

622-0563

F: Asset Limits



DEPARTMENT OF THE TREASURY
WASHINGTON

December 5, 1997

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call him?
-BR

Memorandum To: BRUCE REED
ELANA KAGAN

From: JONATHAN GRUBER JG

Re: Loosening Asset Limits for Public Assistance Programs

SUMMARY

Larry Summers has asked that I discuss with you the possibility of starting a process around the important issue of loosening asset limits for public assistance programs.

Certain government programs, including TANF, Medicaid, Food Stamps, and SSI, place limits on the value of assets (such as cash and cars) that recipients can hold. These limits are generally quite low, around \$2000. The presence of these limitations is inconsistent with our stated policy of promoting self-sufficiency and responsibility among welfare populations. More specifically, the presence of these limitations on asset holdings can be criticized on two grounds:

- They make it harder to leave welfare or other government programs for work: individuals feel unprepared for the vagaries of the job market if they have such a small financial safety net on which to rely. Thus, loosening these asset limits may promote early exit from welfare or other public assistance rolls. They will also provide a sounder financial footing for those families forced off welfare due to time limits.
- They cause a reduction in savings among those populations who are eligible for government programs (or close to eligible), since these families want to be able to avail themselves of the welfare system if necessary. Thus, loosening asset limits will increase savings among poor and near-poor families, reducing the likelihood that they need to rely on government programs if there is an adverse event such as illness or job loss.

These are strong arguments for limiting this restriction on asset holdings among government transfer recipients. This can be done in two ways:

- For the TANF program, we can have HHS write a "Dear Colleague" letter to the states, presenting the case for reducing asset limits, in the hopes that the states follow suit
- For the Medicaid, Food Stamps, and SSI programs, we can directly raise the current asset limit of \$1000-\$2000.

BACKGROUND

Current Asset Limit Policies

- **TANF**

Prior to welfare reform the national asset limit was set at \$1000 for liquid property (cash, financial assets, etc.). Now, however, states individually set asset limits for TANF. The asset limit is still at \$1000 in most states, but in some states it is as high as \$5000. Most states have also placed limits on the value of a car that a TANF recipient can own. Homes are usually exempt from asset limits.

- **Food Stamps**

In general, families must have liquid assets of less than \$2000 (\$3000 if the household has an elderly member) to qualify for Food Stamps. There are also guidelines for less liquid assets, such as the value of a car.

- **Medicaid**

Families that receive TANF or SSI automatically qualify for Medicaid, so the asset limits for those programs also apply to Medicaid. In addition, states are required to cover children with family incomes below poverty, and pregnant women and children under six with incomes under 133% of poverty; if a state chooses to apply a resource test to this population, it can be no more restrictive than that for TANF. Most states have covered these groups with no asset test, but roughly one-quarter of states continue to apply relatively low asset tests.

- **SSI**

SSI recipients cannot have more than \$2000 in assets (\$3000 for a couple). A home and car are excluded from assets.

Economic Effects of Asset Limits

Recent economic evidence provides strong support for the notion that the current very low asset limits reduce self-sufficiency among welfare households and lower the savings of the near-welfare population:

- One study finds that female headed families save 30-50 cents more for each one dollar rise in asset limits.
- Another finds that the removal of asset tests for the Medicaid expansions to children and pregnant women in most states raised the savings of newly eligible families (poor and near-poor) by 17 percent.

These results indicate that by raising asset limits could raise the savings welfare recipients and the near-poor, improving their self-sufficiency and helping them to move off welfare, or to avoid ever moving onto the welfare rolls. Moreover, it seems compelling to allow TANF to build up some savings as they approach the time limit for welfare receipt.

One criticism of raising asset limits is that it will allow "better off" families to join public assistance programs. But this contention is belied by evidence in a recent study by Rebecca Blank and Patricia Ruggles, who find that imposing asset tests has little effect on the population that is deemed eligible for TANF and Food Stamps. That is, right now those families that are eligible on income grounds save so little that loosening asset tests does not substantially increase eligibility. By loosening those asset tests, we will therefore promote those poor families to save more, without bringing into the system many additional families who are already saving. *Scoring?*

POLICY OPTIONS

For the **TANF program**, our options are now somewhat limited. But initial conversations with HHS indicate that they could still influence state policy-making by sending a "Dear Colleague" letter to the states, making the case for loosening asset limits.

- The first step here would be to produce research documenting the costs and benefits of looser asset tests, that could form the basis for such a letter. This would include work on the effect of looser asset limits on increased program exit through increased self-sufficiency, compared to program entry through easier qualification requirements.
- More thought could also be devoted to the question of other policy levers that we can use to influence state behavior in this area.

For the **Food Stamps, Medicaid, and SSI programs**, we can directly set the level of the asset test.

- Once again, we would want to support such a policy decision with solid research on the impacts of asset limit changes on savings behavior and participation rates in these programs.

NEXT STEPS

I would suggest convening a meeting with representation from HHS (^{H/CEA}ASPE and ACF), CEA, Treasury, SSA (who administers the SSI program), Agriculture (who administers the Food Stamps program) and NEC. HHS would be the natural place to house the research component of this project, with support from the other agencies. We have held preliminary conversations with both shops at HHS, and they are interested, but do not seem eager to proceed without White House guidance.

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THE BROOKINGS INSTITUTION

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January 8, 1998

Bruce Reed
Assistant to the President for Policy and Planning
Domestic Policy Council
Old Executive Office Building
Room 213
Washington, DC 20502

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Dear Mr. Reed:

The Brookings Institution Center on Urban and Metropolitan Policy is pleased to send you an advance copy of *EFT '99: How the Congressional Mandate to Deliver Government Benefits through Electronic Funds Transfer Can Help the Poor Build Wealth*, a discussion paper by Michael Stegman, MacRae Professor of Public Policy and Director of the Center for Community Capitalism at the University of North Carolina-Chapel Hill. Professor Stegman was the Assistant Secretary for Policy Development and Research at the U.S. Department of Housing and Urban Development under Secretary Henry Cisneros and Acting Chief of Staff to HUD Secretary Andrew Cuomo.

Professor Stegman's paper explores the opportunities and challenges of EFT '99. Electronic funds transfer (better known as *direct deposit*) allows the federal government to deliver benefits payments electronically and generates substantial savings over traditional check delivery. Beginning in 1999, federal benefits recipients will begin to receive their payments through EFT. EFT, if properly implemented, presents a rare opportunity for getting the estimated 10 million "unbanked" benefits recipients into the mainstream financial system. The implementation of EFT presents a concurrent opportunity to help these newly-banked, low-income families pull themselves out of poverty by building their long-term asset base through the use of individual development accounts and other direct savings incentives.

Professor Stegman suggests that there are steps that the Administration can take now which will increase the visibility and impact of EFT, including:

- Linking EFT implementation with a major effort to stimulate savings and wealth accumulation by the poor;
- Mounting a national outreach effort to help the unbanked understand the benefits of joining the financial mainstream, rather than undermining the potential of the EFT initiative by expanding waivers and exemptions; and

- Coordinating EFT implementation with the existing network of community development financial institutions (CDFIs), while strengthening CDFIs' ability to serve low-income persons in under-served communities.

While written with policy prescriptions in mind, *EFT '99* has significant implications for the private sector and non-profit, community development field as well.

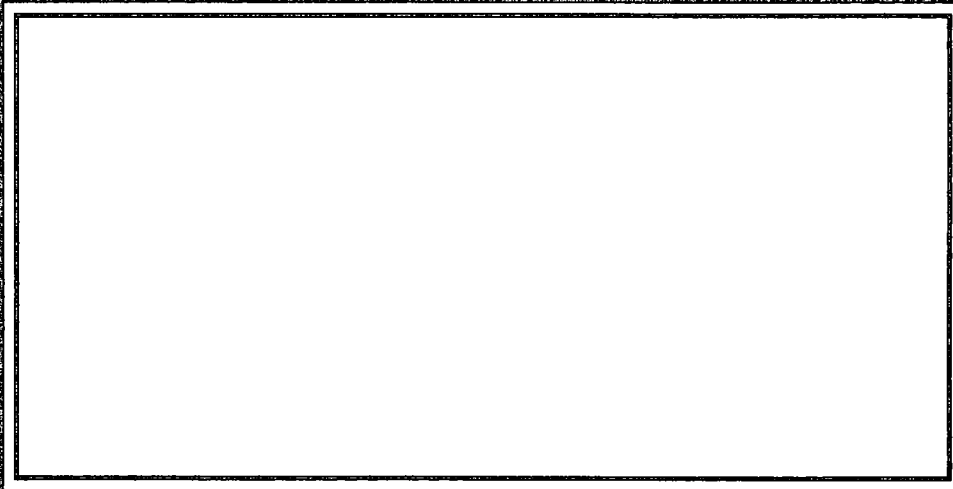
This discussion paper is precisely the type of timely, innovative, and policy-relevant product that the Brookings Urban Center hopes to publish and distribute in the future. *EFT '99* will eventually be converted into a monograph to be published by the Brookings Institution Press. A 5-6 page policy brief on this EFT issue is also forthcoming and will be forwarded to you upon its completion. Additional copies of this discussion paper can be obtained from the Urban Center's web site (www.brookings.edu/es/urbancen/urban_hp.htm). Thank you for your interest.

Sincerely,

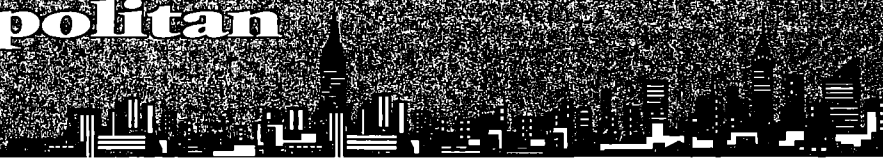
A handwritten signature in black ink, appearing to be 'Bruce Katz', with a large, stylized 'B' and a horizontal line extending to the right.

Bruce Katz
Director and Senior Fellow

Enclosure



**Center on Urban
and Metropolitan
Policy**



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DRAFT FOR CIRCULATION AND DISCUSSION

***EFT' 99:
How the Congressional Mandate to Deliver
Government Benefits through Electronic Funds Transfer
Can Help the Poor Build Wealth***

Michael A. Stegman, MacRae Professor of Public Policy Analysis

and

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prepared for

The Brookings Institution Center on Urban and Metropolitan Policy

December 17, 1997

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Introduction

Thanks to a 1996 amendment of an obscure law and recent advances in banking technology, millions of low-income, "bankless" Americans may soon become part of the financial mainstream. If all goes according to plan, beginning in 1999, federal benefit recipients will join tens of millions of other Americans who receive their salaries or government benefits through electronic funds transfer (EFT,) or by what most of us know as *direct deposit*.

Cost-cutting is the driving force behind the move to a virtually all-electronic federal payment system--it will save an estimated \$100 million a year in postage and check production costs alone. But economy and efficiency are not what gives this unheralded measure the potential "to pave the way for dramatic and far-reaching changes in our society." The real power of what Treasury has come to call *EFT'99*, is that it 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." This is because an estimated 20 percent of American families and 18 percent of all federal benefit payment recipients, approximately 10 million individuals, currently have no bank account. The ranks of the unbanked include a third of all minority households; one of four renters; one of six of those under 35 years of age; and 15 percent of the working poor--families earning between \$10,000 and \$25,000.

From the beginning, Treasury Secretary Robert Rubin recognized the importance of this electronic initiative to a more powerful, economic development-centered welfare reform and the Administration's urban strategy. *EFT'99* presents, said Rubin "...a real opportunity to have an effect on a very large number of people in the inner city..." Referring to the millions of unbanked recipients who "use expensive check cashing services to get hold of cash, which is in itself a disadvantage to them," Rubin went on to say that "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." It is also hard to imagine families successfully transitioning from welfare to work without having access to an affordable, accessible account that provides checking and savings services.

The purpose of this paper is twofold. First, because of its great human development potential, I want to raise the visibility of *EFT'99* and ensure that it is recognized as the powerful antipoverty instrument that it is by the community development and advocacy communities beyond those that traditionally deal with consumer credit and fair lending issues. The second goal of the paper is to present the case for using *EFT'99* as the vehicle through which the federal government can help low-income, low-wealth Americans begin to build financial assets. Like it has done for generations of middle- and upper-income Americans, it is time for the federal government to create a social policy that helps those with lower-incomes join the asset-building classes. Through direct savings incentives, we can make the benefits of a free enterprise society more evident and more accessible to the poor. As Michael Sherraden has said: "Very few poor

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people manage to spend their way out of poverty. The implication of this simple fact for welfare policy, as for the nation, are extremely important."

Part I: Trends in Electronic Banking and New Delivery Systems

Recent advances in communications technology are paving the way for new banking products and services, and changing the way traditional banking is done. As Comptroller of the Currency Eugene Ludwig has said, technology can either resolve long-standing access-to-service problems or raise new ones. Technology can help resolve access-related problems by making it possible to reach more people more cheaply, and can reduce the cost of "connecting dangerous or isolated areas to financial services." New access problems can arise because of the potential cost to low- and moderate-income consumers of taking advantage of the new technology.

With regard to the continuing availability of affordable credit in the inner city, it is no small matter that when CRA took effect in 1978, roughly two-thirds of Americans' long-term savings were in CRA-covered institutions. Today, less than 30 percent are, and the migration of long-term savings and investment from the conventional banking system to mutual funds, money market accounts and other savings vehicles outside of the CRA continues unabated. And technology will accelerate this phenomenon. Charles Rice, Chairman of Barnett Banks, which was recently acquired by NationsBank, sees banks "evolving from being oriented around geography to being oriented around lines of business. "You need to provide services at the lowest possible cost," says Rice, "with technology driving the changes..." Regulators recognize that advances in technology and the rise of online banking makes geography increasingly irrelevant, while the legal structure that governs the regulatory activities of banks and thrifts still has geography at its core. Thus, the move to Internet banking raises serious questions about the future of the CRA, which continues to be rooted in the physical geography of a community and its credit needs

The Rise of Online Banking

Competitive cost pressures will also accelerate the move to electronic banking. For example, sending messages by chip, over telephone lines, or through the air is half to two-thirds cheaper than printing or processing billions of pieces of paper and moving them around by truck and plane. Potential savings from electronic banking of this order of magnitude were confirmed by at least one study which showed that the cost per banking transaction is \$1.07 for a full-service bank, 54 cents for a telephone, 27 cents for an ATM—but just a penny and a half for PC banking. Because the overhead cost of an online banking system is expected to be about a half to a third of the cost of today's branch-dominated retail banking operation—competitive pressures will surely encourage more home banking services. In short, while traditional depository branches will continue to be an essential part of banking's future, optimizing the use of online systems will inevitably become a matter of institutional survival.

New Delivery Systems

Because technology enables a bank to expand its market reach without opening or acquiring new branches--a new bricks and mortar branch costs about \$300,000, ten times as much as a new ATM installation--the lower cost of on-line banking may eventually set a new industry cost standard--the lower marginal cost of serving customers electronically. Technology is already changing banking delivery systems in ways that can significantly increase access to financial services. For example, American Express now has ATMs that read encoded data as they dispense travelers checks so that the company records which travelers checks you received, the same as if you completed the transaction at a typical branch. Diebold, Inc., in partnership with Standard Bank of South Africa, is using technology to overcome illiteracy problems by building biometrics into the software platform of an ATM-touch screen. And here at home, Universal Federal Credit Union in Austin Texas installed a computer banking kiosk that talks back live. Kiosk users can talk to and see the teller, who can answer their questions on the spot.

New Bank Partnerships

Technology is also enabling banks to increase market penetration and customer access through partnerships with a variety of third parties--including high traffic retailers, community organizations and even with much-maligned check cashing outlets. And Treasury hopes that EFT'99 will stimulate the formation of an even richer array of strategic alliances in the future.

Though still limited to test markets, it has been estimated that "Kroger's commission on in-store Western Union transactions already exceeds \$40 million a year. Today, all 88 Kroger supermarkets in the Louisville marketing areas offer Western Union services. Along these same lines, 7-Eleven and others, have reportedly approached Diebold, Inc. for help in turning the ATM into a vending machine that would be able to dispense a wide variety of financial services, in addition to cash.

Citicorp, whose banking subsidiary, Citibank, a national leader in EBT, the electronic delivery of welfare and food stamp benefits, has awarded grants to the National Federation of Community Development Credit Unions to enable them to involve more of their members in the EBT movement. Citicorp is also exploring ways to move its long-standing relationship with ACCION International--a nonprofit organization active in micro finance in the U.S. and Latin America--into the business of electronic benefits transfer. In California, the Bank of America, another leader in the EBT movement, is working with community organizations such as the California Reinvestment Committee, community-based credit unions, social service agencies, and others, to develop educational programs and alternative methods of delivering financial services through community-based electronic banking sites which include ATMs, supermarkets, kiosks, and personal computers.

And, despite their pariah-like status among some financial regulators and many consumer advocates, "there are many good arguments for permitting check cashing outlets to serve as delivery points for the receipt of benefit payments." Among them is that the economics of these

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kinds of partnerships might work better in under served markets. According to check cashing industry representatives, "check cashers have space that is less costly than bank lobby space and have generally lower operating costs," and they "could lend to banks their location, staff and understanding of the marketplace."

Finally, the interplay of many factors--among them, the deregulation of interest rate ceilings, technology, and competition with non depository institutions --has "driven banks to charge for payments and other services that they formerly subsidized with cheap, regulated deposits." This means that banks in the twenty-first century will meet their bottom lines more by charging fees for specific services than by living off the "interest spread." This trend is already discernible. Today, "some 35 percent of American banks' total revenue now comes from fees, almost double the proportion in 1980." This is how Edward E. Crutchfield, CEO of First Union Bank, sees it: "The traditional part of the banking business--taking deposits, making loans and profiting from the spread in the respective rates--is clearly a business in long-term decline, a dinosaur." As fee-generating activities--from money management, underwriting stocks and bonds and selling annuities--grow in importance, banks are finding that unbundling and pricing their services separately is starting to pay off. This is why First Union's long-term plans call for building "a business that is about 50 percent traditional bank while the other 50 percent needs to look like a combination of Merrill Lynch, Fidelity and Charles Schwab."

The reality of increased market segmentation, unbundling services, and fee-based banking is a source of growing concern among important consumer groups, and is a major issue that Treasury must consider as it solicits industry interest in offering new electronic banking products to government benefit recipients. This reality, with which the advocacy community has yet to come to terms, and related issues dealing with the implementation of EFT'99, are discussed in the following section.

Part II: The Opportunities and Challenges of EFT'99

Treasury's Hopes for EFT'99

The goals of EFT'99 are deceptively simple: significantly increase the participation of payment recipients in the country's financial system; make certain that they have access to their funds at a reasonable cost; provide appropriate consumer protections; ensure that the system delivers payments and information accurately, conveniently, and in a timely manner.

One of the most important issues that the Administration had to address at the outset was whether federal regulators should *require* banks to provide low-cost lifeline accounts. Many consumer interest groups urged Treasury to adopt this approach, arguing that such low-fee accounts would only represent a modest cost to financial institutions because of the windfall they would receive from the float on the federal benefit deposits. Thus, the size of the potential float, the interest that a bank earns investing the idle account balance of the benefit recipient, is a critical, but unknown, variable in the EFT/EBT equations. The higher the earnings on undrawn balances, the lower the fees that banks would have to charge the unbanked for various account

services to cover their costs and, possibly, make a profit serving this market segment. Some consumer advocates argue it will be substantial--ACORN estimates aggregate bank earnings from undrawn balances just from the electronic delivery of welfare and food stamp payments could range between \$10.5 million and \$31.5 million a year. However, even the high-end estimate is still quite modest on a per account basis. Despite all the speculation, the only empirical estimates of the float that might be earned from EBT accounts were calculated by Citibank, which carried out a pilot test for Treasury. These tests yielded estimates of trivial earnings of \$0.19 per account per month. If, however, being connected to the mainstream financial system and the development of more culturally sensitive savings instruments might encourage low-income benefit recipients to save more, as some argue might happen, this would, of course, increase the potential float.

