Office of Thrift Supervision Director Ellen Seidman, "institutions that heavily use the Internet to deliver products may be serving very few low- or moderate-income individuals or communities."[24]

The Impetus behind EFT'99: Saving Taxpayers Money

In the midst of this upheaval in the financial services industry, the push to convert millions of federal benefit checks to electronic payment was begun not out of concern for low-income families, but rather to save the federal government money. Specifically, in 1996 Congress amended the Financial Management Act, passed two years earlier in 1994, to require electronic deposits not just for wages and salaries but also for retirement benefits, programmatic benefits, vendor payments, and expense reimbursements to businesses.[25] Although 94 percent of federal workers are now paid by direct deposit, the mandate represents a tremendous logistical challenge. About 390 million payments were disbursed by the U.S. Department of Treasury in the first five months of fiscal 1999, and only 73 percent of those were made electronically.[26] Nevertheless, the cost savings to the government—only 2 cents for an EFT payment compared to 43 cents for a check payment—were deemed substantial enough to justify the transition. Converting to an all-electronic payment system would save the government an estimated $100 million a year in postage and check production costs alone.[27]

Experience also suggested that direct deposit would be safer than delivering checks by mail. Every year, the Treasury Department has to replace more than 800,000 government checks that are lost, stolen, delayed, or damaged during delivery, costing the government another $65 million annually. In addition, an average of more than 75,000 Treasury checks a year are forged and fraudulently negotiated.[28] With electronic funds transfer, forgeries, counterfeiting, and check alteration are virtually nonexistent. According to the Treasury, "misrouted EFT payments are never lost, and are typically routed to the correct bank account within 24 hours."[29]

At the same time that the federal government decided to convert to EFT, states also began taking advantage of its economies. In Ohio, for example, two-thirds of the tax collections in fiscal 1996 were by EFT. Of $10.1 billion in revenues, according to state Treasurer J. Kenneth Blackwell, $7.1 billion "were collected without a single piece of paper."[30] Also, because the food stamp system is so labor-intensive—

food stamps cost federal and state governments $400 million a year[31] to print, ship, store, distribute, reconcile, and destroy—states will save millions when they convert to electronic delivery of food stamps, which they are required to do by 2002 under the national welfare reform law.[32]

According to one estimate, delivering food stamps by electronic benefits transfer (EBT) just in the eight states that compose the Southern Alliance of States would slash the U.S. Department of Agriculture's administrative costs by $22 million a year.[33] And while they are not mandated to do so, as of June 1999, forty states plus the District of Columbia were in the process of converting their emergency cash assistance programs (Temporary Assistance to Needy Families, or TANF) to electronic delivery in order to achieve even greater economies.[34] For example, New York State welfare officials expect to save at least $12 million a year in administrative costs once all welfare benefits are distributed through plastic debit cards.[35] Similarly, with 3 million Food Stamp clients, Texas has the country's largest EBT system. Now that it is fully installed, the state expects to save more than $1 million a year in processing costs alone.[36] Texas also found that "switching to electronic payment substantially reduced its food stamp rolls and wiped out the barter of food stamps for drugs."[37] While EBT advocates note that the EBT card is a more convenient and dignified way for clients to access their benefits, harnessing technology to reduce fraud in the $21 billion food stamp program was one of the policymakers' main motivations in mandating the change. Nationwide, $815 million, or about 4 percent of the face value of all food stamps, are exchanged illegally for cash by food retailers each year.[38]

At least forty states have already begun the transition to EBT. Most of them are embracing *Quest*, a plastic debit card delivery system whose goal is to develop a nationwide EBT system that will piggyback on existing debit card and automated teller machine (ATM) networks.[39] Some states have also added or are considering adding other state-delivered benefits to their EBT systems, including WIC (Women, Infants, and Children nutritional benefits), general assistance, childcare, and child support.[40] Perhaps the most ambitious effort now underway is to use EBT cards to improve information sharing and administrative efficiency among public and private health care providers in a state. The Health Passport pilot project in Bismarck, North Dakota, and Cheyenne, Wyoming is the first effort by states to develop a multipurpose, standard smart card that not only delivers food stamps, but is also designed "to streamline patient check-in, provide up-to-date health information, support referrals among providers, facilitate patient access to medical records, automate appointment reminders and promote access to preventative health information that can be used by many different programs within the state and, eventually, across state lines."[41]

