S. HRG. 107–946

BRINGING MORE UNBANKED AMERICANS INTO THE FINANCIAL MAINSTREAM

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

ON

EXAMINING ISSUES RELATED TO IMPROVING ACCESS TO AFFORDABLE AND CONVENIENT BANKING SERVICES AND PRODUCTS FOR THOSE INDIVIDUALS CURRENTLY LACKING A RELATIONSHIP WITH AN INSURED DEPOSITORY INSTITUTION. A REVIEW OF THE TREASURY DEPARTMENT'S EFFORTS TO IMPROVE ACCESS TO BANKING ACCOUNTS THROUGH ITS IMPLEMENTATION OF THE FIRST ACCOUNTS PROGRAM

MAY 2, 2002

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

88–055 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

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C O N T E N T S

THURSDAY, MAY 2, 2002

WITNESSES

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

BRINGING MORE UNBANKED AMERICANS INTO THE FINANCIAL MAINSTREAM

THURSDAY, MAY 2, 2002

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:10 a.m. in room SD–538 of the Dirksen Senate Office Building, Senator Paul S. Sarbanes (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN PAUL S. SARBANES

Chairman SARBANES. The hearing will come to order.

I am very pleased to welcome before the Committee this morning the very able Assistant Treasury Secretary for Financial Institutions, Sheila Bair, who will testify about issues surrounding the unbanked and specifically discuss the Treasury's implementation of the First Accounts Program.

She will be followed by an able panel of witnesses representing academic and financial institutions, and community groups, and we will get the benefit of their perspectives on this important issue of trying to bring more unbanked Americans into the Nation's financial mainstream.

This morning's hearing will examine the challenges that the unbanked face and explore the roles that policymakers, financial institutions, nonprofits, community-based organizations, and others can and should play in bringing more Americans into the financial mainstream.

Millions of families in the United States lack access to basic banking services that I think most of us would regard as essential for individuals seeking to fully participate in our financial and economic system.

According to the Federal Reserve's 1998 survey of consumer finance, almost 10 percent of families do not have any form of an account with an insured depository institution. The number is even higher for families that have no checking account. Thirteen percent of all American families do not own a checking account, almost one out of every seven. These families are, as one would expect, disproportionately low income or minority.

I think that these statistics should be of great concern to anyone who has any commitment to ensuring that all Americans have access to basic financial services. There is a growing recognition that the cost incurred by the unbanked greatly exceed the high fees paid to cash paychecks, send remittances, and pay bills. In fact, the lack of a relationship with a traditional bank or credit union has profound implications for the ability of an individual to acquire financial assets and to accumulate wealth.

A recent survey by the Office of the Comptroller showed that only 30 percent of unbanked households held savings, compared to 80 percent of those with bank accounts. Furthermore, the Federal Reserve's data reveals that only 8 percent of unbanked families have a retirement account.

Without access to mainstream banks and credit unions, the unbanked end up using fringe financial service entities to conduct routine transactions. The fringe service providers offer no opportunity to build a credit history, which then becomes essential to accessing other affordable financial products, such as mortgages or low-interest lines of credit. Without traditional credit, individuals are vulnerable to exploitation by abusive lenders offering high-cost mortgages, high-interest short-term loans, and very expensive rent-to-own products.

Also of considerable importance, but often overlooked are the public safety implications for the unbanked. These individuals are often the victims of crime because many operate on a cash-only basis, and end up carrying significant amounts of cash on their person or store cash in their homes.

Surveys of the unbanked suggest that there are a variety of reasons why millions of families in the United States do not have accounts with insured depository institutions. These reasons range from the common complaints that barriers to entry exist for low-income individuals in the form of high costs and lack of convenient bank branches, to more complex issues involving distrust and negative attitudes about insured depository institutions borne of past experience. The lack of sufficient financial literacy or information about the availability of low-cost banking accounts are also seen as a significant obstacle.

So it all poses, I think, a significant challenge to those of us who are trying to find a solution. Clearly, increasing the number of banked will not be an easy task and it will really require sustained commitment to eliminate this, in a sense, bifurcated financial services system that currently exists in the country.