Disagreements about earnings from potential idle account balances notwithstanding, Treasury has stood firm with the banking industry in its belief that the goals of EFT'99 should be met through the marketplace, not by mandate. From the beginning, Treasury has sought to maximize private sector competition for the business of handling Federal payments, so recipients have a broad range of choice of payment services and service providers. To protect their franchise is why Treasury believes financial institutions will step up to the plate when it comes to competing for the business of unbanked benefit recipients. If banks allow this population to be lured permanently to nonbank intermediaries, they may lose the opportunity to create long-term relationships in an increasingly competitive market..

Who Should Bear the Cost of EFT'99?

Closely linked to the market vs. mandate issue is that of cost, and Treasury has been strongly criticized for its reluctance to give community advocates guidance on how to interpret the law's "reasonable cost" provision. Treasury believes that the financial institutions "need to determine, based on their knowledge of what their customers and potential customers want, what to offer, what is cost-justified, and what fee structure will work without it being a money-losing subsidy to recipients of federal payments."

To many benefit recipients, however, EFT'99, is not about the noble goal of building bridges to the financial mainstream; it is about ordering people to do something against their will, and cost-shifting. Results from focus groups and telephone surveys conducted for Treasury indicate that benefit recipients think it's okay for the government to want to process payments more cost effectively, but they resent the government telling them what to do. They also feel that if all payments are made electronically, the government or the banks will be making money at their expense. Given the reality that a high percentage of unbanked recipients currently pay to have their benefit and other checks cashed--for fees ranging from 1 percent to more than 20 percent of the face amount of the check, depending upon its source, and with between 60 and 70 percent of unbanked recipients purchasing 10 or more money orders a year, it is hard to understand the advocates' argument that EFT'99 compels benefit recipients to pay for something they used to get for free. These starkly different perspectives suggest the importance of Treasury's consumer education and outreach campaign which, if EFT'99 is to succeed, will help

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Treasury understand and correct real problems, and clear up important misconceptions that are causing greater grass roots opposition to the initiative than the facts might warrant.

Treasury's Proposed Rule for Implementing EFT'99

At the time of this writing [December, 1997], we are about halfway through EFT'99's official implementation timeline. On September 16th of this year, Treasury issued a proposed rule to implement EFT'99 that addresses how current and new recipients of Federal payments will have their payments delivered electronically, how those without accounts at financial institutions will receive their payments, and who is eligible for a waiver. Because it provides important insights into the Administration's current thinking, it is useful to review how the proposed rule deals with such important issues as allowable fees, the role of non depository institutions and the like.

Reality Bites I: Delay the Deadline: The near-impossibility of bringing all federal benefit recipients into the financial mainstream on such a tight timeline is reflected in two key provisions of the proposed rule. The first decision pushes back by up to one year the deadline by which unbanked recipients must receive their benefits through electronic means. The second decision relates to the granting of waivers, which may prove to be more problematic in the long-run. Treasury Under Secretary John Hawke, JR., recognized the sensitivity of the waiver issue in a February, 1997 conversation about EFT'99. Noting that the statute gives the Secretary of the Treasury the authority to develop standards for granting hardship waivers, Hawke went on to say that the "waiver authority will have to be used selectively or the benefits of the electronic program could be undermined."

Reality Bites II: Open The Waiver Door Widely: The September 16th proposed rule does anything but use the waiver authority selectively. Understandably, the rule would grant unbanked recipients a waiver if the switch to EFT would cause them "financial hardship;" it would also grant waivers to unbanked recipients who have physical disabilities or are confronted with a geographical barrier. However, the proposed rule also allows waivers on similar grounds to recipients *with* bank accounts who started receiving benefits before the EFT law was passed (July 26, 1996.) Because neither Treasury nor other participating agencies have the resources to evaluate every waiver request, Treasury decided to make the process "customer-driven." This means that Treasury will let recipients "self-select" themselves for waivers.

Insured Institutions Win: The proposed rule settles the spirited debate about the kinds of financial institutions that Treasury would permit to serve as its authorized agent in providing electronic accounts to the unbanked. Treasury aligned itself with many consumer advocates by slamming the door on nonbank institutions, from check cashers, to Western Union. Under the proposed rule, only federally insured financial institutions will be eligible to serve as Treasury's default banker. Importantly, the rule does keep the door open to the kinds of creative partnerships between bank and nonbank entities discussed earlier, by ruling that while only insured financial institutions could be involved in the disbursement and crediting of federal payments to the new electronic accounts, "other functions may be performed by non depository institutions and non-financial institutions working in partnership with the financial agent."

Treasury Under Secretary John Hawke, underscored the importance of non-depositories in the EFT'99 mix. "Customers may prefer," he said, "dealing with intermediaries that are not financial institutions...One could imagine, for example, major data processing firms developing a standardized product that could be offered to smaller depository institutions around the country."¹ While fraught with technologic challenges, Hawke believes that EFT'99 offers such firms "a great opportunity to act as a kind of a franchiser to attract participants to this market." By refusing to rigidly regulate the prices of deposit services, Treasury might have raised the ire of consumer groups, but in so doing, it also maximized the potential for market innovation, and an explosion of new commercially viable products, services and delivery systems to serve bankless benefit recipients and under served communities.

Dealing With the Unbanked: The proposed rule deals with the unbanked in three ways: First, as indicated above, through a massive public education campaign, Treasury hopes to encourage unbanked recipients to open a bank account on their own, and to designate that institution to receive their benefit payments through direct deposit. Second, Treasury hopes to stimulate an increase in the supply of low-cost account options that become available to unbanked recipients by urging financial institutions to start offering a reasonably priced alternative to traditional checking accounts. Called *Direct Deposit Too* by Treasury, these accounts would feature debit card access to federal benefits, provide no depository or third party bill-payment privileges, nor carry a minimum balance requirement. At this time, there is no way of assessing the success of the *Direct Deposit Too* marketing campaign, although more than 300 Missouri banks with low-fee accounts responded positively to a similar campaign mounted by that state's Department of Social Services as part of its EBT initiative to convert Food Stamps and emergency cash assistance benefit payments to electronic delivery.

Finally, Treasury intends to provide bankless payment recipients who do not voluntarily designate a financial institution to receive their benefits by the legal deadline, with an Electronic Transfer Account (ETA) in their own name. While many attributes of an ETA have yet to be decided upon, according to Treasury, ETA account holders will be able to withdraw their funds through automated teller machines or point-of-sale terminals with an access card. These ETAs will be provided at a reasonable cost and have the same consumer protections as other accounts at the financial institution.

When implementation is complete, EFT'99 and its state-level EBT counterparts will have put in place a more inclusive and responsive financial infrastructure. But infrastructure alone will not stimulate saving among low-wealth households, or help people who successfully work their way off welfare, stay off. Helping the poor accumulate their own assets, however, can bring about the kind of positive behavioral changes that traditional welfare policy could not.

¹ These comments and the comment immediately following are from, John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p 40.

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Part III: Savings Incentives to Help the Poor Build Assets

Michael Sherraden and his colleagues at Washington University in St. Louis have made a cogent case for why individual capital accumulation should be the fabric from which we cut a new American welfare policy. They tell us that there are two phases in the transition from consumption- to asset-based welfare policies. First, it is necessary to remove the barriers to savings and investment from existing safety net programs, and then public policies should affirmatively promote asset-accumulation by low-income households through a variety of means, including direct savings incentives. The much-criticized welfare reform bill the President signed into law last August has begun to do the former. But there are no examples of savings incentives for the poor that are comparable to the enhanced IRAs that were included in the balanced budget agreement. That ten year, \$17.8 billion package of tax breaks is just the most recent example of how the federal government makes it especially worthwhile for middle- and upper-income Americans to save a little extra for their retirement years. We should expect no less from our federal government when it comes to encouraging *and* helping low-income, low-wealth Americans save and invest in their futures. A government-assist to personal asset-building, which a successful EFT'99 can help accelerate, has quietly become a core element of the grass roots community development movement.

The widespread inclusion of measures to allow savings and asset-building by the dependent poor is one of the best kept secrets of welfare reform. Under the old AFDC law, ownership of assets in excess of \$1,000, excluding autos, disqualified a mother from receiving welfare; neither parents nor their dependent children were permitted to have savings accounts; and owning a car worth more than \$1500, even if it was needed to get to work, was also cause for disqualification. Much to their credit, however, many states liberalized their asset rules under waivers granted them by the Department of Health and Human Services before national welfare reform became law. By the time the president signed the welfare reform bill on August 22, 1996, twenty-five states had already received waivers to increase their asset limits; some to as high as \$5000. Several states also raised their vehicle exclusion limits--to \$2500 and \$3000 in Wisconsin and Iowa, respectively; to \$4,500 in California, \$5000 in Maryland, Oklahoma, and North Carolina, and to \$7500 in Virginia.

The Growth of Individual Development Accounts (IDAs)

These liberalized asset rules protect the eligibility status of persons *with* assets, but they do nothing to help them *grow* assets. Administered by grassroots organizations as an integral part of their community-building missions, and carried out in partnership with participating financial institutions, state- and locally-supported asset-building programs go by varying names--Family Savings Accounts in Pennsylvania, Family Development Accounts in Missouri, and the Tenant Investment Program in Portland, Oregon--but are generically referred to as Individual Development Accounts, or IDAs. In essence, IDAs are an effort to democratize tax-driven incentives like IRAs by creating direct incentives that work for low-income, low-tax bracket households. A key feature of IDAs is that for every dollar an individual saves, there are matching dollars of investment by community groups, foundations, churches or government itself." Another distinguishing feature of IDAs which is equally important to the successful

implementation of EFT'99, is that participation is conditional upon the saver's enrollment in an economic literacy program. And because they are designed to help low-income, low-wealth individuals build both human and financial capital, the typical IDA program generally limits withdrawals to three purposes--buying a house, getting an education, or starting a business

While the IDA movement gained much-needed visibility this past September with the start of a national demonstration that will establish at least 2,000 IDAs in 13 low-income communities, it is the welfare reform bill that is stimulating the startup of even more IDA programs as core elements of welfare-to-work strategies. The federal welfare reform legislation authorizes states to create community-based IDA programs with TANF funds and to disregard all money saved by the poor in IDAs in determining eligibility for all means-tested government assistance. Reinforcing the traditional values of work and individual responsibility, the legislation provides that only earned income can be saved and matched in IDAs. It also designates nonprofit, community-based organizations as custodians of IDA accounts, and restricts IDA balances to the uses identified above: education, home ownership and business capitalization." By June 30, 1997, 18 states had included IDAs in their own welfare reform plans.

There is a clear link between the kinds of partnerships that are necessary to make EFT'99 succeed and the IDA movement. For each to work in the community requires strong grassroots support and intensive outreach, education and training in economic literacy. Ohio's Treasurer J. Kenneth Blackwell sums up the importance of such education: "resisting the temptation to spend a virtual dollar requires a firm grasp of what it is to earn a real dollar." Given the shortage of outreach and counseling funds available to grass roots organizations engaged in the growing IDA movement and their importance to growing local support for EBT in low income communities, Treasury should make every effort to fund these organizations as part of its EFT'99 outreach campaign.

The Politics of IDAs

Despite the seemingly broad appeal of an antipoverty policy that, in syndicated urban affairs journalist Neil Peirce's terms," moves from subsistence handouts to investments, and from bureaucratically run income security systems to direct community ties," the IDA movement has yet to gain much currency in the halls of Congress. While IDA supporters point to the bipartisan sponsorship of national IDA legislation in the 104th Congress, the fact is, the bill died in committee. In October of this year, a similar measure to fund a \$100 million federal demonstration that would provide matching funds for 50,000 IDAs over four years, was introduced in the Congress; again, with bipartisan support, and again it will probably die in committee.

For two years running the Administration has failed to take an official position on the Asset for Independence Act despite the fact that IDAs were part of the Administration's own 1994 welfare reform proposal that never found its way to Congress. Perhaps more compelling than any other argument for why the Administration and the Congress should embrace IDAs is the simple matter of fairness. Analysis of the legislation that will bring the federal budget into

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balance by 2002 or sooner, "shows that its program initiatives---which primarily assist low- and moderate-income children and families, legal immigrants, and elderly people--are modest in size and dissipate over time. By contrast, its tax reductions for high-income individuals swell...substantially and grow to large levels over time." Together, the capital gains, estate tax, corporate alternative minimum tax and IRA provisions of the balanced budget deal reach a cost of nearly \$24 billion in a single year in 2007, the tenth year. This is more than six times the \$3.8 billion annual average cost of these provisions from 1998 through 2002. Back-loading is particularly egregious in the provisions for IRAs, the benefits of which will be garnered mostly by taxpayers who have incomes between \$50,000 and \$160,000, and who are *already* covered under an employer-sponsored retirement plan. Treasury estimates the costs of expanding current deductible IRAs and providing new back-loaded, so-called Roth IRAs, to be just \$1.4 billion for FY 1998-2002, ballooning to \$16.4 billion over the succeeding five years (FY 2003-2007.)

IDAs might not have much of a statistical impact on the national savings *rate*, which is currently only about half as high as it was thirty years ago, because of the small amounts of income that the poor can afford to invest. But we can be pretty sure that whatever low-income families do save as a result of a national IDA initiative *will* result in a net increase in *aggregate* personal savings. This is more than we can say for IRAs and other tax-advantaged savings incentives for middle- and upper-income Americans. Economists who have studied this issue report that "wide variation in effective tax rates on saving merely create opportunities for investors to shift funds into the most tax-preferred accounts."

Part: IV: Conclusions and Recommendations

As we approach the 21st century, few would take issue with Litan and Rauch that "to be without a bank account is no small matter." If we believe that surviving, let alone thriving, in today's world requires one to have full access to the mainstream banking system, then it is incumbent upon government to do all it can possibly do to assure the success of the ongoing transitions to electronic delivery of federal- and state-delivered benefits. In assessing where we stand at this point in time, one thing seems pretty clear. Midway through the implementation process, there are too many unresolved issues of concern to community advocates for them to have fully bought into EFT'99. Organizations like ACORN see themselves as stakeholders but neither as customers nor partners--either with Treasury or with the banking community--in the challenge to create a more accessible and inclusive financial services system. Perhaps, this was inevitable given the rising trend in banking fees, Treasury's decision not to mandate "lifeline" accounts, and its reluctance to rigidly regulate the character and costs of ETA default accounts prior to receiving industry bids to design and price them.

The Importance of Education and Outreach

In the meantime, lingering fears and uncertainties have led consumer stakeholders to conclude that EFT'99 looks like a bad deal for poor people. So, they are focusing on ways to expand waivers and exemptions beyond the generous ones already established by Treasury which, if successful, would seriously compromise the Administration's ability to fulfill the

promise of EFT'99. As we implied earlier, their persistent criticism of EFT'99 seems to have already caused Treasury to lower its expectations for EFT'99. For all the reasons discussed earlier, it is important for the Administration to act quickly to reverse this negative dynamic. And the best way to start turning things around is to find the \$10 million that Treasury needs to mount a major, grass roots outreach and education campaign in communities across the country that will help the bankless understand the benefits of becoming part of the mainstream financial system. The campaign should engage major consumer and community stakeholder organizations, their chapters and affiliates who, from the outset, have tried to shape EFT'99 and EBT program regulations on behalf of their members.

Support EFT'99 through the CDFI Program

Recognizing their complementary missions, the Administration should also coordinate its community development financial institutions (CDFI) program, which Treasury also administers, in ways that support the goals of EFT'99 and state-level EBT initiatives. The law creating CDFI authorizes the Fund to enter into community partnerships, and to operate training programs "to increase the capacity and expertise of community development financial institutions and other members of the financial services industry to undertake community development finance activities." The CDFI Fund could also expand its bank enterprise program (BEA) to reward traditional financial institutions that invest in community savings and asset-building initiatives in distressed communities.

Through its technical assistance function, the CDFI Fund could strengthen the capacity of the existing network of 346 federally chartered community development credit unions that were created exclusively to meet the financial services needs of low-income persons in under served communities. The fact that a majority of all credit unions and probably a much higher percentage of community development credit unions, would not be able to participate in EBT programs because they do not presently offer ATM services is an issue that Treasury should help remedy.

In addition to strengthening and expanding the network of community development credit unions in neighborhoods lacking deposit services (e.g. setting up more of them in public housing developments,) Treasury should work with the larger credit union industry to enable its members to become more significant players in the EFT/EBT process.

Most Importantly, Help the Poor Build Wealth

Finally and most importantly, EFT'99 would have substantially more grass roots support and national impact if it were linked to a major, effort to stimulate savings and wealth creation by the poor. This could be done in several ways, including, for example, democratizing IRAs through a federal refundable tax credit that would match low income individuals' deposits on a dollar-for-dollar basis up to, say, \$300 a year. Sherraden suggests another possibility--adding progressivity features to expanded IRAs by providing a tax credit against payroll taxes. In this case, contributions to the accounts would be best handled through an employer's tax return.

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Employers could either match employee contributions into the account, or make contributions to those accounts based on the employees compensation.

Another alternative is to modify the Assets for Independence Act discussed earlier by funding it on the mandatory side of the budget through the vehicle of the earned income tax credit (EITC,) for which all IDA-eligible individuals qualify. Through her annual federal tax return, a low-income worker would instruct IRS to electronically deposit into her IDA account, a specified portion of her EITC, along with a 1:1 federal match, up to a maximum of, say, \$300 a year. Once deposited into the individual's IDA account, withdrawals would be governed by the same kinds of restrictions discussed earlier.

A final option is to mount a five year, \$500 million IDA program that would be funded on the discretionary side of the budget (i.e. from annual appropriations.) Instead of HHS, the program would be administered by the CDFI Fund to underscore its asset-building, as opposed to income maintenance, objectives. And instead of individual community organizations applying for small grants to capitalize 25 to 50 IDAs each, in order to achieve the envisioned scale of 400,000 new accounts a year for five years, the applicants would be financial institutions who, working with community-based organizations to provide required economic literacy services, would each commit to establishing hundreds or thousands of IDA accounts. It makes sense to target the program to insured depository institutions because they have the capacity and motivation to create and administer large numbers of IDA accounts. In addition to receiving CRA credit and possible BEA incentives, they should be attracted to the program because IDA accounts are a source of cheap deposits with low average turnover rates. This strong earnings on idle balances (i.e. a large float.)

In closing, it should be emphasized that EFT'99 is not simply about the technology of electronic banking, but about financial inclusion and making the market economy work for all Americans. The IDA initiative would build upon the financial infrastructure that EFT'99 puts in place at a tiny fraction of the \$17 billion cost of the enhanced IRAs the Congress recently committed to higher income Americans. Adding a wealth-building component to EFT'99 and state EBT initiatives is not about subsidizing the poor. It is about finishing the job of welfare reform. It is about fairness. It is about making compound interest work *for* the poor and giving them a place at the table of American capitalism.

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INTRODUCTION¹

Thanks to a 1996 amendment of an obscure law and recent advances in banking technology, millions of low-income, "bankless" Americans may soon become part of the financial mainstream. If all goes according to plan, beginning in 1999,² federal benefit recipients will join more than 50 million American workers in the private sector,³ the vast majority of federal workers (94 percent), more than three-quarters of all federal retirees, and about two-thirds of all Social Security recipients, who currently receive their salaries or government benefits through electronic funds transfer (EFT,) or by what most of us know as *direct deposit*.⁴ Cost-cutting is the driving force behind the move to a virtually all-electronic federal payment system⁵— an estimated saving of \$100 million a year in postage and check production costs alone⁶. Experience also suggests that direct deposit is safer than delivering checks by mail. Every year, Treasury has to replace more than 800,000 Government checks that are lost, stolen, delayed or damaged during delivery,⁷ at an additional cost of \$65 million a year⁸.

States will save additional millions when they complete the mandated transition from paper- to electronic-delivery of federal food stamps and time limited welfare benefits (TANF) by 2002. For example, Texas, with the country's largest electronic benefits system (EBT)--it will

¹ I want to thank Hillary Bridgers and Luwana Bryant for their excellent research assistance.