While the technical distinctions between direct deposit (EFT) and EBT are discussed in chapter 5, the fundamental difference is that electronic funds transfer requires the recipient to have a bank account, while electronic benefits transfer does not. EBT provides remote access to benefits through debit card and ATM networks without establishing any banking relationship for or on behalf of the recipient. However, although EBT does not bring the unbanked directly into the financial services mainstream, it is a step in that direction, because it fosters the use of electronic banking technology by millions of Americans who may never have used an ATM. Moreover, many of the states that are converting their cash assistance programs to EBT are planning direct deposit campaigns as well, because direct deposit offers even greater cost savings and a chance to connect recipients with mainstream financial services.[42]

Federal direct deposit (EFT) and state EBT programs are both outstanding examples of how technological advances in the private sector can be adopted for the public sector to create a government that "works better and costs less," in the *reinventing government* vernacular. Though they operate under different timetables and separate rules, both EFT and EBT share the potential to connect unbanked individuals to the mainstream financial system. In the pages that follow, discussions of the opportunities and challenges of EFT'99 should be interpreted, in general, to include state-sponsored EBT programs.

As suggested above, however, economy and efficiency are not what gives these unheralded measures the potential "to pave the way for dramatic and far-reaching changes in our society," as Treasury Secretary Robert E. Rubin has argued. Instead, the real power of EFT and EBT is that they could "soon result in millions of Americans being brought into the banking system for the first time, and it will change dramatically the way in which they handle money, "[43] as Treasury Undersecretary John D. Hawke Jr. has noted.

The Unbanked

Nationwide, an estimated 13 percent of U.S. families—including up to 10 million federal benefit recipients—currently have no bank accounts.[44] Among federal benefit recipients, the unbanked are more likely to be people of color, younger, and poorer than are other benefit recipients. This distribution is partially explained by the fact that more than twice as many social security recipients than supplemental security income (SSI) recipients—75 percent compared to 46 percent–have their benefits deposited directly.[45] SSI recipients are much younger, more urban, less likely to have completed high school, and more likely to be of a racial or ethnic minority than people who receive retirement checks. Another reason for this large difference is that many banks reduce or waive fees for depositors who are over 65.[46] Typically, these low-cost services are not available to SSI recipients, or are not widely advertised by banks even when they do provide such accounts. Although seven states have enacted legislation creating lifeline banking accounts[47] and most banks offer some form of basic bank account, a recent study by the New York Public Interest Research Group found "that a third of bank employees did not mention low-cost account options when customers asked about checking accounts. And calls to banks show they frequently emphasize higher-fee accounts and are often slow to mention—and occasionally deny altogether—that they offer low-cost accounts."[48]

The universe of unbanked Americans, both recipients and nonrecipients of federal benefits, represents one third of all minority households. One in four renters, one in six of those under 35 years of age, and 15 percent of the working poor—families earning between $10,000 and $25,000—do not have checking accounts.[49] Among welfare recipients, as many as three out of four are estimated to be without a bank account.[50]

The Policy Implications of EFT'99

To help the unbanked, EFT'99 is arriving on the scene at an especially auspicious time. As national social policy moves away from lifetime entitlements to time-limited emergency cash assistance and work-centered social policies, EFT'99 can help connect the dependent poor to the financial services system and enable them to begin saving money and building assets. From the outset, Treasury Secretary Rubin recognized the importance of this electronic initiative to the Clinton administration's urban strategy and especially to a more powerful welfare reform centered in economic development. Rubin saw EFT'99 as "a real opportunity to have an effect on a very large number of people in the inner city . . . If we can figure out a way to get them into the banking system for the first time, not only will it give them a more efficient way to cash checks and access to other financial services, but it may also encourage people to save, to plan financially, and therefore, to improve their economic life over time," he said. For millions of unbanked recipients, having to use "expensive check cashing services . . . is in itself a disadvantage."[51]

By connecting low-income people to the mainstream banking system, EFT'99 will enable them to build a credit history. It will also provide empirical data on their use of credit and their repayment practices, enabling mainstream financial services providers to create more appropriate methods for credit underwriting—methods that do not automatically assume that people with less income are necessarily higher risks.[52] And the power of EFT'99 will continue to grow as more and more welfare recipients start receiving their benefits electronically and become connected to the mainstream financial system. It is hard to imagine families successfully transitioning from welfare to work without having access to an affordable, secure bank account.

