

NEW AMERICA FOUNDATION

ASSET BUILDING PROGRAM

The California Un-banked

The problem and potential solutions

Testimony given by:

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Hearing on The Growing Use of Stored Value Cards

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Thank you for the opportunity to address the Committee about the potential of stored value cards to help bring un-banked Californians into the financial mainstream. The New America Foundation is a nonprofit non-partisan policy institute based in Sacramento and Washington DC. I'm a California fellow in the Asset Building Program, which aims to broaden the ownership of assets in California and America, providing everyone—especially low-income Californians and Americans—with both the means to get ahead, as well as a direct stake in the overall success of our economy.

First, I'd like to comment on the problem of the un-banked in California and then provide suggestions for how the state can adopt low and no cost solutions to address this problem.

I. The Un-banked in California

1) Who are the un-banked in California?

The term “un-banked” refers to people who don't have checking or savings accounts. The un-banked often rely on high-priced check cashing outlets and pay day lenders to conduct their finances and have few opportunities to save and build assets.

In California, 28 percent of adults don't have a checking or savings account, according to the US Census. Nationally, the estimate is that 10 percent of all households don't have accounts. In San Francisco, the Brookings Institution estimates that one in five San Francisco adults---and half of its Blacks and Latinos---don't have accounts.

The un-banked are most likely to be people of color, less educated, and have lower incomes. For example, a Harvard poll of Hurricane Katrina evacuees in the Superdome found that seven out of ten evacuees did not have checking or savings accounts.

2) Why is this a problem?

The un-banked poor pay more to conduct their financial lives. Check cashing outlets typically charge between 2-3 percent the face value of a check. So, someone who makes \$30,000 a year can pay \$900 a year just to access their salary and pay their bills.

But there are more profound costs to being un-banked, costs that aren't readily apparent.

Families without accounts don't have a safe place to keep their money. They walk around with wads of cash in their pockets. Or they keep it at home in a coffee can. Robberies are more prevalent around check cashing outlets,

according San Francisco police reports. And if people's homes are broken into or there's a fire, they may lose their life's savings.

Also, a bank account is the first step to financial security for many families. I'd also like to call your attention to the attached graphic. It's called "The Credit Path" and was developed by Alternatives Federal Credit Union in Ithaca, New York. A bank account helps people take the first step onto this path. Without one, it's harder to get well-priced car loans, credit cards, or mortgages--the exact financial tools needed to climb up the economic ladder. Many families stay stuck on a different path--going to the pawn shops, pay day lenders, rent to own stores--where the interest rates can reach several hundred percent.

3) Why do so many people not have bank accounts?

The most recent and comprehensive survey of un-banked consumers, conducted by the Center for Financial Services Innovation, found that people faced both "hard" and "soft" barriers to entering the financial mainstream. These "hard" barriers are people's: (1) perceived high cost of accounts; (2) appearance on Chex Systems, a screening device used by banks to identify people who have mismanaged or overdrawn accounts in the past; and (3) perceived lack of proper identification. The "soft" barriers cited by survey respondents included being "intimidated" by banks.

4) What is the private sector doing to address this problem?

Some financial institutions are starting to see the un-banked as a market to tap--not a group to keep out of their lobbies. And technology, like stored value Cards, is bringing down the cost of developing banking products for this market. Many financial institutions are offering checkless checking accounts--card-based accounts that can't be bounced-- and "second chance" checking accounts to people who may have overdrawn their accounts in the past.

II. How can California state government harness stored value card technology to bring Californians into the financial mainstream?

Some of the recommendations I make span beyond using stored value card technology. The Center for Financial Services Innovation (<http://www.cfsinnovation.com>), a partner of the New America Foundation, contributed to the development of these recommendations.

1) Leverage the state's delivery of benefits to bring benefits recipients into the financial mainstream.

The state provides TANF, unemployment, and child support payments to millions of Californians. TANF and food stamps are currently delivered by Electronic Benefits Transfer to stored value cards. Child support and unemployment are delivered by paper checks. Many benefit recipients are likely un-banked. The state could leverage this delivery of benefits in several ways to help bring benefits recipients into the financial mainstream:

- **Encourage people to receive state benefits by direct deposit. Help them open accounts if they don't have them.** Benefits recipients have the option to receive their benefits by direct deposit but this option is not promoted by caseworkers throughout the state. For example, in San Francisco, only twenty percent of CalWorks recipients receive their benefits by direct deposit. Caseworkers and other state government staff should be trained to promote the use of direct deposit and the benefits of account ownership. Illinois is in the process of training its case workers to encourage benefit recipients to open accounts and receive their benefits via direct deposit. I've included the brochure their caseworkers are using. Caseworkers will then help people open bank accounts if they don't have them. The Federal Reserve Bank of Chicago developed a database that is searchable by zip code that caseworkers can use to help people find a low or no cost account at a financial institution near them. The Federal Reserve Bank of San Francisco could do the same for California.
- **Link benefits cards to bank accounts.** Some states, such as Indiana, Arizona, Massachusetts, Alaska and Nevada, attach "limited use" bank accounts to benefits cards. Leading financial institution representatives have indicated that limited use bank accounts could be added to CalWorks cards at no cost to the state. The limited use account could not receive deposits from other sources but would benefit recipients in several

ways. First, they could save benefits in their account, which they currently cannot do. Right now, benefits revert back to the state after 90 days if they are not used. Second, Calworks recipients would have greater privacy, in that the state could not track how and where benefits are spent. Finally, the temporary accounts could also be structured to provide greater consumer protections, including being Regulation E compliant, which, among other things, requires that quarterly statements be sent to account holders.

- **Enhance benefits cards with financial functions.** Cards could be enhanced with functions to help benefits recipients enter the financial mainstream. Cards could be set up to receive deposits from other sources, and bill payment and remittance features could be included. Provisions of these features would have costs attached to them. The state could also set it up so that people could build a positive credit history by paying their bills with these cards.
- **Use stored value cards instead of paper checks to deliver state benefits such as Child Support and Unemployment.** Currently, the state delivers child support benefits and unemployment benefits by paper check to recipients. CalWorks and Food Stamps are delivered to Stored Value Cards. The state and the unbanked recipient would benefit if unemployment and child support were delivered by stored value cards as well. Delivering them by card would be cheaper for the state. The State would also reduce its error rate. Unbanked benefit recipients would no longer lose part of their benefit by using a check cashing outlet. Many states are already delivering child support through stored value cards. Most have plans to do so in the near future. California rewarded Bank of America with a more comprehensive child support disbursement contract last year that included payment by stored value cards, but to date they have not implemented the card services. Oregon and Arizona deliver unemployment through benefit cards.

2) Prepare now for how to use stored value cards to deliver relief to victims of natural disasters. Enhance these cards with financial functions to receive additional deposits, pay bills, etc.

More analysis is needed to fully understand what went wrong with FEMA's effort to distribute relief payments via cards, which was halted after a few days and reached only a small percentage of evacuees. But several early lessons are apparent that are instructive for California as it prepares for how to use prepaid stored value cards to deliver money to victims should a disaster strike. While FEMA discontinued its stored value card program, other aid organizations, state government agencies and private employers collectively issued more than a million stored value cards. Check issuance is impractical when a family is evacuated, and direct deposit doesn't work when a bank is closed or its systems are inoperable. Stored value cards have proven effective in responding to Katrina and other prior disasters. The key is to prepare now. California can take the following steps to prepare to use stored value cards in a disaster:

- **Risk management guidelines must be eased – and communicated clearly – to facilitate quick and easy card issuance.** With no permanent address and little if any personal documentation, few evacuees could pass the typical “know your customer” test, especially in the early days after evacuation. Bank regulators at both the federal and state levels need to develop jointly a set of acceptable risk management practices for financial institutions to follow in disaster situations – not only for preparedness sake, but also so that there is a paper trail 18 months from now when banks are being examined and the memory of Katrina has faded. Fraud is going to occur, but its cost must be weighed against the cost of failing to provide tens of thousands of evacuees with the tools they legitimately need to reestablish themselves.
- **Consumers should have the ability to reload the cards with multiple sources of funds.** One of the primary shortcomings of the FEMA card was that it offered little beyond the \$2,000 already loaded on it. Given the customer identification challenges noted above, it may be necessary to create a two-step process where consumers initially receive a non-reloadable card loaded with immediate relief funds, perhaps with a 30-day expiration date, followed by a more fully functional card once a more complete risk assessment has been completed. This is similar to the procedures that some prepaid card companies use. Consumers are offered a PIN-only card at the cash register; once they call in with additional information, a branded, personalized card is sent to them in the mail. The other advantage of a two-step process is that, from the perspective of financial services companies, evacuees can transform themselves from victim status in need of aid to consumer status in need of a range of products and services.

- **State and federal governments should rethink their role in ensuring that disaster victims have adequate access to financial services.** For individuals who had little financial stability before a disaster and now have even less, that piece of plastic might provide a small but important foothold as they struggle to rebuild their lives. As mentioned earlier, in one poll seven of ten evacuees did not have a checking account, savings account, or credit card. Prepaid debit cards could be used to link disaster victims with a range of financial services opportunities as card processors add functions like bill payment, remittances, saving and credit building.
- **Look to EBT programs to deliver card-based relief.** Through developing and implementing state electronic benefits transfer programs, states have had years to develop and perfect both relationships with third-party card providers and card enrollment and distribution mechanisms. Louisiana is using its existing EBT infrastructure to provide emergency food stamps to hurricane victims, and it recently began providing unemployment compensation via prepaid cards.