² The amendment to the Federal Financial Management Act of 1994 is contained in Public Law 104-134, known as the Debt Improvement and Collection Act of 1996.

³ Today, more than 50 million people are paid by direct deposit, up from 15 million in 1990. According to the National Automated Clearing House Association, between 75 and 80 million people will be paid this way five years from now. David Brindley and Fred Vogelstein, "The Check is Not in the Mail," *U.S. News ONLINE*, April 14, 1997.

⁴ During fiscal year 1997, the U.S. Department of the Treasury disbursed more than 766 million payments, 62 percent of which were made electronically. U.S. Department of the Treasury, Financial Management Service, *Governmentwide Treasury-Disbursed Payment Volume*, October 1, 1996 through September 30, 1997.

⁵ This mandate covers all wage, salary, retirement and federal benefit payments to individuals, as well as vendor and expense reimbursements to businesses.

⁶ According to Treasury, the Government's cost for an EFT payment is only \$.02, while check payments cost \$.43 each. John D. Hawke, Jr., testimony before the House Government Reform and Oversight Subcommittee on Government Management, Information and Technology, June 18, 1997. States are also taking advantage of the economies of EFT. The Treasurer of Ohio reports, for example, that in Fiscal Year 1996, two-thirds of the tax collections in his office were by EFT. Of \$10.1 billion, \$7.1 billion, according to Treasurer J. Kenneth Blackwell, "were collected without a single piece of paper." J. Kenneth Blackwell, "One Degree of Separation: Advances in Technology and their Impact on Money, Banks and the Urban Poor," *Executive Speeches*, February/March 1997, p. 33.

⁷ In addition, an average of more than 75,000 Treasury checks per year are forged and fraudulently negotiated, whereas, forgeries, counterfeiting and check alteration are virtually nonexistent in EFT. John D. Hawke, Jr., testimony before the House Government Reform and Oversight Subcommittee on Government Management, Information and Technology, June 18, 1997.

⁸ In contrast, according to Treasury, "misrouted EFT payments are never lost, and are typically routed to the correct bank account within 24 hours." EFT'99, Fact Sheet: 31 CFR 208: Management of Federal Agency Disbursements; Notice of Proposed Rulemaking. September 16, 1997.

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serve 3 million clients when fully installed in 1998--expects to save more than a million dollars a year in processing costs alone.⁹ Texas also found that "switching to electronic payment substantially reduced its food stamp rolls and wiped out the barter of food stamps for drugs."¹⁰ At least 40 states have already begun the transition to EBT, with most of them having embraced a plastic debit card delivery system called *Quest*, whose goal is to develop a nationwide system for delivering benefits that will piggyback on existing debit card and ATM networks.¹¹

In short, EFT/EBT are outstanding examples of how technological advances in the private sector can be adopted by the public sector to create a government that, in the *reinvention vernacular* "works better and costs less." But 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." The real power of what Treasury has come to call *EFT'99*,¹² is that it 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."¹³ This is because an estimated 20 percent of American families¹⁴ and 18 percent of all federal benefit payment recipients, approximately 10 million individuals, currently have no bank account.¹⁵ As might be expected, "unbanked" Americans are more likely to be people of color, younger, and poorer than other benefit recipients. This partially explains why, for example, more than twice the percentage of Social Security recipients currently receive their benefits by direct deposit than do recipients of Supplemental Security Income (SSI) benefits.¹⁶ SSI recipients are much younger, more urban,

⁹ Kim Girard, "Texas Ropes in Chaotic Call Center," *Computer World*, March 31, 1997, pp. 71-72.

¹⁰Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 148.

¹¹The mandated move to electronic benefit transfer systems for food stamps and cash assistance is contained in the national welfare reform measure that became law in August, 1996. For one progress report of state EBT activity, see Joseph Radigan, "EBT Rule Causes a Stir," *U.S. Banker*, July 1997, pp. 75-76.

¹²In general, I intend that the reader interpret discussions of the opportunities and challenges of EFT'99 to include state-sponsored electronic benefit transfer (EBT) programs. Though they operate under different timetables and separate rules, both initiatives share the common goal of connecting unbanked individuals to the mainstream financial system.

¹³John D. Hawke, Jr., "Comment: New Law Means Millions of New Customers," *American Banker*, November 6, 1996

¹⁴Cited in John D. Hawke, Jr., "Comment: New Law Means Millions of New Customers," *American Banker*, November 6, 1996. The actual number of unbanked is subject to some debate. Comptroller of the Currency Eugene A. Ludwig, for example, uses 12 million households, about 12.5 percent of the population as unbanked. Swarthmore economist John Caskey says that the actual number is unknown--that the *Yankelovitch Monitor* data base puts the number at 6 percent; the Federal Reserve's *Survey of Consumer Finances* says 13 percent, while the *Panel Study of Income Dynamics* says 22 percent. Because it is in the middle range, Caskey suggests that the *Survey of Consumer Finances*' estimate of 13 percent may be the best guess. The consensus estimate of the number of unbanked federal benefit recipients seems to be 10 million. Ludwig and Caskey comments are from *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 1.

¹⁵Most federal benefit payees (88%) are Social Security recipients, and 91 percent of them currently have a banking relationship. Over 64 percent of all Social Security recipients already receive their payments by Direct Deposit. Treasury Under Secretary for Domestic Finance, John D. Hawke, Jr., in testimony before the Senate Committee on Banking, Housing and Urban Affairs, May 22, 1997.

¹⁶The percentages are 65 percent and 31 percent, respectively; data from: Booz Allen & Hamilton, and Shugoll Research, *Mandatory EFT Demographic Study, Executive Summary*, Washington DC, April 22, 1997, p. 2.

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less likely to have completed high school, and more likely to be of a racial or ethnic minority than retirement check recipients. Another reason for this large difference is "that many banks offer those 65 or older special senior accounts with reduced or no service fees,"¹⁷ which they don't typically offer to SSI recipients.

The universe of unbanked Americans, including both federal benefit recipients and non recipients, represent a third of all minority households;¹⁸ one of four renters; one of six of those under 35 years of age; and 15 percent of the working poor--families earning between \$10,000 and \$25,000.¹⁹ Studies show racial differences to be especially pronounced. While 91 percent of all white households, had a deposit account in 1992, this was true for just 59 percent of all Hispanic, and 52 percent of all black households.²⁰

Thus, at this critical juncture in the evolution of national social policy away from entitlements toward work-centered social policies, EFT'99 can stimulate the development of a more democratic form of American capitalism by laying the infrastructure for a more inclusive financial services system that will enable the dependent poor to accumulate wealth. From the beginning, Treasury Secretary Robert Rubin recognized the importance of this electronic initiative to a more powerful, economic development-centered welfare reform and the Administration's urban strategy. EFT'99 presents, said Rubin "...a real opportunity to have an effect on a very large number of people in the inner city..."²¹ Referring to the millions of unbanked recipients who "use expensive check cashing services to get hold of cash,²² which is in itself a disadvantage to them," Rubin went on to say that "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."²³

¹⁷Booz Allen & Hamilton, and Shugoll Research, *Mandatory EFT Demographic Study, Executive Summary*, Washington DC, updated September 17, 1997, p. 2.

¹⁸Almost a third (32%) of Hispanic households and a quarter of black households do not have a checking account. This compares to 2 percent of white households and 6 percent of Asian households. Constance Dunham, *Financial Access in the 21st Century*, Washington, DC, Comptroller of the Currency, proceedings of a forum, held on February 11, 1997, p. 8.

¹⁹Eugene A. Ludwig, in welcoming remarks, in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 1.

²⁰Constance Dunham, *Financial Access in the 21st Century*, Washington, DC, Comptroller of the Currency, proceedings of a forum, held on February 11, 1997, p. 7.

²¹*Making "Welfare-to-Work" Work*, Remarks to the Kennedy School Forum by Secretary Robert E. Rubin, December 12, 1996.

²²According to John Caskey, who has studied the economics of nontraditional financial services providers, check cashing outlets generally charge 1.5-2.5 percent of the face value of the customer's paycheck. This means, according to Caskey, that "a worker with an annual take-home pay of \$12,000 can spend \$250 a year just to convert his paychecks into cash." Although this is a relatively expensive service, While community advocates believe check cashers' exploitative fees are a function of their monopoly power, since low-income communities are typically under served by mainstream financial institutions, Caskey rejects this proposition arguing that in many places, banks and check cashing outlets are located near each other. While "monopoly power may account for a part of these fees" says Caskey, "this is not the major factor. Rather, fringe banking fees are high because the cost of providing the credit or payment service is high relative to the size of the transaction." John Caskey, *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor*, New York, Russell Sage Foundation, 1994, pp. 2, 7.

²³*Making "Welfare-to-Work" Work*, Remarks to the Kennedy School Forum by Secretary Robert Rubin, December

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By connecting low-income people to the banking system, EFT'99 will also enable them to build a credit history, and provide empirical data on their use of credit and repayment practices that the industry can use to create more appropriate methods for credit underwriting that don't automatically assume that people with less income are necessarily higher risks.²⁴ And the power of EFT'99 will grow enormously when welfare recipients start receiving their state benefits electronically and they, too, are 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 and accessible bank account that provides a variety of savings and payment services.

The purpose of this paper is twofold. First, because of its great human development potential, I want to raise the visibility of EFT'99 so that it is recognized as the powerful antipoverty instrument that it is by the community development and advocacy communities beyond those that traditionally deal with consumer credit and fair lending issues. This is necessary because achieving Secretary Rubin's vision for EFT will require more Federal resources than the Department of Treasury alone can muster and much more active and widespread support of grass roots community development stakeholders than have thus far been engaged in the process. The second goal of the paper is to present the case for using EFT'99 as the vehicle through which the federal government can help low-income, low-wealth Americans begin to build financial assets. The government can do this by building upon existing state and local asset-building programs, especially individual development account (IDA) initiatives, that have the potential to improve economic independence, stimulate the development of human and other capital, and enhance the welfare of children.²⁵ Funding a major savings incentive program for unbanked Americans is also the best way for the Administration to meet its stated commitment to share the substantial cost savings made possible by EFT'99 with the recipients of government payments.

Without a sweetener such as a national IDA initiative--I propose a five year, \$500 million program--influential community advocates will continue to oppose EFT'99 on the grounds that "...it compels unbanked recipients into relationships that they have already determined are detrimental to themselves for the federal government's direct benefit..."²⁶ Like it has done for generations of middle- and upper-income Americans, it is time for the federal government to create policies that make compound interest work for the poor and to help those with lower-incomes join the asset-building classes. Through direct savings incentives, we can make the benefits of a free enterprise system more evident and accessible to the poor. As Michael Sherraden has said: "Very few poor people manage to spend their way out of poverty. The implication of this simple fact for welfare policy, as for the nation, are extremely important."²⁷

12, 1996

²⁴Thanks to Carolyn Betts for pointing this out to me.

²⁵These are some of the benefits of IDAs that are identified in S1106, the Assets for Independence Act, introduced in the Senate on July 31, 1997 by Senator Dan Coats (R-IN).

²⁶Letter from ACORN to Director, Card Technology, Financial Management Service, U.S. Department of the Treasury, in reference to 31 CFR Part 207, July 8, 1997.

²⁷Michael Sherraden, *Assets and the Poor: A New American Welfare Policy*, M.E. Sharpe, Inc., Armonk, New

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Because EFT'99 is made possible by the revolution in banking technology, the paper begins with a discussion of the implications of advances in technology, including the rise of online banking, to under served populations and communities. As Sun Microsystems CEO, Scott McNealy, said about the Internet at a recent Harvard conference, "It's equal opportunity if you're online, but if you're not, it isn't."²⁸ Part II discusses Treasury's progress to date in implementing EFT'99. It highlights some of the more contentious issues involving unbanked recipients that have caused the advocacy community to oppose some key Treasury rulings which, if not tempered as the implementation process proceeds, could lessen the antipoverty impacts of this important initiative. The discussion in Part III is about completing the job of welfare reform by helping the poor build assets, and centers upon the recent growth of IDA initiatives across the country. The paper concludes with specific steps the Administration and Congress could take to help millions of low-income Americans become more vested in the American system of individual initiative and free enterprise.

York, 1991, p. 13.

²⁸Keynote Address by Scott McNealy, in *The Harvard Conference on The Internet and Society*, edited by O'Reilly & Associates, Inc., distributed by Harvard University Press, 1996, p. 50. Reinforcing this point, Litan and Rauch report that while about a third of all householders under age 60, with earned incomes over \$50,000 now have personal computers with modems, this is true of fewer than 4 percent of those with incomes below \$15,000. And the disparities are even greater in rural relative to urban areas. Data from Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 140.

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Part I: TRENDS IN ELECTRONIC BANKING AND NEW DELIVERY SYSTEMS

Recent advances in communications technology are paving the way for new banking products and services, and changing the way traditional banking is done. For example, by making possible securitization, which Litan and Rauch consider a “triumph of data processing,” powerful computers have already revolutionized the financial services industry and reduced the cost of credit in the process.²⁹ EFT’99 is also made possible by advances in technology,³⁰ but technology alone cannot assure its success. As Comptroller of the Currency Eugene Ludwig has said, technology can either resolve long-standing access-to-service problems or raise new ones. Technology can help resolve access-related problems by making it possible to reach more people more cheaply, and can reduce the cost of “connecting dangerous or isolated areas to financial services.”³¹ New access problems can arise because of the potential cost to low- and moderate-income consumers of taking advantage of the new technology.³² Litan and Rauch frame it this way: “Like the automobile and the suburban lifestyle that the family car made possible, digital finance offers a potentially vast expansion of choice and opportunity for those who have access to it; but, also like the automobile, it may imply a widening relative gap for those who are left behind in the “inner city” of finance.”³³

With regard to the literal inner city, it is no small matter that when the CRA took effect in 1978, roughly two-thirds of Americans’ long-term savings were in CRA-covered institutions.³⁴ Today, less than 30 percent are, and the migration of long-term savings and investment from the conventional banking system to mutual funds, money market accounts and other savings vehicles outside of the CRA continues unabated. And technology will accelerate this phenomenon. Charles Rice, Chairman of Barnett Banks, which was recently acquired by NationsBank, sees banks “evolving from being oriented around geography to being oriented around lines of business. “You need to provide services at the lowest possible cost,” says Rice, “with technology driving the changes...”³⁵ Federal regulators recognize that technology is making geography increasingly irrelevant, while the legal structure that governs the regulatory activities of banks

²⁹Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 43.

³⁰Definitions of the terms electronic banking and electronic money sometimes overlap. Comptroller of the Currency Eugene Ludwig defines electronic money to include electronic banking. According to Ludwig, electronic money “covers some activities that have been with us for some time now—such as the use of personal computers or telephones to pay bills, transfer funds and obtain account information—and others that we’re just beginning to consider—such as electronic commerce on the Internet, stored value cards in lieu of cash, and using technology to dispense federal and state benefits.” Remarks by Eugene A. Ludwig before the Conference on Digital Commerce 96: Law, policy, Profit and Pitfalls on the Global Information Network, Washington DC, May 6, 1996.

³¹Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 139.

³²Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Women in Housing and Finance Technology Symposium, Washington, DC, December 4, 1996.

³³Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 139.

³⁴National Association of Community Loan Funds, *Business Plan 1998-2002*, May 1997, p. 44.

³⁵Saul Hansell, “Era May be Ending for Big Local Banks,” *New York Times*, September 2, 1997.

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and thrifts still has geography at its core.³⁶ Thus, the move to Internet banking raises important questions about how the CRA will be applied to "virtual banks, and whether it should be limited to just the physical geography of a community and its credit needs.³⁷ Mindful of Reverend King's admonition that "we should not let our technology outdistance our need to understand and be of service to the least among us,"³⁸ this part of the paper discusses the implications of electronic banking for consumers in "the inner cities or poor rural areas who lack access to computers, financial services, and many of the benefits of our modern economy."³⁹

The Rise of Online Banking

Perhaps because it is evolving so fast, surveys tend to show consumers to be ambivalent toward technology⁴⁰ and generally uninterested in banking by computer because it is still too complex to simplify their lives.⁴¹ While only about 200 banks offered services by home computer in late 1996, the consensus forecast is still for a substantial increase in online banking by the turn of the century.⁴² Not only is the projected rise of home banking attributable to continued expected growth in PC ownership—for the first time, Americans bought more home computers than televisions in 1994—but the market will be further enlarged through continued innovation in Internet technology. However, because "...in low-income America a home computer is as rare as a home telephone was in the early years of this century..."⁴³ the

³⁶Remarks by Eugene A. Ludwig, Comptroller of the Currency, Before the Interagency Meeting of Federal Financial Institution Supervisors, Warrenton, VA, April 2, 1996.

³⁷ These challenges are already of more than theoretical interest. "In the case of Security First Network, the first Internet depository institution, the Office of Thrift Supervision determined that the proposal was consistent with CRA, but indicated its intent to monitor CRA compliance as loan and deposit patterns develop.", Steven C. Davidson, p.175.

³⁸Quoted by the Reverend James h. Daniel, Jr., Chairman/CEO of the East Fulton Street Group/21st Century Partnership at FDIC Hearings on Electronic Payment Systems, Washington, DC, September 12, 1996.

³⁹Toward Electronic Money and Banking: The Role of Government, keynote address by Secretary Robert Rubin, at a U.S. Treasury Conference, Toward Electronic Money and Banking, Washington, DC Sept. 19, 1996.

⁴⁰The most recent Yankelovich Monitor Survey suggests that consumers want technology that works for them, is easy to understand, and does not complicate their life. Paul Hammond, Yankelovich Partners, cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 49.

⁴¹Edward Furash, cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 52.

⁴²This estimate (p.7) as well as all those cited below are from: Steven C. Davidson, *The Community Banker's Guide to the Internet and Home Banking*. America's Community Bankers, Washington, DC, 1997. For example, an Earnst & Young study projects a 600 percent increase in home banking by the year 2000--from 1 percent to 6 percent of the population (p.3); another, by the New York-based consulting group, Jupiter Communications, indicates that nearly 13 million households will be banking by PC, compared to around 3.2 million today (p.40). Two recent surveys of financial institutions confirm the expected rise of electronic banking. The first, of community banks by Grant Thornton LP, indicates that over the next five years 49 percent plan to offer electronic home banking, up from just 1 percent today (p.3). The second, a Booze Allen & Hamilton 1996 survey of a broader mix of financial institutions with Internet sites, predicts that 500 institutions will be offering full-fledged Internet banking by the end of the decade, while 2000 will have Internet sites compared to only 285 bank sites at the time of the survey (p.38).

⁴³As a matter of fact, according to Litan and Rauch, in 1995, about a fifth of all households with incomes below \$10,000, and 10 percent of households in the \$10,000 to \$20,000 range still did not have a telephone at home, let

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development of such inexpensive technologies as WebTV, which permits the viewer to access the World Wide Web without a computer and modem, has the potential to vastly increase low-income householders' access to electronic shopping, including online banking.⁴⁴

Cost Implications: Competitive cost pressures will also accelerate the move to electronic banking. For example, Litan and Rauch report that sending messages by chip, over telephone lines, or through the air is half to two-thirds cheaper than printing or processing billions of pieces of paper and moving them around by truck and plane.⁴⁵ Potential savings from electronic banking of this order of magnitude were confirmed by at least one study which showed that the cost per banking transaction is \$1.07 for a full-service bank, 54 cents for a telephone, 27 cents for an ATM—but just a penny and a half for PC banking.⁴⁶ Because the overhead cost of an online banking system is expected to be about a half to a third of the cost of today's branch-dominated retail banking operation⁴⁷—competitive pressures will surely encourage more home banking services.⁴⁸ In short, while traditional depository branches will continue to be an essential part of banking's future, optimizing the use of online systems will inevitably become a matter of institutional survival.⁴⁹

Despite minimum market penetration to date and some high level skepticism--Comptroller of the Currency Eugene Ludwig, for example, thinks that many forecasts of shopping by home computer are grossly optimistic--a persuasive case can still be made that electronic banking will help shape the industry's future by facilitating the development of new, lower cost distribution channels.⁵⁰ By reducing overhead costs, more intensive use of

alone a computer and modem. This is why they conclude that "access to the information superhighway is today still a disproportionately higher-income phenomenon." Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 140.