Understanding why so many Americans conduct their daily business without any formal relationship to the banking system is important for other reasons as well. Research suggests that the unbanked are less concerned about their credit ratings than are those who participate in the financial mainstream.[53] Knowing that minorities and immigrants are disproportionately likely to be unbanked, it is instructive that a recent Fannie Mae Foundation survey found significant percentages of African Americans and Hispanics who did not think that being late in paying their bills would reduce their chances of qualifying for a mortgage.[54] Along similar lines, housing economist George Galster found an inverse relationship between immigration rates (measured as people with poor English proficiency) and homeownership. "Cities with higher proportions of people who cannot speak English well," said Galster, "find housing demands skewed from owner to rental occupancy, greater demands for mortgage finance by those who do own, and a greater chance that their mortgage applications will be denied."[55] Thus connecting low-income families to mainstream banks can help educate them about the financial system and prepare them for homeownership.

The Purpose of This Book

With the aim of helping the unbanked and encouraging the transition to more asset-based social policies, I undertook this book. I wanted to chronicle the evolution of EFT'99 from an obscure exercise in technology transfer to a nationwide movement that has the potential to help millions of working families join the financial mainstream. If all the pieces come together, EFT'99 can do for the provision of affordable financial services what the Communty Reinvestment Act has done for the provision of mortgage credit in underserved communities. The CRA has proven to the financial community that low-income markets can be served profitably. We are at the front end of that same kind of discovery process for basic financial services. EFT and EBT are forcing policymakers to look at how technology and new delivery systems can be used to serve this community more effectively—*and* profitably. But achieving this goal will not be easy because EFT'99 raises many serious questions about consumer protection, access to technology and services, and costs. Because of these unresolved issues, the move to electronic benefits delivery is opposed by some powerful consumer groups and community development advocates, who believe EFT'99 "compels unbanked recipients into relationships that they have already determined are detrimental to themselves for the federal government's direct benefit."[56] I hope this book helps convince these advocates and others that this initiative can become a vehicle for building individual wealth in low-income communities and that they must work to secure the political support and resources EFT'99 needs to achieve its full potential.

The United States faces a very serious problem with under-saving. Despite blistering economic growth in 1998, Americans' personal savings rate fell to a post–World War II low of 0.5 percent of disposable income,[57] and declined still further to –1.2 percent in May 1999.[58] As Senator Bob Kerrey, D-Nebr., has said, "In a global economy, your economic health and security is measured by what you own, in addition to what you earn."[59] About 30 percent of U.S. households have no financial assets, and about half of all children in the United States are growing up in families that have no financial assets. Along racial lines, the difference in asset holdings between whites and African Americans is far greater than the difference in their incomes.[60] The household income of blacks is 61 percent that of whites, while black families possess only 12 cents for every dollar of wealth (median net worth) held by white families.[61] According to sociologist Thomas Shapiro, "the racial wealth gap is a very robust $48,817."[62] Under-saving for retirement is another big problem. As it has done for generations of middle- and upper-income Americans, the federal government should create policies that make compound interest work for the poor and help those with lower incomes join the asset-building classes. Thus my second goal in writing this book is to convince the administration and Congress to use EFT'99 as the vehicle for giving lower-income, low-wealth Americans—in Senator Kerrey's words—"a chance to own a piece of their country."

By bringing millions of unbanked people into the financial mainstream, EFT will facilitate savings by providing recipients with bank accounts. However, on its own, it will not provide them with a concrete incentive to save. We have a golden opportunity to expand EFT's impact by linking it with a national financial education campaign and a new savings initiative targeted at the working families of America who do not benefit from existing tax-preferred savings incentives such as individual retirement accounts.

