



# REINVESTMENT ALERT

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Woodstock Institute

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## Protecting the 'Unbanked': Federal Electronic Funds Transfer and Low-Income Consumers

### Key Decisions Need Your Input Now!

Over the next few months community organizations and others can play an important role in shaping a new regulation which will impact millions of low-income households. The federal government has made electronic fund transfer available for those who want it since July 1996. Beginning January 1999, the Treasury Department will make social security and other program payments through electronic funds transfer (EFT) mandatory for most federal benefit recipients. EFT can serve to encourage low-income people without bank accounts, often referred to as the 'unbanked', to establish financial relationships with mainstream financial institutions. However, as currently proposed, EFT can also preserve the status quo--keeping a substantial portion of low-income people reliant on high-cost currency exchanges for check cashing and money orders.

**...EFT can serve to encourage unbanked low-income people to establish financial relationships...**

According to a recent Woodstock Institute study, check cashing outlets:

- ◆ Are disproportionately located in low-income minority communities.
- ◆ Charge up to three times as much as financial institutions for basic financial services.
- ◆ Do not provide key services like savings accounts and financial advice.
- ◆ Experience returns on equity that are over ten times higher than for national banks, secure large profits for owners and do little to protect customers from unreasonable costs.

The Treasury Department, which published proposed EFT rules in September, will take public comments until December 16, 1997. The Woodstock Institute is working with several organizations, including the Poverty Law Project, National Community Reinvestment Coalition, First Nations Development Institute, and the Center for Community Change to develop recommendations to the Treasury Department to insure that the interests of low-income people are protected. We invite you to become part of this process by writing to the Treasury Department regarding your concerns with the proposed regulations. Woodstock Institute's recommendations are listed on page 5.

### Background

**...Social Security, SSI, and veterans benefits will be transferred directly into the recipient's account.**

Beginning January 2, 1999, the Treasury Department will make most federal payments electronically, rather than by check. Senior citizens as well as the disabled will be impacted as Social Security, SSI, and veterans benefits will be transferred directly into the recipient's account. The proposed regulations guiding EFT are known as 31 CFR 208: Management of Federal Agency

Disbursement; Notice of Proposed Rulemaking. It was drafted by the Treasury Department in response to a law passed by Congress known as the Debt Collection Improvement Act of 1996 that requires wire transfers for most federal payments.

The Treasury's proposed regulations require that all those who receive federal payments provide information on their bank accounts so that funds can be deposited electronically. However, ten million beneficiaries of federal funds do not currently have bank accounts. As a result, the Treasury is charged with establishing electronic transfer accounts (ETA) in their names at federally insured financial institutions, which include banks, savings and loans, and credit unions. Therefore, under the proposed regulations, currency exchanges can not directly receive transfers. ETA services, such as ATM access, will be determined by the Treasury. It is likely that these accounts will be limited purpose--- allowing recipients to withdraw funds, but not write checks or make additional deposits. The fees depository institutions will charge recipients have not been negotiated.<sup>1</sup>

The Treasury will grant EFT waivers that will allow some recipients to continue to receive paper checks. The waiver process is relatively simple--people may self-certify hardships and waivers will be granted automatically:

- ◆ Individuals without bank accounts can request a waiver for these reasons or because of financial hardship.
- ◆ Individuals with bank accounts, and who became eligible for federal benefits before July 26, 1996, can opt out of the EFT program if they are disabled or do not have access to financial institutions due to geographic barriers.

The proposed regulations are not clear on the options of people who became eligible for federal benefits after July 26, 1996 and who currently have a bank account. As currently proposed, they may not have the ability to request a waiver or to have access to an EFTA if fees associated with their current account becomes a hardship.

## **Advantages and Disadvantages of EFT**

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<sup>1</sup> Center for Community Change. 1997. Treasury Department announces plans for electronic payment of federal benefits. October 13: 3-4.