⁴⁴Steven C. Davidson, *The Community Banker's Guide to the Internet and Home Banking*, p.1. Davidson reports that in late 1996, WebTV, which provides direct access to the Internet, entered the marketplace at a price of less than \$500, p.15.

⁴⁵Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 54.

⁴⁶Cited by Eugene A. Ludwig, Comptroller of the Currency, in remarks before the Women in Housing and Finance Technology Symposium, Washington, DC, December 4, 1996

⁴⁷ Steven C. Davidson, *The Community Banker's Guide to the Internet and Home Banking*, America's Community Bankers, Washington, DC, 1997, p.38.

⁴⁸According to Davidson, "the consensus estimate of less than 1 percent of assets overhead or operating expense means that a PC-based banking system, e.g. Internet banking, will result in a potential savings of 1 to 2 percent on assets. these savings are quite significant when we remember that return on assets for the typical community bank is around 1 percent. p. 39.

⁴⁹A recent survey of community banks found that "almost every community bank (93%) said that employing technology effectively was critical to their survival. Over the next five years, community banks plan to increase their offerings of the following: debit cards, from 43% today to 88% in five years; automated account inquiry, from 28% to 73%; and electronic home banking, from just 1% today to 49% in five years. Grant Thornton, LLP, Community Banks' Attitudes Towards Alternative Payment Systems, Technology-Based Services and the Internet, September 12, 1996.

⁵⁰Comptroller of the Currency Eugene Ludwig made this point in a recent address: "With all due respect to those who think everybody in the world will be on the Internet by the year 2004, I think we need to take projections like these with a large grain of salt. For example, one major consulting firm recently projected that 20 percent of U.S.

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online technology allows banks to maintain profit margins in highly competitive product markets with narrow interest spreads, and to “compete on a price basis more aggressively with such non-branched entities as money market funds.”⁵¹ Because financial services companies and “virtual” banks—several Internet-only banks have already been chartered by federal regulators⁵²—“don’t have the overhead of a bank with branches,” they can pass on their savings to customers in the form of higher interest rates.⁵³ This is why some of the most aggressive interest rates available to depositors aren’t being offered by banks or thrifts, but by non-depository financial institutions and Internet-only banks.⁵⁴ Last Fall, for example, “American Express began marketing a one-year CD whose rate locks in at 0.75 percent above the national average,” while in May of this year, Atlanta’s Internet Bank—the nation’s second Internet-only bank—was offering the country’s top money market yield.⁵⁵

There are a few examples, though not in the United States, where the overhead savings from online banking are reportedly being directed to the creation of new products for underserved populations rather than the payment of higher dividends to depositors. Standard Bank of South Africa has created an electronic bank called E-Bank. As a matter of policy, customers who choose to bank through E-Bank will be offered a lower minimum balance and a package of services specifically designed for them.⁵⁶ Estrellamar Grupo Financiero, in Panama, has created an electronic bank and micro credit facility using a magnetized credit card that meets the same international standards as Visa, Master Charge and other well known charge cards. Offering 6 percent interest on short term deposits, \$500 micro credit loans through ATMs, and no fees for accessing one’s account by EFT, Estrellamar targets poor Panamanians. Their marketing material says “the only difference between the international cards [e.g. Visa, etc.] and us, is the different segments of the market that we serve: they serve 2 percent and we serve 98 percent of the world’s population.”⁵⁷ Like Treasury’s hopes for EFT’99 here at home, these low cost, stripped down bundles of services are specifically designed to attract a new customer segment, and possibly, a new profit center, to Standard Bank of South Africa and Estrellamar—the

household spending would take place on the Internet by the year 2005. Just to put things in their proper perspective, to achieve that level of spending, Internet commerce would need to grow more than 130 percent each year for the next ten years. Maybe that’s not inconceivable, but I think it’s unlikely. consider the growth of some other recent technologies. Between 1986 and 1995, the sales of compact discs achieved a compound annual growth rate of just 30 percent. Sales of color televisions increased at an annual compound growth rate of 10 percent from 1970 to 1985.” Remarks by Eugene A. Ludwig before the Conference on Digital Commerce 96: Law, Policy, Profits & Pitfalls on the Global Information Network, Washington, DC, May 6, 1996.

⁵¹Steven C. Davidson, *The Community Banker’s Guide to the Internet and Home Banking*, America’s Community Bankers, Washington, DC, 1997, p.41.

⁵²Two of these are Security First Network Bank, and Atlanta Internet Bank, the first and second Internet-only banks to be chartered by the OCC. Cited in Steven C. Davidson, p.40.

⁵³Steven C. Davidson, *The Community Banker’s Guide to the Internet and Home Banking*, America’s Community Bankers, Washington, DC, 1997, p.38.

⁵⁴Kerry Hannon, “Branchless Banks,” *U.S. News ON-LINE*, May 28, 1997.

⁵⁵Kerry Hannon, “Branchless Banks,” *U.S. News ON-LINE*, May 28, 1997.

⁵⁶Thomas Swidarski, Diebold, Inc., cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 45.

⁵⁷See Estrellamar’s Web site at <http://www.Estrellamar.com/English>.

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unbanked. Innovations like these should be studied for possible adaptation in America's low income communities.

Because technology enables a bank to expand its market reach without opening or acquiring new branches--a new bricks and mortar branch costs about \$300,000, ten times as much as a new ATM installation⁵⁸--the lower cost of online banking may eventually set a new industry cost standard--the lower marginal cost of serving banking customers electronically.⁵⁹ This possibility is implied in a number of recent surveys and studies. For example, a 1996 Booze Allen & Hamilton national survey of financial institutions⁶⁰ concluded that in ten years, "the Internet will be the most important delivery system, while traditional branches ranked only eighth in importance."⁶¹ However, despite the recent wave of mergers and acquisitions,⁶² there is still one branch for every 22,000 Americans, which is five times as many banks per person as in the United Kingdom, ten times as many as in Germany, and thirty-five times as many as in Japan.⁶³ While today's financial delivery system still includes 82,000 branches,⁶⁴ it is not surprising that a recent Deloitte & Touche study predicted that competitive pressures will force banks to close nearly half of them over the next decade.⁶⁵ This is also consistent with the views of a widely respected bank analyst who has written that "the valuation of banks for the balance of the century will be determined, not by the geographic coverage of their branches, but by how effectively they use technology."⁶⁶

While experts generally agree that "Internet banking and alternative electronic payment systems will have a more lasting effect on the way banks interact with and serve their customers than almost anything else in recent history," knowledgeable sources find some financial institutions poorly prepared to operate in the 21st century world of electronic banking. For example, a recent survey of community banks by Grant Thornton LLP found that only 19 percent

⁵⁸Matt Andrejczak, Carrollton Bank on Target with new ATMs in Area, *Washington Business Journal*, Dec. 1997

⁵⁹Steven C. Davidson, *The Community Banker's Guide to the Internet and Home Banking*, America's Community Bankers, Washington, DC, 1997, p. 40.

⁶⁰The survey was of all financial institutions that had an address on the World Wide Web as of the date of the study, which was released in late 1996. Because the respondents were among the first to use the Internet, the results should not be construed to be representative of all financial institutions.

⁶¹Steven C. Davidson, *The Community Banker's Guide to the Internet and Home Banking*, America's Community Bankers, Washington, DC, 1997, p.26.

⁶²According to Litan and Rauch, since the mid-1980s, a wave of mergers and consolidations has caused the number of commercial banks in America to drop from about 14,000 to fewer than 10,000, while the S&L crisis led to a 60 percent reduction in the 4,000 thrift institutions that were operating in 1980. Today, only about 1600 are still in business. They also point to recent economic studies that predict further shrinkage in the number of banks by the year 2000 of anywhere from 2,000 to 6,000 institutions. Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 68.

⁶³Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 91.

⁶⁴Thomas Swidarski, Diebold, Inc., cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 44.

⁶⁵Cited in Susan Headden, *The New Money Machines*, *U.S. News ON-LINE*, August 5, 1996.

⁶⁶Thomas Hanley, from UBS Securities, cited by Steven C. Davidson, *The Community Banker's Guide to the Internet and Home Banking*, America's Community Bankers, Washington, DC, 1997, pp. 2-3.

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have a chief information officer to oversee their use of technology, and just 5 percent are planning to hire a CIO in the next twelve months.⁶⁷ The survey also found that

Most [community] banks are jumping onto the Internet with little time, expense or planning. Nearly two-thirds (64 percent) created their Web sites in less than three months; half (52 percent) spent less than \$5,000, and less than a third (30 percent) have a written business plan for their Internet sites. This lack of strategic planning where technology investments are concerned is a theme that resonates through a number of studies that Grant Thornton has conducted among banks, and gives us pause for concern.⁶⁸

New Delivery Systems

As implied above, technology is already changing banking delivery systems in ways that can significantly increase access to financial services. For example, American Express now has ATMs that read encoded data as they dispense travelers checks so that the company records which travelers checks you received, the same as if you completed the transaction at a typical branch⁶⁹. Diebold, Inc., in partnership with Standard Bank of South Africa, is using technology to overcome illiteracy problems by building biometrics into the software platform of an ATM-touch screen.⁷⁰ "People using the machine can swipe their card and use their fingerprint for identification without having to enter a personal identification number (PIN.)" In addition, the joint venture has developed a method of "leading the customer through a transaction using both voice and graphics." According to Diebold officials, "the bank had signed up about 500,000 people in the last year for this account, focusing basically on the unbanked."⁷¹ And here at home, Universal Federal Credit Union in Austin Texas installed a computer banking kiosk that talks back live. Kiosk users can talk to and see the teller, who can answer their questions on the spot.⁷²

Computers Also Make Telephones More Powerful: As competition heats up with nonbank financial institutions and the rising cost of face-to-face transactions erodes profit margins, technology is making the good old telephone a more critical component of electronic

⁶⁷Grant Thornton LLP, statement about Community Banks' Attitudes Towards Alternative Payment Systems, Forum on Technology-Based Services and the Internet, Washington, DC, September 12, 1996.

⁶⁸Grant Thornton LLP, statement about Community Banks' Attitudes Towards Alternative Payment Systems, Forum on Technology-Based Services and the Internet, Washington, DC, September 12, 1996.

⁶⁹Thomas Swidarski, Diebold, Inc., cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 45.

⁷⁰Thomas Swidarski, Diebold, Inc., cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 45.

⁷¹Thomas Swidarski, Diebold, Inc., cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 45.

⁷²Earl Golz, Video Banking in Austin, Press Release Archives, North Communications, July 12, 1995. Here's how the system works: A customer touches the kiosk computer screen to activate various banking services, bringing a teller onto the video screen. The teller can answer questions about the customer's account. Transactions include transferring funds, applying for a loan, stopping payment on a check, opening an account and applying for an automatic teller machine card. Prerecorded messages can be called up in color graphics. A fax machine also is part of the technology.

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banking. A recent New York Times article on the growth of North Carolina's First Union Bank, the nation's sixth largest, discussed how "routine services now provided by branches are increasingly being shunted to huge telephone banks...where sophisticated computers display a customer's entire relationship with the bank."⁷³ Recognizing that "if we don't still have the human element we will lose," First Union plans to use lower cost telephone service to maintain personal contact with its customers. The hope is that "maybe 'person-to-person' will prove an adequate substitute for 'face-to-face;'" but for those who demand more personal service at the branch, it will continue to be available, but at a higher price.⁷⁴ Even in the less-than-full-service electronic benefit transfer environments, telephone communication is important. While less full-service than University Federal Credit Union's touch screen kiosk, Citicorp's EBT customers do have 24 hour-access to a toll-free 800 customer service number.⁷⁵

New Bank Partnerships

With Major Retailers: Technology is also enabling banks to increase market penetration and customer access through partnerships with a variety of third parties--including high traffic retailers, much-maligned check cashing outlets, and community-based organizations. And Treasury hopes that EFT'99 will stimulate even more such strategic alliances in the future. As Litan and Rauch report, "an automated teller machine in a shopping mall is much cheaper than a full service bank branch, and installing a computer terminal in a grocery store, McDonald's restaurant, post office, or check cashing outlet may prove cheaper still."⁷⁶ Among retailers, "supermarket-based financial services are rapidly becoming an important access point for financial services both here and abroad. National Commercial Bank Services has a successful business of in-store bank branches, which it started more than ten years ago. Western Union's strategic vision includes broadening its network of agents to include neighborhood grocers to deliver its menu of automated services--money transfers, money orders, walk-in payment services, and prepaid phone cards.

Though still limited to test markets, it has been estimated that "Kroger's commission on in-store Western Union transactions already exceeds \$40 million a year. Today, all 88 Kroger supermarkets in the Louisville marketing areas offer Western Union services⁷⁷. Along these same lines, 7-Eleven and others, have reportedly approached Diebold, Inc. for help in turning the ATM into a vending machine that would be able to dispense a wide variety of financial services, in addition to cash."⁷⁸

⁷³Robert D. Hershey Jr., "2 Banks, One Goal: Cast Long Shadows," *The New York Times*, November 15, 1997

⁷⁴Robert D. Hershey Jr., "2 Banks, One Goal: Cast Long Shadows," *The New York Times*, November 15, 1997

⁷⁵*Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 51.

⁷⁶Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 139.

⁷⁷"Making the Most of Financial Services," *Progressive Grocer*, April 1996, p. 75)

⁷⁸Thomas Swidarski, Diebold, Inc., cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 44.

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As indicated earlier, with a new bank branch costing about ten times as much to create as a new ATM location, ATMs have become an increasingly popular expansion method.⁷⁹ Carrollton Bancorp, parent of Carrollton Bank, has opened 30 ATM machines in Target Stores in Maryland and Virginia in the past eighteen months, and has struck similar deals with Wal-Mart, Sam's Club, and Valu Food stores in the region. The bank has also installed an ATM in a McDonald's in Hanover.

The use of technology to expand market reach of major banking firms has also gone global. In Peru, for example, in-store bank branches are reportedly going into a large retail chain; in Portugal, banking kiosks are being launched through a joint venture between Commercial de Portuguese and a retail partner; and in the U.K. the Sainsbury Bank has been recently chartered as a joint venture of the Bank of Scotland and the Sainsbury supermarket chain.⁸⁰

With Community Organizations: Citicorp, whose banking subsidiary, Citibank, is a national leader in the electronic delivery of welfare and food stamp benefits (EBT,) has awarded grants to the National Federation of Community Development Credit Unions to enable them to involve more of their members in the EBT movement. Citicorp is also exploring ways to move its long-standing relationship with ACCION International--a nonprofit organization active in micro finance in the U.S. and Latin America--into the business of electronic benefits transfer.⁸¹ In California, the Bank of America, another leader in the EBT movement, is working with community organizations such as the California Reinvestment Committee, community-based credit unions, social service agencies, and others, to develop educational programs and alternative methods of delivering financial services through community-based electronic banking sites which include ATMs, supermarkets, kiosks, and personal computers.⁸²

With "Fringe Bankers": Despite their pariah-like status among some financial regulators and many consumer advocates, "there are many good arguments for permitting check cashing outlets to serve as delivery points for the receipt of benefit payments."⁸³ Among them is that the economics of these kinds of partnerships might work better in under served markets. According to check cashing industry representatives, "check cashers have space that is less costly than bank lobby space and have generally lower operating costs," and they "could lend to banks their location, staff and understanding of the marketplace."⁸⁴ Fringe banking scholar John Caskey

⁷⁹These costs and the following data on Carrollton Bank's use of ATMs to expand its market are from Mat Andrejczak, "Carrollton Bank on Target with New ATMs in Area," *Washington Business Journal*, Dec. 8, 1997.

⁸⁰Douglas Ferris, National Commercial Bank Services, Inc., cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 47.

⁸¹Pamela Flarherty, "Expanding Access Through Technology,"

⁸²Letter to docket clerk, from John H. Huffstutler, Senior Vice President and Chief Regulatory Counsel, Bank of America on Direct Federal EBT Program 31 CFR Part 207

⁸³John P. Caskey, cited in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 41.

⁸⁴Martin Lieberman, in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 32.

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would also consider allowing check cashing outlets to function as agents for banks and to take deposits. This would, according to Caskey, "permit people who live in communities without bank branches to obtain bank payment and deposit services locally while saving banks the cost of establishing a full-service bank."⁸⁵ If these partnerships materialize, however, Caskey cautions that "such an approach should not, of course, excuse banks from the obligations to ensure that credit is available in low income and minority communities for legitimate business and housing needs."⁸⁶

Financial giant Chase Manhattan Bank even recognizes that when it comes to customer service, "check cashers are far superior to banks in terms of the days and hours they are open for business and their ease of access."⁸⁷ It is no surprise, therefore, that technology is leading mainstream banks like Chase to partner with more customer-friendly and accessible check cashing outlets. Despite their unsavory reputations among the advocate community, these bank-check casher strategic alliances have the potential to significantly expand the range of saving and payment services that are accessible to the unbanked. Beginning in June, 1996 cardholders for ATMs that are part of the NYCE teller-machine network in New York were able to start getting cash at a check-cashing outlet just as they would at an ATM machine. The alliance hopes eventually to open the network to people without bank accounts. The day they got paid they would be able to access a direct-deposit payroll account with a swipe card at check-cashing locations."⁸⁸ By virtue of this partnership, the check cashers would be able to do virtually anything that Chase could do, and, in effect, would become an extension of Chase in under served communities and neighborhoods. This new reality sends chills up the spines of consumer advocates.

Toward Fee-Based Banking: Finally, the interplay of a host of factors--the deregulation of interest rate ceilings, technology, and competition with non depository institutions among them--has "driven banks to charge for payments and other services that they formerly subsidized with cheap, regulated deposits."⁸⁹ This means that banks in the twenty-first century will meet their bottom lines more by charging fees for specific services than by living off the "interest spread." This trend is already discernible. About a third of Chase Manhattan's profits now come from investment banking, which produced a 28 percent return on equity in the third quarter of 1997, while its retail banking operations managed a return of just 19 percent.⁹⁰ Today, "some 35 percent of American banks' total revenue now comes from fees, almost double the proportion in 1980."⁹¹ In short, "the traditional part of the banking business--taking deposits, making loans and profiting from the spread in the respective rates--is clearly a business in long-term decline, a

⁸⁵John P. Caskey, *Fringe Banking*, New York, Sage 1994, p. 136.

⁸⁶John P. Caskey, *Fringe Banking*, New York, Sage 1994, p. 136.

⁸⁷Kenneth Rosenblum, Chase Manhattan Bank, *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 46.

⁸⁸David Brindley and Fred Vogelstein, "The Check is Not in the Mail," *US News ONLINE*, April 14, 1997.

⁸⁹Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 54.

⁹⁰"American Banks: The Good Times Keep on Rollin'," *The Economist*, October 25, 1997, p. 83.

⁹¹"American Banks: The Good Times Keep on Rollin'," *The Economist*, October 25, 1997, p. 83.

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dinosaur."⁹² As fee-generating activities--from money management, underwriting stocks and bonds and selling annuities--grow in importance, banks are finding that unbundling and pricing their services separately is starting to pay off. For example, KeyCorp., based in Cleveland, "saw its [1997] third quarter fee income grow by 36 percent, much faster than income from lending, as investments in asset management, insurance and stockbroking began to pay off."⁹³ This also explains why First Union's long-term plans call for building "a business that is about 50 percent traditional bank while the other 50 percent needs to look like a combination of Merrill Lynch, Fidelity and Charles Schwab."⁹⁴

The reality of market segmentation, unbundling services, and fee-based banking is a source of growing concern among important consumer groups, and is a major issue that Treasury must consider as it solicits industry interest in offering new electronic banking products to government benefit recipients. This reality, with which the advocacy community has yet to come to terms, and related issues dealing with the implementation of EFT'99, are discussed in the following section.