This morning, we will hear about the multifaceted approaches currently being undertaken by the Federal Government, by insured depository institutions, by community groups, and by others to address this issue.

I am hopeful that today's hearing will lead to a broader understanding of the needs of the unbanked, as well as provide a forum for an exchange of ideas on improving access to basic financial services. A central focus of this hearing will be a review of the Treasury Department's efforts to improve access to affordable and convenient accounts through the implementation of the First Accounts Program, which was announced in January of 2000. The Treasury Department has played an important role in highlighting the problems of the unbanked and addressing their needs.

I especially want to express my appreciation to Assistant Secretary Sheila Bair for her strong leadership and continuing commitment to the First Accounts Program, and we look forward this morning to hearing an update of Treasury's efforts.

Before turning to the Assistant Secretary, I also want to commend those banks, credit unions, thrifts, community development financial institutions, and others that have worked together to create innovative programs that remove many of the obstacles that low-income, unbanked consumers face when they seek to establish checking or savings accounts.

I strongly urge other insured depository institutions that have not yet taken up the challenge to work with the Government, the nonprofit organizations, community development financial institutions, and employers to design products that address the needs of the unbanked and increase their financial stability.

I obviously feel very keenly that if we can bring the unbanked into the mainstream of the financial system, it will clearly be to their advantage. But beyond that, it will really be to the advantage of the workings of our economic system. It will give it greater legitimacy and credibility. It will strengthen it. I think mainline institutions will discover that, in fact, there is a market there to be developed and grown that will prove to be advantageous to them.

And we will rid ourselves of this distressing problem of having part of our population not accessing the services that most of us consider as standard or routine, and therefore, in a sense, being alienated from the workings of the economic and financial system. I regard that as a highly undesirable thing and we have been working very hard, and we are very pleased with the work that Treasury has been doing.

Before I turn to Ms. Bair, I will yield to my colleague, Senator Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman.

I strongly appreciate your holding this hearing. And in fact, I will keep my remarks brief because you have essentially said it very well. With your permission, I would associate myself with your remarks and comments. I strongly agree with everything you have said.

I too want to commend and thank Assistant Secretary Sheila Bair for all of the work that she has done on this important issue and the other important work that she has done over the years. I know that she comes with a lot of experience in the financial sector of our economy. I appreciate your willingness to be involved in public service.

Ms. BAIR. Thank you.

Senator CRAPO. In Idaho, when you look at the statistics that you have talked about, Mr. Chairman, that means that we have something like, if those statistics hold in Idaho, something like 47,000 households that are unbanked. Surveys have found, as you have indicated, Mr. Chairman, that the groups that are most likely to be unbanked are lower-income households, households headed by African-Americans and Hispanics, households headed by young adults, and households in which the home is rented.

I see that as a significant and increasingly difficult problem in Idaho. And that is why I believe that this hearing and the efforts that are being undertaken by so many who are here today are so critical. We have looked particularly in Idaho at one of our growing and significant groups, the Hispanic population, and have found that not only are they squarely hit by these kinds of problems, but also with the types of problems that relate to access to affordable housing, either ownership or rental. These issues are connected.

We have, because of that, started what we are calling an Hispanic Initiative in my office to try to identify the universe of issues that are faced by the Hispanic population in Idaho, not just the housing and the financial services issues, but the remainder of those issues, and to try to see what we can do from our position here to help increase the opportunities for the people who fall into these categories and face these difficult burdens. This hearing today is hitting squarely at one of those important issues.

I do want to give my thanks not only to Assistant Secretary Bair and the Treasury Department for their effective work in this area, but also to the National Credit Union Foundation, in which one of these First Accounts awards made it to Idaho and is helping us to get ourselves very involved in financial literacy efforts in rural Idaho and developing that basic consumer financial education that is so critical, and helping our people to gain access to affordable international money transfer services at greatly reduced costs. So, there is a lot being done here and there is a lot of great thinking and a lot of innovative ideas and a lot of resources that can be brought to bear on this issue.