There is much to recommend this program. Electronic payments will save the Federal government at least \$100 million per year in processing and postage costs. Electronic payments are also safer, faster, and less expensive than payments made by paper check, which can be lost, stolen, or delayed. EFT also enhances predictability of payments to recipients--allowing immediate access to funds. Low-income people will have the same benefits of technology that middle-class consumers have enjoyed for years: 24-hour ATM and point-of-sale (POS) access to funds. Further, unlike paper checks which may take weeks to replace if lost or stolen, difficulties with EFT can be resolved relatively quickly.<sup>2</sup>

**...Low-income people will have the same benefits of technology that middle-class consumers have enjoyed for years:**

EFT may encourage low-income people to become consumers of mainstream financial services. Using a bank or a credit union brings low-income people into regular contact with financial institutions, allowing them to learn more about financial management and the availability of other financial services.

**...Using a bank or a credit union brings low-income people into regular contact with financial institutions...**

However, EFT will serve the interests of low-income people only if several conditions are met:

- ◆ Fees associated with ETAs, including ATM and checking account fees, must be kept to a minimum.
- ◆ Considerable consumer education, from ATM use to financial asset management, must be provided to customers.
- ◆ Offices of banks and credit unions with ETAs, as well as ATMs and POS outlets must be available in low-income communities where people can access services.
- ◆ ETAs must include sufficient services. The intent to introduce people to mainstream services will be defeated if people take cash from ATM machines or POS terminals to a currency exchange to purchase a money order to pay their rent. Further, ETAs that do not accept additional deposits will discourage thrift.

In addition to these concerns is the unresolved issue of the potential involvement of currency exchanges, which are pressing for participation in the federal EFT program. Experiences with state electronic benefit transfer (EBT) programs, such as Illinois', indicate that currency exchanges may find a way to participate, albeit indirectly.

## **EBT, Welfare Reform, and Currency Exchanges**

The currency exchange industry is concerned about the effect that EFT will have on its revenues. Cashing government checks accounts for about 25 percent of the check cashing industry's business<sup>3</sup>. However, some

<sup>2</sup> Department of the Treasury. 1997. Press Release: 31 CFR 208: management of Federal Agency Disbursement; Notices of Proposed Rulemaking, September 11; and Fact Sheet: 31 CFR 208: Management Federal agency Disbursement; Notice of Proposed Rulemaking, September.

<sup>3</sup> Electronic Benefits Transfers: Check Cashers Hold On. 1997. Future Banker. August: 34.

currency exchanges are offsetting losses by developing cooperative arrangements with banks as distribution points for EFT payments.

Illinois is a case in point. By the end of 1997, all payments for food stamps and welfare benefits in Illinois will be distributed through the Illinois Link Card EBT system. The State has contracted with First of America Bank Corporation, a Michigan-based company, to provide services to its 472,000 public aid recipients. For those without bank accounts, the state assigns an account, which allows recipient's access to benefits, but does not permit them to write checks or make additional deposits. Recipients can access their funds through First of America ATMs, cash stations, and EBTI (Electronic Benefit Transfer - Illinois), and POS terminals.

**...recipients receive four free ATM withdrawals per month if they use an ATM operated by an affiliate of First of America.**

Consumer costs are limited; recipients receive four free ATM withdrawals per month if they use an ATM operated by an affiliate of First of America. Subsequent withdrawals are \$1 each. Obtaining cash and making purchases from POS terminals is free of charge.

However, the currency exchange industry has found a way to participate in the program. In partnership with Corus Bank and LaSalle National Bank, it has developed SecureCheck. With SecureCheck, benefits are transferred to a bank that maintains trust accounts for currency exchanges. That bank electronically transfers funds to a currency exchange designated by a recipient, who then collects the benefit in the form of a check<sup>4</sup>. The catch? The recipient must pay the currency exchange's check cashing fees, estimated at \$4.30 per month<sup>5</sup>.

## Recommendations

We have developed the following recommendations for the proposed EFT regulations. Our intent is to encourage low-income persons to develop mainstream financial accounts, remove barriers to use of financial institutions by the 'unbanked' and encourage banks to extend services to low-income persons.