⁹²Edward E. Crutchfield, CEO of First Union Bank, quoted by Robert D. Hershey Jr., in "2 Banks, One Goal: Cast Long Shadows," *The New York Times*, November 15, 1997"

⁹³American Banks: The Good Times Keep on Rollin'," *The Economist*, October 25, 1997, p. 83.

⁹⁴Robert D. Hershey Jr., "2 Banks, One Goal: Cast Long Shadows," *The New York Times*, November 15, 1997"

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Part II: THE OPPORTUNITIES AND CHALLENGES OF EFT'99**Treasury's Hopes for EFT'99**

The goals of EFT'99 are deceptively simple: significantly increase the participation of payment recipients in the country's financial system; make certain that they have access to their funds at a reasonable cost; provide appropriate consumer protections; ensure that the system delivers payments and information accurately, conveniently, and in a timely manner.⁹⁵ In a November 1996 op-ed, Treasury Under Secretary John D. Hawke, Jr. identified some of the key features of an account that would meet these goals:

One might expect, for example, that banks would, at a minimum, seek these new customers by offering them a basic account into which their monthly payments could be made by EFT, and from which withdrawals could be made by *plastic card at ATMs and POS terminals*.

Additional deposits could be accepted, and other attributes of the account could be based on expected balances. *Some specified number of withdrawals per month might be permitted before service charges were imposed, and the ability to make some number of free third-party payments by telephone transfer or other means might also be afforded.* Additional services, such as balance inquiries, could also be provided.

By making such accounts purely electronic--with no paper checks to process or account statements to send out--banks could hold both their costs and customer charges to a minimum, and the risk and cost of overdrafts could be entirely eliminated. At the same time, these new accounts could provide customers with *a safe and convenient means for receiving, holding and accessing their EFT payments*⁹⁶ (emphases added).

This section discusses Treasury's plans for implementing EFT'99 and some of the more contentious issues relating to the unbanked which pose significant barriers to achieving its full potential.

Markets vs. Mandates

One of the most important issues that the Administration had to address at the outset was whether federal regulators should *require* banks to provide low-cost, lifeline accounts.⁹⁷ The American Association of Retired Persons (AARP) and the National Consumer Law Center,

⁹⁵31 CFR Part 208 Management of Federal Agency Disbursements; Proposed Rule, *Federal Register*, Sept. 16, 1997.

⁹⁶John D. Hawke, Jr., "Comment: New Law Means Millions of New Customers," *American Banker*, November 6, 1996

⁹⁷"Lifeline" banking proposals, aim to ensure that bank accounts are affordable for low- and moderate-income families. Although there are many variations, most would require banks to offer, for modest monthly fees, deposit accounts with low minimum-balance requirements and some checkwriting privileges. In response to concerns about high fees in the 1980s, many states enacted lifeline banking laws although efforts to do so nationally failed. John Caskey, *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor*, New York, Russell Sage Foundation, 1994, p. 129.

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among others, have urged Treasury to adopt this approach, arguing that providing such low-fee accounts would only "represent a modest cost to financial institutions...[because of] the financial windfall institutions will receive from the float on these federal deposits..."⁹⁸ Arguing the other side, the New York Clearing House, an association of 10 large New York City banks, made a two-part case against a lifeline rule. NYCHA says that a federal regulation directing that low-income consumers receiving federal benefit payments be given specific rights would not only greatly complicate the compliance burden on banks, but that it would also force them to offer services below cost. The latter is why they urged Treasury to follow New York State law by adopting a policy that "no bank be required to offer banking services at a loss."⁹⁹

The Size of the "Float": Disagreement over the cost of serving the bankless is why the size of the float, the interest that a bank earns investing the idle account balance of the benefit recipient, is important to any discussion of EFT/EBT. The higher the earnings on undrawn balances, the lower the fees that banks would have to charge the unbanked for various account services to cover their costs and, possibly, make a profit serving this market segment. While some consumer advocates argue it will be substantial--ACORN estimates aggregate bank earnings from undrawn balances just from the electronic delivery of welfare and food stamp payments could range between \$10.5 million and \$31.5 million a year.¹⁰⁰ However, even the high-end estimate is still quite modest on a per account basis. With all the speculation, the only empirical estimates of the float that might be earned from EFT/EBT accounts were calculated for Treasury by Citibank, which carried out a pilot test in Texas to measure the float. The 90 day EBT pilot, which was conducted from the end of August to late November 1996, yielded estimates of trivial earnings of \$0.19 per account per month that a financial institution may see from idle balances attributable to benefit payments.¹⁰¹ However, this small test does not put the issue to rest.

Connecting benefit recipients to the mainstream financial system, and developing more culturally sensitive savings vehicles¹⁰² might encourage benefit recipients to save more, as some believe would happen, and if these things happen, they would probably increase the float.

⁹⁸"Banking is becoming increasingly expensive as financial institutions charge for services previously offered free of charge, and most have raised fees for such core banking needs as writing a check, using an ATM machine, or making balance inquiries. Increasing costs are a significant reason why 10 million recipients of federal checks do not have bank accounts--they cannot afford it." Comments in letter from Martin Corry, Director, Federal Affairs Department, American Association of Retired Persons to Financial Management Services on 61 Fed. Reg. 39253, November 25, 1996.

⁹⁹The New York Clearing House: specific advice to Treasury on this matter was that "Treasury would do well to adopt as a cardinal principle the policy of the State of New York that 'no banking institution be required to offer lower cost banking services at a cost to the account holders which is less than the actual cost to the banking institution to provide such services.'" From November 26, 1996 letter to Docket Clerk from Jill M. Considine, President.

¹⁰⁰Letter from ACORN to Director, Card Technology, Financial Management Services, U.S. Department of the Treasury, re: Treasury Request for Comments--31 CFR 207, July 8, 1997.

¹⁰¹U.S. Department of the Treasury, Financial Management Services, *Direct Payment Card Pilot--Statistical Evaluation of Float Earnings*, June 26, 1997, p. 2.

¹⁰²See, for example, discussions of this issue by Elizabeth Rhyne, of the U.S. Agency for International Development, Lisa Mensah of the Ford Foundation, and Pamela Flaherty of Citicorp, in *Financial Access in the*

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Although there was insufficient data from the pilot test to measure it, Citicorp recognized the possibility of a learning curve that would result in benefit recipients increasing their savings over time, or at least, slowing the pace of withdrawals from their electronic accounts. According to Citicorp:

New account holders who are unaccustomed to working with bank accounts may continue to operate from a cash horde by drawing all funds out as quickly as possible. Experience with the system may induce a more gradual draw down of account balances. A mature EBT delivery system might be characterized by far longer mean time to exhaustion of account funds and large average undrawn balances. To the extent that there is turnover among the Texas DPC population, the test may not be representative of what can be expected in a more established EBT environment.¹⁰³

Creating a national IDA initiative in conjunction with federal and state EFT/EBT programs which would match benefit recipient deposits from wages on a dollar-for-dollar basis, could also improve the float arithmetic. Presumably, the availability of the federal match would encourage recipients to save more, thus increasing average account balances. And if withdrawals from these accounts were restricted to certain uses such as buying a home or starting a business as they are in most IDA programs, then a relatively high percentage of these "cheap deposits" would remain in the account longer, which would increase the float even more.

In the Meantime, Markets Win: Disagreements about earnings from potential idle account balances notwithstanding, Treasury stands firm with the banking industry in its belief that the goals of EFT'99 should be met through the marketplace, not by mandate. From the beginning, Treasury has sought to maximize private sector competition for the business of handling Federal payments, so recipients have a broad range of choice of payment services and service providers.¹⁰⁴ Enlightened self-interest is why Treasury believes financial institutions will step up to the plate when it comes to competing for the business of unbanked benefit recipients:

...Profit and business expansion opportunities are a fundamental reason for seeking this market, using the cost savings available in the electronic environment to make money, and still provide a service to the unbanked population that receives federal payments.

Financial institutions should be interested in this market to protect their franchise. If they allow this population to be lured permanently to nonbank intermediaries, they may lose the opportunity to create long-term relationships.

21st Century, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997.

¹⁰³U.S. Department of the Treasury, Financial Management Services, *Direct Payment Card Pilot--Statistical Evaluation of Float Earnings*, June 26, 1997, p. 4.

¹⁰⁴John D. Hawke, Jr., testimony before House Government Reform and Oversight, Subcommittee on Government Management and Technology, June 18, 1997.

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Check cashers, data processing companies, and other innovators will find ways to serve this population. They will be competing and trying to find ways to attract this population away from banks and into other forms of payment services¹⁰⁵

The Administration's "...fondest hope is that a thousand flowers will bloom, and that when it comes time to deal with those folks who have not told us where to send their payments, we will be able to direct them to the many offerings that private institutions will be providing to this population," However, the Administration has also indicated a readiness to "wield a heavier hand of government" should the industry fail to respond to Treasury's overtures.¹⁰⁶

Treasury's decision to foster innovation should not be mistaken for an uncritical embrace of market solutions to access-to-services problems. The Administration's successful campaign to strengthen the CRA is testament to its belief in using public policy to correct market failures in the financial services industry. Instead, it seems to be a recognition that premature, heavy-handed regulation has the potential to nip innovation in the bud. At this early stage of the EFT'99 process, if Treasury does not know what the industry response to its invitation to create special products and services for the unbanked will be, then how can it intelligently decide what access-to-service issue(s) its regulations should specifically address? Litan and Rauch's assessment of the regulatory options that apply to the introduction of smart card and digitized money technology seem to apply equally to EFT'99:

In trying to set rules of the road...the government faces an especially delicate problem. On the one hand, the advent of these new and potentially useful monetary vehicles could be slowed if some rules of the road are not set early. Indeed, if sufficient protections to consumers are not provided against abuses, then if and when problems emerge, the danger arises that policy makers may overreact and thus thwart the technology. But, on the other hand, until the instruments themselves appear and settle into regular patterns, it is impossible to know just what is to be regulated, let alone how to regulate. And if the government lays down too many rules too early, it may distort or misdirect the development of the very instruments whose usefulness it seeks to refine. So, even in principle, it is impossible to know with any precision how many rules, or what sort of rules, the government should try to set.¹⁰⁷

Who Should Bear the Cost of EFT'99?

Closely linked to the market vs. mandate issue is that of cost, and Treasury has been strongly criticized for its reluctance to give community advocates and others guidance on how to

¹⁰⁵John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 39.

¹⁰⁶John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 40.

¹⁰⁷Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 82.

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interpret the law's "reasonable cost" provision. Some of the friction has to do with differences over the anticipated size of the float. As suggested above, some advocates believe the float will be sufficiently large to cover most if not all of the costs of providing unbanked benefit recipients basic accounts. While not disagreeing with the desirability of such an outcome, Treasury correctly asserts that, at this time, there is no empirical basis for such optimism and that institutions "need to determine, based on their knowledge of what their customers and potential customers want, what to offer, what is cost-justified, and what fee structure will work without it being a money-losing subsidy to recipients of federal payments."¹⁰⁸ General unhappiness with high bank fees is also a big part of the problem.

That's why consumer interests want Treasury to specify in advance maximum allowable charges on default accounts for the unbanked. For example, the Consumer Federation of America has urged Treasury to limit monthly fees on default accounts to a maximum of \$3; assure reasonable access to cash withdrawals, which they define as no fewer than four free ATM withdrawals per month at which the account is held; plus at least two free ATM balance inquiries. Noting that bank fees have been rising at twice the rate of inflation, ACORN expressed concern that if the electronic accounts that Treasury establishes in the name of unbanked recipients do not include no-cost or very low-cost checking or third-party payment services, in addition to having to pay withdrawal fees, consumers will also have to pay for payment services separately.¹⁰⁹ "Given that money orders typically cost between \$3 and \$5 at banks, and most people pay at least rent and two utilities each month, ACORN argues that the cost could climb as high as \$15" just for the payment side of the equation. When you add ATM-type transaction charges for accessing account balances and possible surcharges for using "foreign" ATMs,¹¹⁰ ACORN shows how "...depositors could pay as much as \$25 in assorted fees each month--nearly \$6 more than the unbanked beneficiaries pay now using check cashers for all financial transactions."¹¹¹

And surveys confirm that it's not just high fees that discourage the unbanked from having a bank account. Although the categories are broad and it is not always easy to interpret what respondents mean when they select certain coded responses,¹¹² the Federal Reserve's latest Survey of Consumer Finances (1995) indicated that some 23 percent of the unbanked "do not

¹⁰⁸John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 39.

¹⁰⁹A survey by Bank Rate Monitor shows that the average minimum balance required to avoid fees on non-interest bearing checking accounts was \$346 in September, 1997. The average threshold to avoid fees on interest-bearing checking accounts was \$1647. The national average bounced check fee on noninterest accounts was \$20.79 in March; about 48 percent of banks surveyed charge non-customers a fee to use their ATM machines. "Bank Fees Get Easier," *USA Today*, November 6, 1997.

¹¹⁰According to a new national survey of 860 ATM machines by PIRG, 45 percent of ATMs surveyed in 27 states and the District of Columbia surcharged non account holders in March, 1997, nearly double the 23 percent found in a 19-state ATM survey conducted in September 1996. According to PIRG, nationally, the average ATM surcharge was \$1.15 in 1997. Press Release, Public Interest Research Group (PIRG) Tuesday, April 1, 1997

¹¹¹Letter from ACORN to Director, Card Technology, Financial Management Services on 31 CFR 207, July 8, 1997

¹¹²There is no way, for example, to know from these surveys whether unhappiness dealing with banks has to do with feeling unwelcome when respondents enter the bank, don't want "audit trails" of their financial activities because they participate in the underground economy earning money "off-the-books," etc.

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like dealing with banks;" 27 percent said they did not write enough checks to make an account worthwhile; 21 percent said they did not have enough money to make an account worthwhile; while only 8 percent cited high service charges.¹¹³ So, the advocates question, why should we rush to embrace EFT?

Cost-Shifting--Not Cost-Saving: To many benefit recipients, the answer to the above question is pretty straightforward. EFT'99, they believe, is not about the noble goal of building a bridge to the financial mainstream; it is about ordering people to do something against their will, and cost-shifting. Results from focus groups and telephone surveys conducted for Treasury indicate that benefit recipients think it's okay for the government to want to process payments more cost effectively, but they resent the government telling them what to do.¹¹⁴ They also feel that if all payments are made electronically, the government or the banks will be making money at their expense. Given the reality that a high percentage of unbanked recipients currently pay to have their benefit and other checks cashed--for fees ranging from 1 percent to more than 20 percent of the face amount of the check, depending upon its source, and with between 60 and 70 percent of unbanked recipients purchasing 10 or more money orders a year, it is hard to understand the advocates' argument that EFT'99 promises to be a big rip-off. While strongly disagreeing with this view, Treasury Under Secretary John Hawke seemed sympathetic to the advocates' cost shifting argument. In a recent discussion of EFT'99, he addressed this issue in the following rhetorical question: "when those rolls of paper disappear at the processing centers and the people who stack those paper checks are employed in other occupations, how do we," asked Hawke, "ensure that the cost savings will enure to the benefit of recipients?"¹¹⁵

Treasury's Solution for the Unbanked: an Electronic Transfer Account (ETA)

Treasury intends to provide bankless payment recipients who do not voluntarily designate a financial institution to receive their benefits by the legal deadline, with an Electronic Transfer Account (ETA) in their own name. While many attributes of an ETA have yet to be decided upon, according to Treasury,

With an ETA recipients will be able to withdraw their funds through automated teller machines or point-of-sale terminals with an access card. These ETAs will be provided at a reasonable cost and have the same consumer protections as other accounts at the financial institution. Similar to an ATM card, the card will give recipients a safe and convenient way to withdraw funds electronically.¹¹⁶

¹¹³Cited in Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 146.

¹¹⁴The demographic research is being conducted for Treasury by Booz, Allen & Hamilton, and Shugoll Research, *Mandatory EFT Demographic Study, Executive Summary*, Washington, DC, April 22, 1997. The results cited here are from page 5 of the Executive Summary.

¹¹⁵John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 38.

¹¹⁶U.S. Department of the Treasury, Financial Management Services, *Fact Sheet: 31 CFR Part 208: Management of Federal Agency Disbursements: Notice of Proposed Rulemaking*, updated Sept. 16, 1997.

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Who Should Treasury Select to Provide ETA Accounts to the Unbanked?

Another important issue is the kind of financial institutions that Treasury will allow to compete to serve as its authorized agent(s) in providing ETA accounts to the unbanked. Consumers Union, among others, have urged Treasury to exercise great care in this matter because "many entities presently serving the needs of the unbanked have exploited and continue to exploit their customers."¹¹⁷ Echoing those same sentiments, the National Consumer Law Center wants Treasury to limit qualifying agents to commercial banks, savings banks, credit unions, and the U.S. Post Office. Allowing fringe bankers--check cashing outlets, finance companies, pawn brokers and rent-to-own stores, who "are currently bleeding residents of poor communities by charging interest rates from 60 percent to 600 percent"--to serve as Treasury's financial agent would, they argue, "constitute the federal government's blessing of grossly abusive practices against low-income and elderly people."¹¹⁸ Such attacks notwithstanding, the check cashing industry made its own passionate case to Treasury for why its members should be permitted to be major players in EFT⁹⁹. The National Check Cashers Association, envisions its 6,000 members serving as "efficient end points in a delivery system that links check cashers with one or more financial institutions that Treasury designates as qualified agents." Because check cashers are located in many areas where there are few banks, NaCCA proposes that check cashers be permitted to serve effectively as branches of whatever depository institution(s) is selected to serve as Treasury's financial agent(s).¹¹⁹

At the other end of the corporate financial services continuum, Western Union made a powerful case for why it should be allowed to serve as Treasury's agent in creating ETA accounts. According to Western Union officials, not only does the company "guaranty the integrity of consumer funds, thus meeting the EFT law's threshold for safety and security, but "with 50,000 locations in the U.S., the company argued that it is clearly as convenient as a bank for many people, and is far more convenient than a bank for lower income populations that live in communities under served by traditional banking institutions."¹²⁰

¹¹⁷Letter from Michelle Meier, Counsel for Government Affairs, Consumer Union, to Financial Management Service, U.S. Department of Treasury, on 61 Fed. Reg. 39253, November 25, 1996.

¹¹⁸Comments of the National Consumer Law Center on Department of Treasury Notice of Proposed Rulemaking on Electronic Benefits Transfer: Selection and Designation of Financial Institutions as Financial Agents, 31 CFR Part 207 July 8, 1997.

¹¹⁹Letter to Docket Clerk on 61 Fed Reg 39253, National Check Cashers Association, Stephen Wolf, Chairman of the Board.

¹²⁰In its written submission on Treasury's interim rule (61 Fed. Reg. 39253), Western Union noted that one of the largest obstacles to a successful implementation of a fully electronic payment system will be the resistance of unbanked and underbanked individuals to banks in general, due to a perceived lack of interest by banks in their particular needs, as manifested by branch closures in their neighborhoods and/or lack of capital to fund new businesses in their neighborhoods. Tom Norton, Vice President-Business Manager, Consumer Products, November 25, 1996.

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Agreeing with Treasury that competition should determine pricing and product mix, a consortium of non-bank money transmitters argued that the market place has already demonstrated that they are in fact the cheaper financial services alternative. They are cheaper, they say, because they are "servicing expertly a niche market and have certain economies of scale that banks do not have. As a result, they told Treasury,

in Washington, DC, money orders cost \$7 at NationsBank, while at Western Union a money order may be purchased for 75 cents. Similarly, wire transfers of modest amounts of funds--under \$100, for example--cost only \$13 at MoneyGram but can cost \$30 at Washington, DC banks. Likewise, obtaining a check in foreign currency costs \$20 to \$35 at commercial banks such as Bank of America, but only \$7.50 at Thomas Cook; and cashing foreign currency checks cost \$15 at some banks in Washington, DC, but only \$7.50 at Thomas Cook, Inc.¹²¹

The Proposed Rule for Implementing EFT'99

At the time of this writing [December, 1997,] we are about halfway through EFT'99's official implementation timeline. On September 16th of this year, Treasury issued a proposed rule to implement EFT'99 that addresses how current and new recipients of Federal payments will have their payments delivered electronically, how those without accounts at financial institutions will receive their payments, and who is eligible for a waiver. Treasury gave the public 90 days (until December 16th) to comment on the proposed rule, sometime after which it will issue a final rule that will govern the program. Because it provides important insights into the Administration's current thinking, it is useful to review how the proposed rule deals with such important issues as allowable fees, the role of non depository institutions and the like.