The Clinton administration has made a commitment to share with benefit recipients the substantial cost savings made possible by EFT'99, and Treasury intends to meet part of this commitment by subsidizing recipients' electronic bank accounts. Subsidizing banks is not the best way to share savings with consumers; a better approach would be a major savings incentive for working families. This approach is explored in chapter 7.

How This Book Is Organized

The greatest challenge of the national move to electronic benefits transfer is in reaching the millions of benefit recipients without bank accounts, who have never used automated teller machines or plastic debit cards. Therefore, this book begins by examining the unbanked: who they are in the country as a whole and in Los Angeles, in particular. I have chosen Los Angeles because it is arguably the most diverse metropolis in the United States and a harbinger of America's urban future. Chapter 2 focuses on differences between the national and local perspective, a critical distinction because banking practices vary dramatically according to local demographics, racial differences, patterns and rates of immigration, the extent of concentrated poverty, and other local factors. To my knowledge, the Los Angeles analysis is one of the first local studies of the unbanked.

Chapters 3 and 4 address issues of electronic banking and the unbanked. A major focus is the digital divide. A July 1999 survey by the Commerce Department confirms that such a divide "still exists, and in many cases, is actually *widening* over time. Minorities, low-income persons, the less educated, and children of single-parent households, particularly when they reside in rural areas or central cities, are among the groups that lack access to information resources. Households with incomes of $75,000 and higher are more than twenty times more likely to have access to the Internet than those at the lowest income levels, and more than nine times as likely to have a computer at home."[63] Signs abound that the digital divide is fast becoming "a racial ravine," in the words of Commerce Assistant Secretary for Telecommunications Larry Irving.[64] "Between 1997 and 1998, the divide between those at the highest and lowest education levels increased by 25 percent, and the divide between those at the highest and lowest income levels grew by 29 percent."[65] This vast technology gap was recognized by Sun Microsystems CEO Scott McNealy when he said of the Internet: "It's equal opportunity if you're online, but if you're not, it isn't."[66] Recognizing this, chapters 3 and 4 pay special attention to how technology is shaping the banking industry's cost structure, opening up new delivery channels, and affecting access. Chapter 3 discusses the rise of electronic banking, its cost implications, and how technology is affecting the availability of banking services in low-income communities. Chapter 4 focuses on the rise of the fringe banking industry and how technology enables mainstream bank**s** to partner with check cashers in order to improve their market penetration in lower income communities. Because they layer fees upon fees and can isolate the poor from the financial mainstream, it is these kinds of partnerships that have led the syndicated financial columnist Jane Bryant Quinn to believe that EFT'99 could end up hurting, not helping, the poor.[67] However, surveys suggest that fringe bankers—with their convenient locations, flexible hours, and bilingual services—have their fingers on the pulse of low-income communities, and that stopping them from playing a significant role in EFT'99, as many consumer advocates would like to do, will be no simple matter.

Chapter 5 is about EFT'99 and its transition from an exercise driven by economy to a new social policy built around financial inclusion and wealth accumulation. The chapter tracks the rulemaking process, from the inception of EFT'99 to Treasury's adoption of the final rule, and the struggle to engage the banking industry to use technology to create affordable products and services that a successful move to EFT/EBT demands. The chapter concludes with a discussion of how some states are using their electronic benefits programs to bring welfare clients into the mainstream banking system.

The final two chapters deal with asset building, and why federal policy should link EFT'99 to a nationwide effort to help working poor begin to build wealth. Chapter 6 suggests that, contrary to popular belief, lower-income people do respond to well-conceived savings incentives; the chapter discusses the role of savings and asset building in state welfare reform plans. The concluding chapter presents four steps the president and Congress should take to make the transition to electronic benefit transfer all that it should be. The chapter starts with recommendations on how to maximize the potential of EFT'99 to connect the unbanked to the financial mainstream and ends with a proposal for creating a nationwide Individual Development Account (IDA) initiative.

One theme emerges above all others in this book. EFT'99 is not simply about the technology of electronic banking. It is, above all else, about financial inclusion, closing the opportunity gap, and building assets for the future.