1. **Importance of Mainstream Banking:** the Woodstock Institute supports restrictions in the currently proposed regulations that do not allow currency exchanges to serve as direct recipients of Treasury transfers. However, we believe that Treasury should also disallow EFT partnerships between regulated institutions and currency exchanges. In addition, there is preliminary interest on the part of the US Post Office to serve as an EFT distribution point. Although this proposal has some merit, we support limiting transfers to depository institutions to encourage non-banked consumers to establish banking relationships. For this same reason, we recommend that Treasury carefully consider granting EFT waivers. The EFT options of individuals eligible for federal benefits after July 26, 1996 and who have bank accounts are unclear. We recommend that the Treasury Department should allow them to access an ETA or apply for a waiver if maintaining their current account becomes a hardship.
2. **Consumer Costs:** the Treasury has stipulated that ETAs should be provided at a 'reasonable' cost. We are concerned that ETA service fees, as well as the costs of wire transfers, are kept to a minimum. Banks should also limit holds on funds to increase customer access to deposited funds.

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<sup>4</sup>Cleaver, Joanne. 1997. Check it out: For currency exchanges, its a brave new world. Crains Chicago Business. October 20: 17-21.

<sup>5</sup>Currency exchange fee to cash a \$300 public aid check estimated by the Woodstock Institute. For more information, see Reinvestment Alert: Currency Exchanges Add to Poverty Surcharge for Low-Income Residents, March 1997.

3. **Consumer Protections:** protections available to other account holders should be available to ETA holders. This includes assurances that account balances can not be attached by creditors and limited liability on the part of account holders in case of theft of ATM or debit cards.

1. **Consumer Education, Outreach and Marketing:**

although the Treasury Department has made provisions to contract with consumer groups and others to help people learn to use ATMs and manage personal finance, many low-income consumers have little or no experience with banks. Some may have attempted to access banks services in the past and been repelled for a variety of reasons. EFT recipients will therefore require significant person-to-person training and education on balancing checkbooks, planning monthly finances, and using an ATM. This training should be conducted by established consumer and community groups or community development credit unions, experienced with working with low-income persons. Further, financial institutions must commit to providing ongoing, personal assistance.

**...EFT recipients will therefore require significant person-to-person training and education...**

1. **Access:** banks and bank regulators should consider EFT an important component of the new Community Reinvestment Act's (CRA) service test. Service innovations, such as establishing branches in low-income neighborhoods, mobile bank branches on reservations, rural areas and small towns in under-served areas or in senior citizen buildings should be recognized and encouraged by bank and credit union regulators.

**...EFT is an important component of the new Community Reinvestment Act's (CRA) service test.**

2. **Waivers:** individuals with language and literacy barriers should also be eligible for waivers.

## What You Can Do

The time is ripe to shape EFT policy. You can help by submitting comments to the Treasury before the comment period expires, December 16, 1997. Please feel free to incorporate points 1-5 above. Your comments should be addressed to:

Cash Management Policy and Planning Division  
 Financial Management Service  
 US Department of the Treasury  
 401 14th Street, S.W. Room 420  
 Washington, D.C. 20227

In addition to writing Treasury, there are other ways to insure banking service to low-income EFT recipients. Write to your Congressperson or Senator, expressing your concerns that currency exchanges be prohibited from participating in the EFT program. If you belong to a credit union, ask your Manager or board President if they have developed low-cost or free accounts for EFT customers. Ask the same question of your bank manager. Community organizations and social service providers can also play an integral role in providing consumer education and training on EFT and other personal financial concerns. If your organization is unable to provide this service directly, find out who does and refer constituents to that agency. For more information on how your organization can provide financial management services to your constituency, call:

- ◆ Marva Williams, Woodstock Institute, (312) 427-8070
- ◆ Dory Rand, Attorney at Law, with the Poverty Law Project of the National Clearinghouse for Legal Services, Inc., (312) 263-3830
- ◆ Debbie Goldberg, Neighborhood Revitalization Specialist, the Center for Community Change, (202) 342-0567

### **For More Information**

The Treasury Department maintains a web site with information on EFT, including the proposed regulations, fact sheets and questions and answers, as well as comments made by testifiers at public meetings. The site can be found at <http://www.fms.treas.gov/eft>. The proposed regulations can also be found in the September 16, 1997 issue of the Federal Register (Volume 62, Number 179) pages 48713-48726.

**Prepared by  
Marva Williams  
Senior Project Director  
Woodstock Institute**