Reality Bites I: Delay the Deadline: The near-impossibility of bringing all federal benefit recipients into the financial mainstream on such a tight timeline is reflected in two key provisions of the proposed rule. The first decision pushes back by up to one year the deadline by which unbanked recipients must receive their benefits through electronic means. Under the proposed rule, unbanked recipients may continue to receive paper checks until January 2, 2000, or the time at which Treasury provides them with an ETA, whichever is earlier. The second decision relates to the granting of waivers, which may prove to be more problematic in the long-run. Treasury Under Secretary John Hawke, JR., recognized the sensitivity of the waiver issue in a February, 1997 conversation about EFT'99. Noting that the statute gives the Secretary of the Treasury the authority to develop standards for granting hardship waivers, Hawke went on to say that the

¹²¹Data included in July 8, 1997 submittal to Director, Card Technology Division, Financial Management Services of the Department of the Treasury, from Howrey & Simon, Attorneys at Law, representing the following leading national providers of non-bank money transmission services: Thomas Cook, Inc., American Express Travel Related Services Company, Inc., Western Union Financial Services, Inc., Travelers Express Company, Inc., Comdata Network, Inc., and MoneyGram Payments System, Inc. Data included in attachment to letter entitled "The Non-Bank Money Transmitter Industry Serves Vital National Financial Interests."

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“waiver authority will have to be used selectively or the benefits of the electronic program could be undermined.”¹²²

Reality Bites II: Open The Waiver Door Widely: The September 16th proposed rule does anything but use the waiver authority selectively. Understandably, the rule would grant unbanked recipients a waiver if the switch to EFT would cause them “financial hardship;” it would also grant waivers to unbanked recipients who have physical disabilities or are confronted with a geographical barrier¹²³. However, the proposed rule also allows waivers on similar grounds to recipients *with* bank accounts who started receiving benefits before the EFT law was passed (July 26, 1996.) Because neither Treasury nor other participating agencies have the resources to evaluate every waiver request, Treasury decided to make the process “customer-driven.” This means that Treasury will let recipients “self-select” themselves for waivers. In formal Treasury language, “the waiver from payment by EFT will be automatic and based solely on the individual’s certification.”¹²⁴

In stark contrast to Treasury's initial vision that EFT'99 had “the potential to pave the way for dramatic and far reaching changes in our society,” the proposed rule recognizes that people have “accustomed ways of doing things and are going to take very unkindly to the idea that the federal government is now sort of mandating to them that they’d better change the way they handle their financial affairs.”¹²⁵ At a news conference at which he discussed the proposed rule, Treasury Under Secretary Hawke implicitly tied the waiver decision to some of the concerns advocates have raised about EFT, which were discussed above. “We don’t want to precipitate,” said Hawke, “a broad-scale adverse reaction to [this] important program by being heavy-handed in the way it’s applied.”¹²⁶

Reality Bites III: Education and Outreach is More than PR: The lead paragraph of a recent *Washington Post* story on the proposed rule suggests that the liberal use of waivers was made necessary because Treasury had not yet quieted the fears of millions of unbanked recipients that EFT'99 would end up saving the federal government money at their expense. About the unbanked, said the *Post* article: “Many of them are poor, don't speak English and worry that they would have to pay bank fees to get their money when now they can cash their government checks for free.”¹²⁷ The waiver decision also implicitly recognized that the urgently needed education and outreach campaign that Treasury had planned to mount, hadn't yet gotten off the ground. Under Secretary Hawke acknowledged that the Administration has been slow out of the blocks

¹²²John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, pp. 37-38.

¹²³Beth Berselli, “Treasury to Exempt Some Recipients of Payments From Electronic Delivery Rules,” *The Washington Post*, September 12, 1997, p. A-14.

¹²⁴31 CFR Part 208, Management of Federal Agency Disbursements; Proposed Rule, September 16, 1997.

¹²⁵Beth Berselli, “Treasury to Exempt Some Recipients of Payments From Electronic Delivery Rules,” *The Washington Post*, September 12, 1997, p. A-14

¹²⁶Beth Berselli, “Treasury to Exempt Some Recipients of Payments From Electronic Delivery Rules,” *The Washington Post*, September 12, 1997, p. A-14.

¹²⁷Beth Berselli, “Treasury to Exempt Some Recipients of Payments From Electronic Delivery Rules,” *The Washington Post*, September 12, 1997, p. A-14.

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on this when he said "Our initial estimate vastly understated the amount of investment in public education needed merely to make people aware of what is coming, let alone how they should seek out a service to meet their needs by January 1, 1999."¹²⁸

Recognizing the problem Treasury has begun consulting with representatives of the entire community development community--civil rights, fair housing, fair lending, low-income housing, economic development, other consumer interests--and community development intermediaries about both the kinds of outreach activities that might be included, and their participation in an organized, grass roots campaign on the benefits of EFT'99. According to knowledgeable sources, however, such a campaign could cost up to \$10 million over the next eighteen months--funds which are not currently included in Treasury's budget.

Insured Institutions Win: The proposed rule did settle the type of financial institutions that would be permitted to serve as Treasury's authorized agent in providing electronic accounts to the unbanked.¹²⁹ On this issue, Treasury aligned itself with many consumer interest groups by slamming the door on nonbank institutions. Under the proposed rule, only federally insured financial institutions would be permitted to compete to serve as Treasury's default banker.¹³⁰ Importantly, the rule does keep the door open to the kinds of creative partnerships between bank and nonbank entities discussed earlier, by ruling that while only insured financial institutions could be involved in the disbursement and crediting of federal payments to the new electronic accounts, "other functions may be performed by non depository institutions and non-financial institutions working in partnership with the financial agent."¹³¹

Treasury Under Secretary John Hawke, underscored the importance of non-depositories in the EFT'99 mix. "Customers may prefer," he said, "dealing with intermediaries that are not financial institutions...One could imagine, for example, major data processing firms developing a standardized product that could be offered to smaller depository institutions around the country."¹³² While fraught with technologic challenges, Hawke believes that EFT'99 offers such firms "a great opportunity to act as a kind of a franchiser to attract participants to this market." By refusing to rigidly regulate the prices of deposit services, Treasury might have raised the ire of consumer groups, but in so doing, it also maximized the potential for market innovation, and

¹²⁸John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p 40.

¹²⁹"Treasury will determine the specific terms, conditions, and attributes of the account to be offered and will request that interested organizations submit bids on the cost of providing such an account within geographic areas. Bidders may also be requested to submit bids on different permutations of alternative account structures and geographic areas." 31 CFR Part 208 Management of Federal Agency Disbursements; Proposed Rule, September 16, 1997.

¹³⁰According to Treasury, only federally insured depository institutions provide important protections for consumers as well as participate in the Automated Clearinghouse (ACH) network, which processes most electronic fund transfers.

¹³¹ 31 CFR Part 208 Management of Federal Agency Disbursements; Proposed Rule, September 16, 1997.

¹³²These comments and the comment immediately following are from, John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p 40.

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an explosion of new commercially viable products, services and delivery systems to serve bankless benefit recipients and under served communities.

Dealing With the Unbanked: The proposed rule deals with the unbanked in three ways: First, as indicated above, through a massive public education campaign, Treasury hopes to encourage unbanked recipients to open a bank account on their own, and to designate that institution to receive their benefit payments through direct deposit. Second, Treasury hopes to stimulate an increase in the supply of low-cost account options that become available to unbanked recipients by urging financial institutions to start offering a reasonably priced alternative to traditional checking accounts. Called *Direct Deposit Too* by Treasury, these accounts would feature debit card access to federal benefits, provide no depository or third party bill-payment privileges, nor carry a minimum balance requirement. At this time, there is no way of assessing the success of the *Direct Deposit Too* marketing campaign, although more than 300 Missouri banks with low-fee accounts responded positively to a similar campaign mounted by that state's Department of Social Services as part of its EBT initiative to convert Food Stamps¹³³ and emergency cash assistance benefit payments to electronic delivery.¹³⁴

With fewer than 10 percent of Missouri's welfare recipients with bank accounts, the goal is to raise that level to at least 50 percent as a byproduct of the switch to EBT. One early success of the state's campaign, has been the willingness of most of the cooperating banks to waive their minimum deposit requirements for accounts that receive emergency cash assistance funds electronically. To reduce the costs of opening direct deposit accounts, Missouri's Department of Social Services established an "800" number and offered it to banks for use 24 hours a day. According to Melba Price, Associate Director, Policy Coordination at Missouri's Department of Social Services, "the banks can punch in account numbers on the phone, and at night our computer system retrieves them and sets up direct deposit records for those beneficiaries. The banks don't have to send paperwork back to the state to make it happen."¹³⁵ While it is still too early to tell whether Missouri will achieve its ambitious goal to bring one out of every two of the state's 70,000 welfare recipients into the mainstream banking system, early results are promising. According to Ms. Price, "we have some areas of the state that already have 20 percent receiving direct deposit, up from almost 0 percent."¹³⁶

¹³³According to the Department of Agriculture, twenty-five states currently have operational on-line food stamp electronic benefit (EBT) systems. All states must convert to electronic delivery by 2002 (Food Stamp Program Electronic Benefits Transfer (EBT) Project Status, Highlights, October 1997.) Treasury has been working with a number of States to link the delivery of Federal payments to State EBT programs so that recipients of both federal and state-delivered benefits can be accessed by means of a single card (31 CFR Part 208 Management of Federal Agency Disbursements; Proposed Rule, September 16, 1997.)

¹³⁴ "Low fee" means bank accounts ranging from fee to \$4 or \$5 a month. There are no transaction fees, and you can have unlimited ATM transactions at the recipient's own bank. "Missouri Using Smart Cards," *State and Local Communications Report*, Telecommunications Reports International, Inc., August 8, 1997.

¹³⁵"Missouri Using Smart Cards," *State and Local Communications Report*, Telecommunications Reports International, Inc., August 8, 1997.

¹³⁶"Missouri Using Smart Cards," *State and Local Communications Report*, Telecommunications Reports International, Inc., August 8, 1997.

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Finally, as indicated above, Treasury also plans to contract with one or more federally-insured depository institutions to serve as its financial agent for the provision of ETA accounts to the unbanked. While the proposed rule describes the ETA in terms similar to a *Direct Deposit Too* account-- recipients should be able to withdraw their funds through automated teller machines (ATMs) or point-of-sale (POS) terminals with an access card--Treasury leaves open the possibility that they could also provide other features."¹³⁷ Taking to heart the criticisms leveled at EFT'99 by groups representing unbanked recipients, the proposed rule solicits public comment on the desirability of expanding the services an ETA provides to include, among others, provision for making third-party payments; access to the account at other outlets; a savings feature; and a ban or limit on ATM surcharges. Treasury also seeks public comment on "the appropriate standard by which to weigh tradeoffs between increased costs and additional account features."¹³⁸ With the public comment period closing on December 16th, it is unlikely that we will see a final EFT'99 rule before the Spring of 1998, or the completion of the ETA procurement process before next Fall.

When implementation is complete, EFT'99 and its state-level EBT counterparts will have put in place a more inclusive and responsive financial infrastructure. But infrastructure alone will not stimulate saving among low-wealth households, or help people who successfully work their way off welfare, stay off. Helping the poor accumulate their own assets, however, can bring about the kind of positive behavioral changes that traditional welfare policy could not. In Part III that follows, I explain why a national savings incentive program is the best way for the Administration and the Congress to share the savings that EFT'99 makes possible with benefit recipients.

¹³⁷EFT'99, Fact Sheet: 31 CFR 208: Management of Federal Agency Disbursements; Notice of Proposed Rulemaking. September 16, 1997.

¹³⁸EFT'99, Fact Sheet: 31 CFR 208: Management of Federal Agency Disbursements; Notice of Proposed Rulemaking. September 16, 1997.

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Part III: SAVINGS INCENTIVES TO HELP THE POOR BUILD ASSETS

Michael Sherraden and his colleagues at Washington University in St. Louis have made a cogent case for why individual capital accumulation should be the fabric from which we cut a new American welfare policy.¹³⁹ They tell us that there are two phases in the transition from consumption- to asset-based welfare policies. First, it is necessary to remove the barriers to savings and investment from existing safety net programs--such as the asset limits that have long characterized means-tested welfare policy. Then, public policies should affirmatively promote asset-accumulation by low-income households through a variety of means, including direct savings incentives. The much-maligned welfare reform bill the President signed into law last August has begun to do the former. Unfortunately, there are no examples of savings incentives for the poor that are comparable, for example, to the enhanced IRAs that were included in the balanced budget agreement. That ten year, \$17.8 billion package of tax breaks is just the most recent example of how the federal government makes it especially worthwhile for middle- and upper-income Americans to save a little extra for their retirement years. We should expect no less from our federal government when it comes to encouraging *and* helping low-income, low-wealth Americans save and invest in their futures. A government-assist to personal asset-building, which a successful EFT'99 can help accelerate, has quietly become a core element of the grass roots community development movement. This section summarizes the growing role that wealth-creating activities are playing in the increasingly decentralized world of welfare reform and community development, and suggests a number of ways that EFT'99 and state-run EBT campaigns can help move the country further along the path to an asset-based antipoverty policy.

Helping Americans Build Asset is Nothing New

For nearly a hundred and fifty years--from the nineteenth century Homestead Act through the mortgage interest deduction, to the GI bill, capital gains tax preferences and tax-favored IRAs-- federal policies have long encouraged individual asset-accumulation. Because most modern-day savings incentives operate through the tax system, they are either not available to the poor or are not as effective in encouraging the poor to save or invest due to their lower marginal tax rates.¹⁴⁰ Though much more modest in size, there are also several examples of national policies that have encouraged asset-building by low-income individuals. While they differ in their specifics, each of these initiatives share one thing in common: they have built into them special-purpose savings accounts that are set up for the benefit of participating individuals or households who must satisfy mutually agreed-upon program obligations before they get to keep the subsidy.¹⁴¹

¹³⁹Michael Sherraden, *Assets and the Poor: A New American Welfare Policy*, Armonk, New York, M.E. Sharpe, Inc., 1991, p. xiv. See also, Karen Edwards, *Individual Development Accounts: Creative Savings for Families and Communities*, Center for Social Development, Washington University in St. Louis, p. 14 no date.

¹⁴⁰Karen Edwards, *Individual Development Accounts: Creative Savings for Families and Communities*, Center for Social Development, Washington University in St. Louis, p. 14 no date.

¹⁴¹There have also been programs that enable low-income households to grow assets through means other than special purpose savings accounts. For example, to encourage commitment to the community and to guard against

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Saving Incentives & Job Training: For example, since the program's inception in 1964, Job Corps members have received a living expense allowance that accumulates in their personal account during their tour of duty that is intended to help tide them over while they look for a job after they leave the program.¹⁴²

Saving Incentives & Home Ownership: Using savings incentives to expand home ownership opportunities for low- and moderate-income Americans should be a high national priority. Not only does home equity represent the greatest source of individual household net wealth, but for many, it *defines* the American Dream. In 1995, half of all homeowners held at least half of their net wealth in home equity, while among owners with incomes under \$20,000, half held more than 71.9 percent of their wealth in home equity.¹⁴³ Perhaps, more telling than anything else is the difference in net wealth among owners and renters. In 1995, homeowners had a median net wealth of more than \$102,000, compared to just \$4,750 for renters. There are also community and economic development reasons why owning a home is important. Home equity is a primary source of capital that enterprising individuals frequently use to start a small business. And revitalization is generally harder to accomplish in communities with low home ownership rates because low income renters fear that improvements will result in affordable rent increases. As a result, many revitalization projects limp along without the full engagement or support of the community.¹⁴⁴

In recent times, there have been at least three efforts to create special-purpose savings accounts to help low- and moderate-income households achieve home ownership. Under the Turnkey III public housing program in the late 1960s, aspiring tenant buyers could earn credit towards their down payment based upon the value of the "sweat equity" labor they contributed to the maintenance of their unit. Since 1990, HUD's self-sufficiency program has enabled more than 10,000 assisted households grow their own savings by permitting public housing authorities to disregard wages from work for rent-determination purposes.¹⁴⁵

windfall gains, several local housing authorities have provided "silent second" mortgages to residents which were forgiven if they remained in their unit for more than a specified period.

¹⁴²Called Job Corps Living Readjustment Accounts, Job Corps Centers are required to deposit into these accounts \$37.50 for every \$50 the student is paid in monthly living allowance. According to Karen Edwards, "bonus plans are also connected to the savings accounts. Bonuses are credited to the student for obtaining a GED, vocational training certificate, or college credit, while in the Job Corps program. The total bonus dollars possible is \$850 per student." Karen Edwards, *Individual Development Accounts: Creative Savings for Families and Communities*, Center for Social Development, Washington University in St. Louis, p. 14 no date.

¹⁴³The State of the Nation's Housing 1997, Harvard University, Joint Center for Housing Studies, Cambridge, 1997, pp. 18-19.

¹⁴⁴The lack of control over local real estate may also discourage commercial revitalization efforts. An economic development staffer for a mid-sized city recently told me that he was having a tough time doing facade improvements and other kinds of commercial rehab because the small business owners didn't own the buildings. Moreover, successful businesses that needed room to expand were reluctant to invest in their present places of business because they didn't own them.

¹⁴⁵As an incentive to participate in the program, the monthly rent of Family Self Sufficiency participants are not affected by increases in earned income as long as they do not exceed 80 percent of the local median income. The differences between the rents they would normally pay (based on 30 percent of their incomes) and their actual rents are placed in escrow accounts. Participants can make partial withdrawals from those accounts once interim

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And just last year, the Federal Housing Finance Board amended its Affordable Housing Program (AHP) regulations to permit member banks to set aside a portion of their annual AHP contributions for use as matches in special down payment savings accounts for first-time home buyers. Rather than award income-eligible households down payment grants, the program encourages potential home buyers to save for a down payment by matching their deposits on at least a 2:1 basis. Over the past year, several regional home loan banks have established such pilot programs.¹⁴⁶ For example, under its First Home Club program, the New York Home Loan Bank will match a household's saving on a 3:1 basis, up to a maximum of \$5,000.¹⁴⁷ The first-time buyer, whose income cannot exceed 80 percent of area median, must adhere to its personalized savings plan for a minimum of 10 months, and must achieve its down payment/closing cost goal within 24 months. The Seattle Home Loan Bank's HomeStart Plus program is particularly impressive because it is targeted to working families in public housing who participate in the housing authority's self-sufficiency program. HomeStart Plus matches two dollars for every dollar the family deposits in its self sufficiency escrow account, up to a maximum of \$10,000. As in New York, HomeStart participants in Seattle must complete a program of home ownership counseling and money management. While it is still in its infancy, by mid-October 1997, four families had graduated out of public housing into a home of their own thanks to HomeStart Plus.¹⁴⁸

Asset Building and Welfare Reform

The widespread inclusion of measures to allow savings and asset-building by the dependent poor is also one of the best kept secrets of welfare reform. Under the old AFDC law, ownership of assets in excess of \$1,000, excluding autos, disqualified a mother from receiving welfare; neither parents nor their dependent children were permitted to have savings accounts; and owning a car worth more than \$1500, even if it was needed to get to work, was also cause for disqualification. The result of these punitive provisions is that families on welfare were unable

self-sufficiency goals are achieved, but they must use those funds to fulfill their contracts, such as paying college tuition or buying a car so they can get to work. Participants have full access to the funds in their accounts once they complete the program." William M. Rohe and Rachel Garshick Kleit, *Housing, Welfare Reform and Self-Sufficiency: An Assessment of the Family Self-Sufficiency Program*, Center for Urban and Regional Studies, The University of North Carolina at Chapel Hill, September 1997, p. 4.