3) State regulators should balance the need to encourage innovation and provide needed consumer protections for stored value cards.

I believe others are testifying on how stored value cards should be regulated. I'll keep my comments here minimal and "big picture."

Banking looks little like it did 20 years ago, yet the regulatory frameworks as it relates to the provision of basic financial services has not kept pace with these changes. Financial transactions increasingly take place outside the bank branch, electronic payments have eclipsed checks and new products like stored value cards are challenging the very definition of terms like "deposit" and "account."

These innovations are still in their early stages, but hold the potential for both promise and peril for unbanked consumers. For instance, stored value cards could indeed become alternatives to bank accounts, particularly with the addition of certain enhancements. They clear away many of the obstacles identified by the un-banked in accessing and using traditional deposit accounts, while offering financial services firms a less-costly tool for serving those with lower average balances.

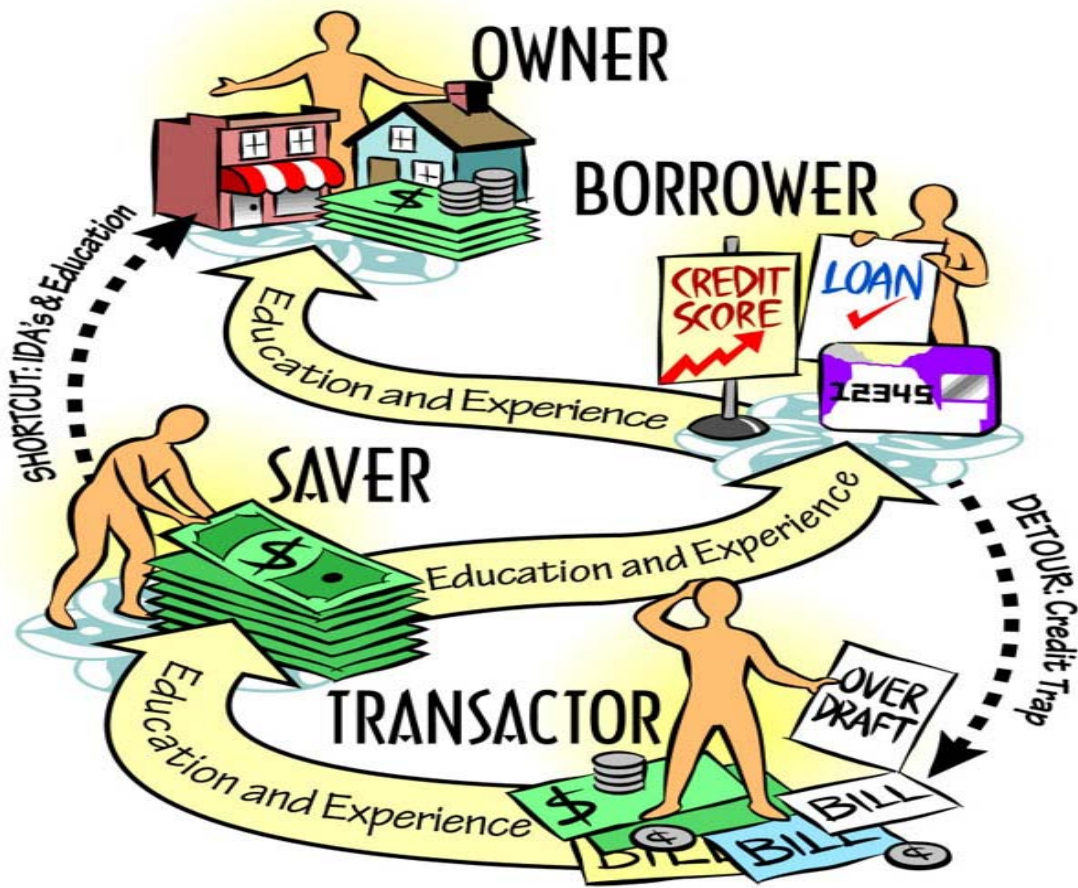
Regulators do not have an easy job in this rapidly changing environment. I encourage you to tread carefully on these and similar issues, encouraging innovation on the one hand while protecting consumers on the other.

CONCLUSION

The un-banked problem is one that is large, challenging, and little understood. Its encouraging that some financial institutions are starting to see the un-banked as a market and developing products that are good for both company and un-banked consumers. The state needs to encourage the private sector to keep moving in the right direction. The recommendations presented here show how the state can leverage its existing programs and functions to do so.

MORE INFORMATION

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“The Credit Path.” Alternatives Federal Credit Union. Ithaca, New York