¹⁴⁶Under the matched saving plan, participating banks may set aside up to the greater of \$1 million or 10 percent of their annual required AHP contribution to be used as matching funds for first-time home buyers' savings deposits maintained with a FHLB member. Each dollar of a household's savings may be matched with up to three dollars of AHP funds, up to \$5,000 per household, for down payment and closing costs on the first-time purchase of a one to four family, owner-occupied property. Participating households must have incomes at or below 80 percent of area median income and must complete a home buyer counseling program. If a homeowner sells their home within five years of receiving the AHP funds, they must repay a portion of the funds reduced on a pro rata basis. Karen Edwards, *Individual Development Accounts: Creative Savings for Families and Communities*, Center for Social Development, Washington University in St. Louis, p. 12 no date.

¹⁴⁷Federal Home Loan Bank of New York, *First Home Club Program Guidelines*, May 1996.

¹⁴⁸According to Judy Dailey, Vice President and Community Investment Officer for the Federal Home Loan Bank of Seattle, the match averaged \$4,000 across the four families who had purchased a house under the program, implying that the average escrow balance attributable to the households' work-generated savings averaged \$2,000 per household.

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to save for school or training, to buy a home, pay the deposit on an apartment in a better neighborhood, or to buy a reliable car. Much to their credit, however, many states liberalized their asset rules under waivers granted them by the Department of Health and Human Services before national welfare reform became law.¹⁴⁹ By the time the president signed the welfare reform bill on August 22, 1996, twenty-five states had already received waivers to increase their asset limits; some to as high as \$5000.¹⁵⁰ Several states also raised their vehicle exclusion limits--to \$2500 and \$3000 in Wisconsin and Iowa, respectively; to \$4,500 in California, \$5000 in Maryland, Oklahoma, and North Carolina, and to \$7500 in Virginia.¹⁵¹

The Treatment of Savings: As indicated above, the two generation-old welfare law also discouraged savings. Under federal waivers granted to several states as well as under national welfare reform legislation, individuals receiving time-limited cash assistance are not only permitted to begin saving on a regular basis, but are encouraged to do so. For savings to be disregarded for purposes of determining eligibility for benefits, withdrawals are typically limited to specific uses, such as for the purchase of a home, the payment of post-secondary or vocational education or training, or family emergencies. California and Virginia, for example, permit savings account balances of up to \$5000 without jeopardizing eligibility. South Dakota and Minnesota, among others, allow children to have a savings account of up to \$1,000.

The Growth of Individual Development Accounts (IDAs)

These rules protect the eligibility status of persons *with* assets, but they do nothing to help them *grow* assets. This is why the recent rise in savings incentive programs, originally championed by social work professor Michael Sherraden in his 1991 seminal book, *Assets and the Poor*, is so important.¹⁵² Administered by grassroots organizations as an integral part of their community-building missions, and carried out in partnership with participating financial institutions,¹⁵³ these asset-building programs go by varying names--Family Savings Accounts in

¹⁴⁹Because the federal welfare reform law does not contain prescriptive asset limits, states are free to set asset limits higher or lower than they were under the old AFDC law, and may keep in place the higher limits they established under the waivers as long as they are not inconsistent with the national goals of welfare reform.

¹⁵⁰California, and New Hampshire are at the \$2000 level, Wyoming, among others settled at \$2500, North Carolina, Connecticut, Illinois and South Carolina are at \$3000. South Carolina also exempts from the asset limit the cash value of life insurance policies, and Maryland and Nebraska increased the limit to \$5000. Many of these same states have also raised the limit on the value of a car an applicant for TANF can own and still remain eligible for cash assistance.

¹⁵¹Other states, including Colorado, Maine, Georgia, New York and Pennsylvania, removed limits of any kind as long as the vehicle owned by the recipient is used for transportation to and from work or school. As part of their welfare-to-work strategies, some states are even helping welfare recipients get a car when they haven't the means to buy one. Recognizing that lifting value limits on vehicle ownership doesn't make it any easier for a poor mother to afford to buy a car, several states have created programs to overcome the absence of reliable transportation.

Kentucky, for example, "...has joined with social agencies to secure auctioned or donated cars for recipients who land jobs." Pennsylvania has bought cars for recipients, who must pay the cost of taxes, tags, and registration fees to gain title to the car, and the car's value is excluded from the asset limits in determining eligibility.

¹⁵²Michael Sherraden, *Assets and the Poor: A New American Welfare Policy*, New York, M.E. Sharpe, Inc., 1991.

¹⁵³In Indianapolis, for example, Eastside Community Investment's IDA accounts are managed by its own affiliated community development credit union (Corporation for Enterprise Development, "How IDAs Work, Washington, DC (no date); the Philadelphia-based Women's Opportunities Resource Center is partnering with Jefferson Bank

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Pennsylvania, Family Development Accounts in Missouri, and the Tenant Investment Program in Portland, Oregon--but are generically referred to as Individual Development Accounts, or IDAs. In essence, IDAs are an effort to democratize tax-driven incentives like IRAs by creating direct incentives that work for low-income, low-tax bracket households. A key feature of IDAs is that for every dollar an individual saves, there are matching dollars of investment by community groups, foundations, churches or government itself.¹⁵⁴ Another distinguishing feature of IDAs which is equally important to the successful implementation of EFT'99, is that participation is conditional upon the saver's enrollment in an economic literacy program.¹⁵⁵ And because they are designed to help low-income, low-wealth individuals build both human and financial capital, the typical IDA program limits withdrawals to three purposes -- buying a house, getting an education, or starting a business.¹⁵⁶

IDAs and Welfare Reform: While the IDA movement gained much-needed visibility this past September with the start of a national demonstration that will establish at least 2,000 IDAs in 13 low-income communities,¹⁵⁷ it is the welfare reform bill that is stimulating the startup of even more IDA programs as core elements of welfare-to-work strategies. The federal welfare reform legislation authorizes states to create community-based IDA programs with TANF block grant funds and to disregard all money saved by the poor in IDAs in determining eligibility for all means-tested government assistance.¹⁵⁸ Reinforcing the traditional values of work and individual responsibility, the legislation provides that only earned income can be saved and matched in IDAs. It also designates nonprofit, community-based organizations as custodians of IDA accounts, and restricts IDA balances to the uses identified above: education, home ownership and business capitalization.¹⁵⁹ By June 30, 1997, 18 states had included IDAs in their own welfare reform plans.¹⁶⁰

and CoreStates Bank; while in Maine, the financial institutions which supported the IDA legislation have proposed the creation of an IDA bank, which would be created jointly by participating financial institutions to share the costs and benefits of serving IDA account holders (Corporation for Enterprise Development, *Assets: A Quarterly Update for Innovators*, Spring 1997.)

¹⁵⁴Neal R. Peirce, *Savings Incentives---For the Poor?*, syndicated column, Oct. 5, 1997

¹⁵⁵Though the specifics of the curricula vary from program to program, Eastside Community Investment (ECI), one of the first community-based organizations to administer an IDA program, has collaborated with the Purdue University Cooperative Extension Service to create an economic literacy curriculum entitled "Making Your Money Work." This five-session curriculum includes lessons on money management, getting the most from your money, understanding and managing credit, money plans, and record keeping, in addition to individual meetings and homework for each IDA participant. (CFED, *How IDAs Work*, p. 3)

¹⁵⁶Permitted uses do vary, however, from program to program. In addition to the three uses noted in the text, Missouri would permit account balances to be used for major repairs or improvements to a home, while Maine would also permit withdrawals to buy or repair a car needed for work or for family emergencies. Other programs are more restrictive, one of North Carolina's IDA programs will be exclusively targeted to home ownership *Assets*, Spring, 1997.

¹⁵⁷See, for example, Peirce, *Savings Incentives---For the Poor?*, October 5, 1997

¹⁵⁸These provisions are contained in Section 404(h) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996

¹⁵⁹National Governors' Association *Issue Brief, Building Assets and Economic Independence Through Individual Development Accounts (IDAs)*, January 31, 1997, p. 1

¹⁶⁰*Assets*, Volume III, No. 1, Winter 1996-97

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Massachusetts', Michigan's and Oregon's workfare programs combine IDAs with wage subsidies,¹⁶¹ while Iowa's stand-alone program will create 10,000 IDAs and provide \$1 million in matching funds to the savings of low-income families by 2000."¹⁶² Oregon's Individual Education Accounts can only be used to pay for education or training, and requires the employer to contribute \$1 for each hour worked after a participant has been employed for thirty days.

Recent State Actions: Among other recent state actions, Tennessee has authorized a 12-community IDA pilot to be administered by the Tennessee Network for Community Economic Development, and in Pennsylvania, Governor Tom Ridge's fiscal 1998 budget allocated \$1.25 million to an IDA initiative which would create 2,500 savings accounts for low-income families. The Family Savings Accounts will be administered by community-based organizations and held in participating financial institutions. The Indiana legislature not only committed \$6.5 million in general revenues to fund IDAs over the next four years to match participant savings on a 3:1 basis, but also provided an additional \$500,000 a year in tax credits to private contributors to the IDA program. The National Governors' Association, a strong believer in IDAs, has urged its members to follow the Indiana example by using tax credits to increase available IDA resources. NGA also advises its members not to limit IDAs to welfare recipients because they "generally comprise only about 23 percent of the poor; other people in poverty, including working families, single persons, recipients of other public benefits, and other families near poverty or vulnerable to economic changes, need and could use IDAs."¹⁶³

Several other states took actions to support IDAs in their most recent legislative sessions, including Maine¹⁶⁴ and Missouri,¹⁶⁵ North Carolina stands to become one of the country's hotbeds of activity with three new IDA initiatives now getting underway. In addition to a \$600,000 State appropriation to fund a 600 account IDA pilot over the next two years, the Division of Community Assistance, an arm of the North Carolina Department of Commerce, has set-aside \$250,000 of small cities community development block grant funds (CDBG,) also over two-years, to pay for a home ownership-centered IDA pilot for working families in rural and non metropolitan communities.¹⁶⁶ Finally, this past summer, the Durham City Council approved \$50,000 in general revenues to fund its own test of the effectiveness of IDAs as a means of

¹⁶¹"Under these 'full employment plans' public benefits (i.e. food stamp payments under previous welfare guidelines) are 'cashed out' to provide wage subsidies to employers hiring welfare recipients. After 30 days of employment, employers are required to pay \$1 for every hour worked into an IDA for the welfare recipient. The account holder may use the account to pursue further education or job training. National Governors' Association, *Issue Brief*, p. 3.

¹⁶²National Governors' Association *Issue Brief*, p. 3

¹⁶³National Governors' Association, *Issue Brief*, p. 4.

¹⁶⁴The Maine legislation authorizes both AFDC recipients and working poor families to participate.

¹⁶⁵Missouri's IDA program, to be administered by the Department of Economic Development, would target individuals and families at or below 200 percent of the federal poverty level, and would be funded by private contributors who would receive 50 percent tax credits from the state for their contributions. The state would cap tax credits at \$4 million annually. *Assets*, Winter 1996-97, p.7.

¹⁶⁶The demonstration calls for the creation of 150 IDA accounts at a minimum of three sites, with a 2:1 match rate and a \$2,000 match ceiling. Local programs will be implemented by a CDC or nonprofit partner that has an existing clientele of lower-income residents and some past experience working with CDBG and/or home ownership programs. *Assets*, Spring 1997, p.4

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increasing home ownership among low-wealth working households. With similar operating policies to Seattle's Home\$tart Plus program, the funds would match on a 2:1 basis, down payment and closing costs deposits for up to 20 eligible families seeking to purchase a home within the city. Should it prove successful, the City would consider expanding the demonstration in future years.

Down Payment on the American Dream: While the IDA movement has strong conceptual underpinnings and widespread grassroots support, Yadama and Sherraden correctly point out that evidence of the positive impacts of assets on the ability of families to get out of poverty and to stay out, "has been more in the realm of social philosophy than social science."¹⁶⁷ The recently announced 13 site, national IDA demonstration, dubbed by its sponsors the Down payment on the American Dream, is the first systematic effort "designed to test the extent to which poor people can and will save if supported in appropriate ways, can use those leveraged savings to build businesses, homes and skills, and in so doing, generate jobs, profits, taxes economic and social development."¹⁶⁸ And its intentions are grand. According to Robert Friedman, founder of the nonprofit Corporation for Enterprise Development, the "national champion" of IDAs, "our aim is to build the case for making available to low-income people asset-building incentives equivalent to those we currently offer the non-poor."¹⁶⁹

The thirteen nonprofit organizations selected to create pilot programs of between 50 and 150 IDA accounts as part of the national demonstration span the full range of community development missions--from traditional community action and family services, to micro enterprise and women self-employment, to affordable housing and community development finance.¹⁷⁰ While all pilots will target the poor, several will emphasize youth, others current or former welfare recipients, some the working poor, and still others will target single parents, low-income renters or public housing residents. While the broad parameters will be similar, specific program designs will vary, including matching rates--which range from 1:1 all the way

¹⁶⁷Gautam N. Yadama and Michael Sherraden, *Effects of Assets on Attitudes and Behaviors: Advance Test of a Social Policy Proposal*, Center for Social Development, George Warren Brown School of Social Work at Washington University in St. Louis, no date, p.1.

¹⁶⁸Sherraden has developed several propositions concerning the positive impacts of assets that will be systematically tested in the national demonstration. Among others, these include: greater household stability, increased long-term thinking and planning, increased effort in maintaining and enhancing assets, increased human capital development, increased risk-taking, greater personal efficacy and self esteem, increased social status, increased community involvement, and increased political participation. Gautam N. Yadama and Michael Sherraden, *Effects of Assets on Attitudes and Behaviors: Advance Test of a Social Policy Proposal*, George Warren Brown School of Social Work, Washington University in St. Louis, Center for Social Development, (no date).

¹⁶⁹Bob Friedman, "Down payments on the American Dream: What's in a Name?" *Assets*, Fall 1997, p.2.

¹⁷⁰This is the first large-scale test of the efficacy of IDAs as a route to economic independence for low-income Americans. Thirteen community organizations out of 99 applicants were selected through a competitive process to mount local IDA initiatives. While most pilots will be limited to 50-150 accounts, the research design calls for one of the 13 sites to be selected and funded in 1998 to expand its demonstration to 500 accounts and be subject to random assignment, control group experimental design, and impact evaluation. *Assets, a Quarterly Update for Innovators*, Fall 1997, p.1.

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up to 7 matching dollars for every dollar the account holder saves. Some sites will vary the match depending upon the specific purpose for which the IDA account was created.¹⁷¹

The Link to EFT'99: There is a clear link between the kinds of partnerships that are necessary to make EFT'99 succeed and the IDA movement. For each to work in the community requires strong grassroots support and intensive outreach, education and training in economic literacy. As discussed earlier, Treasury plans a two-pronged education campaign, one emphasizing the requirements of the mandatory EFT legislation to a broad array of stakeholder groups, and the other aimed at "...educating those check recipients without bank accounts on how to maintain a bank account, including instruction on basic finances to help them make the best informed choices."¹⁷² According to Treasury Under Secretary John Hawke, the "grassroots public outreach effort will involve identifying hundreds of local community organizations that will assist efforts in reaching current check recipients."¹⁷³ Given the shortage of outreach and counseling funds available to grass roots organizations engaged in the growing IDA movement and their importance to growing local support for EBT in low income communities, Treasury should make every effort to fund these organizations as part of its EFT'99 outreach campaign.

Another similarity between the two is that virtually all IDA programs consist of the kinds of partnerships between community-based organizations and depository institutions that Treasury would want to see as part of EFT'99. In this regard, two of the national IDA pilots warrant special attention because their sponsors are mainstream financial institutions. In keeping with its tradition as one of the Nation's preeminent full-service community development financial institutions (CDFIs,) Chicago's Shorebank will try to design a highly adaptable core IDA product that can be seamlessly integrated into a wide range of programs to achieve maximum community development impact.¹⁷⁴ Shorebank plans to focus on designing the most efficient systems, and exploiting emerging technologies such as smart cards, that will enable it to service an unlimited number of IDA accounts at the lowest possible costs.

Similarly, Ithaca New York's Alternatives Federal Credit Union (AFCU,) another pioneering CDFI, is crafting a pilot IDA program that could serve as a model for other community development credit unions that might want to offer IDAs in the future. AFCU "will provide financial expertise, capital, information, and account management services in the IDA program and will partner with various other Ithaca community organizations, including the Ithaca Housing Authority, to provide training, counseling and other essential IDA components."

¹⁷¹The Bay Area IDA Collaborative, for example, intends to match education or job training IDAs on a 1:1 basis, business development as much as 2:1 and home ownership IDAs up to a maximum of \$4 matching dollars for each dollar saved. Participants in Shorebank's home ownership program will save \$50-\$100 a month and receive a 1:1 match (accumulating up to \$2400,) those with education and business IDAs will save \$25-\$75 a month and receive a 2:1 match (accumulating up to \$1800.) *Assets*, September 1997, p. 10)

¹⁷²Testimony of John D. Hawke, Jr., Treasury under Secretary for Domestic Finance, before the Subcommittee on Government Management, information and Technology of the House Government Reform and Oversight Committee, June 18, 1997.

¹⁷³Testimony of John D. Hawke, Jr., Treasury under Secretary for Domestic Finance, before the Subcommittee on Government Management, information and Technology of the House Government Reform and Oversight Committee, June 18, 1997.

¹⁷⁴*Assets*, Fall 1997, p.10.

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The Ithaca Housing Authority's Family Self-Sufficiency Program will provide economic literacy training and peer support¹⁷⁵ to all IDA participants."

Enabling the poor to gain a foothold on the American Dream through the fruits of their own labor, which is what IDAs are all about, has strong and growing grassroots support in state houses and legislatures across the country. As indicated above, the NGA encourages states to use some of their TANF funds for IDA matches as cost-effective elements of comprehensive welfare-to-work strategies, and as a way to promote job retention. According to NGA, since "most employed welfare recipients return to welfare because they have neither savings to weather illnesses, accidents, and setbacks, nor any means to advance beyond the sub-poverty entry-level job they first obtain," IDAs could provide a necessary buffer against accidents and illnesses; and the means to invest in additional training and skill upgrading."¹⁷⁶ NGA suggests that states might want to tie the number of accounts they fund in any given year to the number of TANF recipients expected to transition off welfare in that year.

Perhaps, the most important link between IDAs and EFT'99 is that the electronic transfer of government benefits may actually stimulate households to start saving, a possibility discussed earlier. Treasury Under Secretary John Hawke cited anecdotal evidence of such behavior from some of the earliest state experiments with electronic transfer of welfare benefits (EBT.) At a recent forum on financial access in the 21st Century, Hawke indicated that "some of the early indications from the EBT programs are that if recipients do not have to turn their payments at the beginning of each month into cash which they carry around, they will keep something in their accounts and have some savings at the end of the month. This suggests," said Hawke, "that there are opportunities for financial institutions to offer vehicles to encourage savings."¹⁷⁷ Litan and Rauch hold similar hopes for EFT and EBT efforts. They say that "when federal money is deposited electronically into accounts held by (or for) federal beneficiaries, many of them will prefer to withdraw cash as they need. Many will therefore maintain at least modest balances, and those with balances, while perhaps too meager to support full-service checking accounts, might support low-cost, limited access accounts, whose features would depend on balances maintained."¹⁷⁸ In short, as discussed with reference to Citicorp's Texas pilot test to measure the EBT float, the federal support of a national IDA initiative could contribute to the success of EFT'99/EBT by substantially increasing government benefit recipients' marginal propensities to save.

The Politics of IDAs

In Congress: Despite the seemingly broad appeal of an antipoverty policy that, in syndicated urban affairs journalist Neil Peirce's terms," moves from subsistence handouts to

¹⁷⁵ *Assets*, Fall 1997, p.4.

¹⁷⁶ National Governors' Association, Issue Brief, January 31, 1997, p.4.

¹⁷⁷ John D. Hawke, Jr., *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p 40.

¹⁷⁸ Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 149.

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investments, and from bureaucratically run income security systems to direct community ties,"¹⁷⁹ the IDA movement has yet to gain much currency in the halls of Congress. While IDA supporters point to the bipartisan sponsorship of national IDA legislation in the 104th Congress, the fact is, the bill died in committee with scarcely a whimper.¹⁸⁰ In October of this year, a similar measure to fund a \$100 million federal demonstration that would provide matching funds for 50,000 IDAs over four years, was introduced in the Congress; again, with bipartisan support.¹⁸¹ While this more recent version of the Assets for Independence Act could grow stronger political legs by virtue of the favorable publicity that accompanied the recent startup of the foundation-sponsored IDA demonstration, there's been no movement in that direction.

Silence in the Administration: Despite its broad appeal, for two years running the Administration has failed to take an official position on the Asset for Independence Act, and IDAs have failed to attract a champion in the Clinton the Cabinet. To be fair, the Administration's 1994 welfare reform bill did include IDAs, and the Administration supported their inclusion in last year's national welfare reform bill that was enacted into law. Nevertheless, its silence on the Asset for Independence Act is disappointing given the direct link between IDAs and the success of welfare reform, and the fact that work-centered savings incentives complement the president's own community empowerment strategy that, in his own words, seeks to "...grow the middle class, to shrink the underclass, to expand opportunity and to shrink bureaucracy, [and] to empower people to make the most of their own lives..."¹⁸²

Whether or not the addition of an IDA component to EFT'99 would guarantee greater grass roots support, it is the best way to share the savings from EFT with low-income benefit recipients without having to subsidize benefit recipient bank fees on ETA accounts on a continuing basis. A major IDA initiative would also be an ideal way for the Administration to address for the first time the critical role that wealth plays in creating "...individual and family access to life chances," an issue of great concern to the president. Since wealth is even more unequally distributed than income,¹⁸³ few would question the proposition that if we are ever to

¹⁷⁹Neil R. Peirce, Savings Incentives---For the Poor?, syndicated column, released for publication October 5, 1997.

¹⁸⁰S.1212, the Assets for Independence Act, was introduced in the Senate on September 6, 1995 by Senators Dan Coats (R-IN) and Carol Mosley-Braun (D-IL) and referred to the Committee on Finance.. While the proposal attracted a few additional sponsors a few months after being introduced--Lugar (R-IN) Cochran (R-MI) and Bradley (D-NJ)--it was never reported out of committee. Budget Committee Chairman John Kasich, sponsored similar legislation in the House. Other measures containing IDA-like accounts were also bottled up in committee. For example, KidSave, sponsored by Senators John Kerry (D-MA) and Joseph Lieberman (D-CT), would provide a \$500 per child tax credit to capitalize children's education or retirement accounts. The Personal Economic Empowerment Act of 1996, sponsored by Representatives J.C. Watts (R-OK) and James Talent (R-MO.) would, among other things, establish "Family Development Accounts" to match the savings of working residents in designated "renewal areas" that could be used for the purchase of a home, paying for post-secondary education, or creation of a small business.

¹⁸¹On October 6, 1997, S.1255 was introduced in the Senate by Senator Dan Coats (R-IN), with Senator Tom Harkin (D-IA) joining as a cosponsor. One month later, on November 6, Congressman Tony Hall (D-OH) and Congressman John Kasich (R-OH) introduced an identical bill in the House (HR 2849).

¹⁸²President bill Clinton, March 13, 1995, quoted from *Empowerment: A New covenant with America's Communities*, President Clinton's National Urban Policy Report, August, 1995, p. 27.

¹⁸³"While the top 20 percent of Americans command 43 percent of earned income, they control 85 percent of net

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deal effectively with the problems of disadvantaged people and communities "...we need policies that directly promote asset opportunities for those on the bottom of the social structure...who are locked out of the wealth accumulation process."¹⁸⁴ And because such a high percentage of people of color are unbanked and are twice as likely as whites to have no or a negative net worth--including 61 percent of all black households--¹⁸⁵ a convincing case can also be made that EFT'99 and asset-building issues should be incorporated into the ongoing dialogue of the President's Commission on Racial Reconciliation.

But Most of All, It's a Matter of Equity: Perhaps, more compelling than any other argument for why states, the Administration, and the Congress should embrace IDAs is the simple matter of fairness. With respect to the states, a recent study found that despite growing surpluses and enactment of large income tax cuts for middle- and upper-income families, "...the majority of states with a personal income tax continue to tax poor families with incomes below the poverty line."¹⁸⁶ While eliminating the tax burden on poor and working families altogether is the most direct way for states to improve the fairness of their income tax systems, they might also consider increasing appropriations for existing IDA programs and funding new IDA initiatives where they do not now exist.

With respect to the federal government, analysis of the legislation that will bring the federal budget into balance by 2002 or sooner, "shows that its program initiatives--which primarily assist low- and moderate-income children and families, legal immigrants, and elderly people--are modest in size and dissipate over time. By contrast, its tax reductions for high-income individuals swell...substantially and grow to large levels over time."¹⁸⁷ Together, the capital gains, estate tax, corporate alternative minimum tax and IRA provisions of the balanced budget deal reach a cost of nearly \$24 billion in a single year in 2007, the tenth year. This is more than six times the \$3.8 billion annual average cost of these provisions from 1998 through 2002. Back-loading is especially egregious in the provisions for IRAs, the benefits of which will be garnered mostly by taxpayers who have incomes between \$50,000 and \$160,000, and who are *already* covered under an employer-sponsored retirement plan.¹⁸⁸ Treasury estimates the costs of expanding current deductible IRAs and providing new back-loaded,

financial assets. The top 1 percent controls more net financial assets than the bottom 80 percent." Corporation for Enterprise Development, *USAs, Universal Savings Accounts--A Route to National Economic Growth and Family Economic Security*, 1996, p. 9.

¹⁸⁴Melvin L. Oliver and Thomas M. Shapiro, *Black Wealth/White Wealth: A New Perspective on Racial Inequality*, New York, Routledge, 1995, p. 9.

¹⁸⁵According to Oliver and Shapiro,. Moreover, middle-class blacks earn seventy cents for every dollar earned by middle-class whites but they possess only fifteen cents for every dollar of wealth held by middle-class whites. Melvin L. Oliver and Thomas M. Shapiro, *Black Wealth/White Wealth: A New Perspective on Racial Inequality*, New York, Routledge, 1995, p. 7.

¹⁸⁶Elizabeth C. McNichol and Edward B. Lazere, *Most States Still Tax the Working Poor After Five Years of Economic Recovery*, Washington, DC, Center for Budget Policy and Priorities, April 11, 1997.

¹⁸⁷Center on Budget and Policy Priorities, *Joint Tax Committee Distribution Table of the Roth Bill Produce Misleading Results*, Washington, DC, June 19, 1997, p. 2

¹⁸⁸Iris J. Lav, *The Final Tax Bill: Assessing the Long-term Costs and the Distribution of Tax Benefits*, Center for Budget and Policy Priorities, Washington DC, August 1, 1997, p. 1.

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so-called Roth IRAs,¹⁸⁹ to be just \$1.4 billion for FY 1998-2002, ballooning to \$16.4 billion over the succeeding five years (FY 2003-2007).¹⁹⁰

IDAs might not have much of a statistical impact on the national savings *rate*, which is currently only about half as high as it was thirty years ago, because of the small amounts of income that the poor can afford to invest. But we can be pretty sure that whatever low-income families manage to save as a result of a national IDA initiative, will in fact result in a net increase in *aggregate* personal savings. This is more than we can say for IRAs and other tax-advantaged savings incentives for middle- and upper-income Americans. According to William Gale of the Brookings Institution, "wide variation in effective tax rates on saving merely create opportunities for investors to shift funds into the most tax-preferred accounts."¹⁹¹ This kind of behavior has been empirically confirmed. Gale reports, for example, that:

Over the last several decades, as the personal saving rate has fallen, tax-favored saving (via pensions, 401(k)s, IRAs, Keoghs, and life (insurance) has become an ever more important component of total personal savings. Between 1986 and 1993, saving in tax-preferred accounts constituted about 100 percent of net personal saving. This does not mean there was no other saving activity, it just means that any gross saving in other accounts was fully offset by withdrawals from those accounts or by increases in borrowing.¹⁹²

A direct way of democratizing IRAs is through a national IDA initiative that would provide federal matching funds to encourage the working poor to invest in their own future. The concluding section of this paper suggests some steps that the Administration and Congress should take to increase the long-term success of EFT'99 and that would, at the same time, lay the foundation for an individual asset-building policy that will help, in the president's words "grow the middle class and shrink the underclass."

¹⁸⁹"The Roth IRA proposals, which primarily benefit taxpayers in the upper parts of the income distribution, are engineered so taxpayers can opt to pay taxes during 1999 through 2002 that they otherwise would pay in future years in return for very generous tax breaks for years to come." Center on Budget and Policy Priorities, *Joint Tax Committee Distribution Table of the Roth Bill Produce Misleading Results*, Washington, DC, June 19, 1997, p.2.

¹⁹⁰Unpublished estimates from the Department of Treasury, September 30, 1997.

¹⁹¹William G. Gale, Senior Fellow, The Brookings Institution, *Public Policies Toward Saving: Should We Expand Individual Retirement Accounts?* Testimony before the U.S. Senate Committee on Finance, March 7, 1997

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PART IV: CONCLUSIONS AND RECOMMENDATIONS

As the twentieth century draws to a close, few would take issue with Litan and Rauch that “to be without a bank account is no small matter.” In the modern economy, to be among the unbanked means, to begin with,

holding savings as cash, a practice that is both dangerous and insecure. It may also discourage saving in its own right, thus increasing the vulnerabilities of the poor. Furthermore, being without a checking account requires many of the poorest Americans to pay considerably more for basic financial services than other people need ever contemplate...¹⁹³

Picking up on this same theme, the Consumer Federation of America’s Stephen Brobeck suggests that while the market may be meeting the current demands of the bankless for quick access to cash and small loans (from check cashers) and for a way to pay rent, utility and other bills (by money order), the bankless have other needs that are not being met. These include “access to savings instruments, encouragement to save and not to borrow for discretionary spending, relatively inexpensive services, secure banking, and protection against theft.”¹⁹⁴ If surviving, let alone thriving, in today’s world requires one to have full access to the mainstream banking system., then government must do all it possibly can to assure the success of EFT’99.

In assessing EFT’99 progress to date, one thing seems clear. Midway through the implementation timeline, there are too many unresolved issues for consumer and community advocates to have fully bought into the process. Organizations like ACORN see themselves as stakeholders but neither as customers nor partners in the challenge to create a more accessible and inclusive financial services system for the twenty-first century. Perhaps their reluctance to hop on the EFT’99 bandwagon was inevitable given their vocal opposition to rising bank service fees, Treasury’s decision not to mandate “lifeline” accounts, and its refusal to regulate the character and costs of ETA accounts before the industry has had a chance to design and price them.

Even without a major IDA initiative to motivate the unbanked to open an account and, perhaps, start a modest saving program, the prognosis for EFT’99 could improve with time. A year from now, we should know the banking community’s response to Treasury’s *Direct Deposit Too* campaign and the extent to which unbanked recipients have voluntarily signed up for one of these new electronic accounts. The greater their popularity, the fewer benefit recipients that have to be assigned default accounts. By then, too, we will know more about the fees that unbanked consumers will have to pay for their electronic accounts and the services they include. The variety of partnerships that insured depositories will forge with financial services companies, software providers, retailers, check cashers and community-based organizations, will also have come into sharper focus. In short, by Christmas 1998, it should be possible to say with certainty

¹⁹³Robert E. Litan with Jonathan Rauch, *American Finance for the 21st Century*, Washington, DC, The United States Department of the Treasury, November 17, 1997, p. 146.

¹⁹⁴Stephen Brobeck, in *Financial Access in the 21st Century*, Washington, DC, Office of the Comptroller of the Currency, proceedings of a forum held on February 11, 1997, p. 27.

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that ACORN's worst nightmare about EFT'99 will not come to pass; that nightmare being, a check casher goes to a bank, establishes an account on behalf of unbanked recipients to accept their benefits through EFT, and then provides them access to their account only through that check casher at a fee without making other banking services available to them.¹⁹⁵

Funding National Education and Outreach

In the meantime, lingering fears and uncertainties have led consumer stakeholders to conclude that, for the time being at least, EFT'99 looks like a bad deal for poor people. So, they are focusing on ways to expand waivers and exemptions beyond the generous ones already established by Treasury which, if successful, would seriously compromise the Administration's ability to fulfill the promise of EFT'99. As we implied earlier, their persistent criticism of EFT'99 seems to have already caused Treasury to lower its expectations for EFT'99. For all the reasons discussed earlier, it is important for the Administration to act quickly to reverse this negative dynamic. And the best way to start turning things around is to find the \$10 million that Treasury needs to mount a major, grass roots outreach and education campaign in communities across the country that will help the bankless understand the benefits of becoming part of the mainstream financial system. While this is not the place to design an economic literacy curriculum, in his book, *Fringe Banking*, John Caskey speaks directly to this issue:

An effective program should be tailored specifically to the lives of the people enrolled, perhaps, based on courses offered through schools, community development groups, church groups, or local civic organizations. An appropriate course might contrast the cost of fringe banking services with the costs of similar services at mainstream institutions.¹⁹⁶

These topics are closely related to those routinely covered in various economic literacy, home ownership counseling, and other financial management, budget and credit counseling courses offered by community-based organizations across the country as part of their primary community development missions. Treasury should take advantage of this as it develops its national campaign.

Coordinate EFT'99 with the CDFI Program

Recognizing their complementary missions, the Administration should coordinate its community development financial institutions (CDFI) program, which Treasury also administers, in ways that support the goals of EFT'99 and state-level EBT initiatives. The law creating CDFI authorizes the Fund to enter into community partnerships to provide development services to targeted areas and populations, and to operate training programs "to increase the capacity and expertise of community development financial institutions and other members of the financial

¹⁹⁵NNC Information Report, Newsletter of the National Neighborhood Coalition, November 1997, p. 6.

¹⁹⁶John P. Caskey, *Fringe Banking: Check Cashing Outlets, Pawnshops and the Poor*, New York, Russel Sage Foundation, 1994, p. 148.

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services industry to undertake community development finance activities.”¹⁹⁷ The CDFI Fund could also expand its bank enterprise program (BEA) to reward traditional financial institutions that invest in community savings and asset-building initiatives in distressed communities.¹⁹⁸

Technical Assistance for Community Development Credit Unions. Through its technical assistance function, the CDFI Fund could strengthen the capacity of the existing network of 346 federally chartered community development credit unions that were created exclusively to meet the financial services needs of low-income persons in under served communities. The fact that a majority of all credit unions,¹⁹⁹ and probably a much higher percentage of community development credit unions, would not be able to participate in EBT programs because they do not presently offer ATM services is an issue that Treasury should help remedy.

Work with State & Federally Chartered Credit Unions: In addition to strengthening and expanding the network of community development credit unions in neighborhoods lacking deposit services (e.g. setting up more of them in public housing developments,) given its enthusiastic support of EFT’99, Treasury should work with the entire credit union industry to enable its members to become more significant players in the EFT/EBT process. In its public comment on the proposed EBT rule, the National Association of State Credit Union Supervisors advised Treasury that “we can (1) provide information with regard to state credit union EBT programs; (2) provide information about state laws which enable credit unions to serve nonmembers; and (3) help you develop programs which may bring the unbanked into fields of membership of credit unions in their community.”²⁰⁰ And federally chartered credit unions have asked Treasury to work with the National Credit Union Administration to determine “whether, for purposes of providing electronic government payments to individuals who do not currently have an account, credit unions should be allowed to serve individuals outside their fields of membership if they so choose.”²⁰¹

¹⁹⁷Public Law 103-325, Title I--Community Development and Consumer Protection, September 23, 1994, Sections 102(7) and 109(a) and 109(b).

¹⁹⁸The BEA program is designed to recognize the key role played by insured depository institutions in community development and to complement the CDFI Program by strongly encouraging support of CDFIs by such traditional financial institutions. The BEA Program offers incentives to these institutions to increase their efforts to lend, invest, and provide services in distressed communities. BEA Program incentives are in the form of awards that equal a percentage of the dollar value of the level of activities increased, compared to a baseline period. See, U.S. Department of the Treasury, Community Development Financial Institutions Fund *Annual Report Fiscal Year 1996*, Message from Director Kirsten S. Moy.

¹⁹⁹According to a recent survey of 6,952 credit unions by Credit Union National Associates (CUNA), 59 percent of all credit unions lack ATM facilities. Letter from Mary Mitchell Dunn, Acting Director, Regulatory Affairs, CUNA, submitting comments to the Department of the Treasury on 31 CFR Part 207, Direct Federal EBT Program, July 8, 1997.

²⁰⁰Letter from Douglas F. Duerr, President and CEO, National Association of State Credit Union Supervisors, to Department of the Treasury on 31 CFR Part 207, Direct Federal EBT Program, July 8, 1997.

²⁰¹Letter from Mary Mitchell Dunn, Acting Director, Regulatory Affairs, CUNA, submitting comments to the Department of the Treasury on 31 CFR Part 207, Direct Federal EBT Program, July 8, 1997.

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Bringing an Asset-Building Program to Scale

Democratizing IRAs: Finally and most importantly, EFT'99 would have substantially more grass roots support and national impact if it were linked to a major effort to stimulate savings and wealth creation by the poor. This could be done in several ways, including, for example, democratizing IRAs through a federal refundable tax credit that would match low income individuals' deposits on a dollar-for-dollar basis up to, say, \$300 a year.²⁰² Sherraden suggests another possibility--adding progressivity features to expanded IRAs by providing a tax credit against payroll taxes. In this case, contributions to the accounts would be best handled through an employer's tax return. Employers could either match employee contributions into the account, or make contributions to those accounts based on the employees compensation.

Linking Savings Incentives to the EITC: Another alternative is to modify the Assets for Independence Act discussed earlier by funding it on the mandatory side of the budget through the vehicle of the earned income tax credit (EITC,) for which all IDA-eligible individuals qualify. Through her annual federal tax return, a low-income worker would instruct IRS to electronically deposit into her IDA account, a specified portion of her EITC, along with a 1:1 federal match, up to a maximum of, say, \$300 a year. Once deposited into the individual's IDA account, withdrawals would be governed by the same kinds of restrictions discussed in Part III of this paper.

A National IDA Program Targeting Depository Institutions: Another alternative is for the Congress to authorize a five year, \$500 million IDA program that would be funded on the discretionary side of the budget (i.e. from annual appropriations.) Instead of being administered by HHS as in the current bill, the modified program would be administered by the CDFI Fund to underscore its asset-building objectives and the importance of partnering with the full range of depository institutions. And instead of individual community organizations applying for small grants to capitalize 25 to 100 IDAs each, in order to achieve the envisioned scale of 400,000 new accounts a year for five years, the applicants would be financial institutions which, working with community-based organizations to provide the required economic literacy services, would each commit to establishing hundreds or thousands of IDA accounts. It makes sense to target the program to insured depository institutions because they have the capacity and motivation to create and administer large numbers of IDA accounts. In addition to receiving CRA credit and possible BEA incentives, they should be attracted to the program because IDA accounts are a source of cheap deposits with low average turnover rates. This means higher earnings on idle balances (i.e. a larger float.)

A Final Thought

In closing, it should be emphasized that EFT'99 is not simply about the technology of electronic banking, but about financial inclusion and making the market economy work for all Americans. The IDA initiative would build upon the financial infrastructure that EFT'99 puts in

²⁰²The expanded IRA proposals are from Michael Sherraden, Agenda for Research and Publication on Saving and Asset Building in Low Wealth Households and Communities. Center for Social Development, Washington University in St. Louis, no date.

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place at a tiny fraction of the \$17 billion cost of the enhanced IRAs the Congress recently committed to higher income Americans. Adding a wealth-building component to EFT'99 and state EBT initiatives is not about subsidizing the poor. It is about finishing the job of welfare reform. It is about fairness. It is about making compound interest work *for* the poor and giving them a place in the American capitalist system.

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