One of the hopes that I have is that we can strengthen those opportunities through the things that we learn in these hearings, and also that we can identify what is there and bring them effectively into play across the Nation, but in particular, in Idaho.

So thank you very much, Mr. Chairman, Assistant Secretary Bair, and for all of the witnesses who are here to help us work on this critical issue.

Chairman SARBANES. Senator Crapo, thank you very much for your strong support for what we are trying to do. And I look forward to continuing to work closely with you as we try to advance the goals that we have set out here.

Senator CRAPO. Thank you.

Chairman SARBANES. Sheila, we would be delighted to hear from you. We are pleased to welcome you back before the Committee.

STATEMENT OF SHEILA C. BAIR
ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS
U.S. DEPARTMENT OF THE TREASURY

Ms. BAIR. Thank you, Chairman Sarbanes and Senator Crapo, I appreciate the opportunity to appear before you this morning to talk about First Accounts, a grant program administered by the Treasury Department, that is designed to help unbanked low- and moderate-income individuals establish banking relationships with insured depository institutions.

Mr. Chairman, I commend you for focusing the national spotlight on this critical issue of expanding consumer access to mainstream financial services by convening today's hearing, as well as the hearings you held previously on the remittance industry and financial education. The policy objective of First Accounts is embraced by Members of both parties. Moreover, it is of great importance to me personally, to the Treasury Department, and to the Bush Administration.

Secretary O'Neill recently noted that: "We must work to ensure that all Americans have the knowledge and tools to build their own financial security. Ownership, independence, and access to wealth should not be the privilege of a few. They should be the hope of every American." Establishing a bank account at an insured depository institution is one of the basic tools necessary for individuals to build their own financial security. Expanding low- and moderate-income Americans' access to mainstream banking services is very much in line with the compassionate conservatism of President Bush to give all Americans the chance to fully participate in the benefits of our free economy. In a recent speech, President Bush defined this compassionate conservatism by saying: "It is compassionate to actively help our fellow citizens in need. It is conservative to insist on responsibility and results." Consistent with this philosophy, we have strived to direct First Accounts funding to those initiatives which are replicable, self-sustaining, and, most importantly, promise to bring the greatest number of unbanked individuals into stable banking relationships.

Who are the unbanked? Simply put, the unbanked are people who do not have a banking relationship with a traditional financial institution, such as a commercial bank, a savings association, or a credit union.

Although there are few statistics available regarding the true size of the unbanked population in the United States, some estimates indicate that as many as one in ten families, or even one in seven, as Chairman Sarbanes noted, may not have bank accounts.

In light of this, an obvious question is: Why do so many people remain outside of the mainstream banking system? Are they shut out of the system or do they make a conscious choice not to do business at traditional financial institutions? Surveys on this issue reveal varied responses to these questions, including: Bank fees or minimum balance requirements are too high; the types of accounts offered by traditional financial institutions do not meet the needs of the unbanked; a person may not write enough checks or have enough month-to-month savings to make it worthwhile to maintain an account; or the unbanked are simply not comfortable dealing with banks or letting them know their private financial information.

We believe that an individual should have the right to choose where he or she will seek financial services. This right to choose, however, is an illusory right if people do not have accurate and complete information that will enable them to make educated decisions and access to a range of financial service providers.

There are several advantages to being banked. The unbanked typically pay higher costs in the form of transaction fees for financial services than individuals with banking relationships.

Individuals also face heightened safety and security risks as a result of having to conduct all financial transactions in cash. Carrying large amounts of cash is dangerous and keeping cash at home is obviously risky.

Finally, establishing a banking relationship is taking a first step toward building a promising economic future. A traditional banking relationship offers the account holder an opportunity to become familiar with fundamental financial concepts that are critical in asset building and bank accounts provide a tool to help families fulfill their savings goals and manage their household money.

Through the First Accounts Program, Treasury is funding initiatives to connect unbanked low- and moderate-income individuals to mainstream financial services. But the paramount goal of First Accounts is to move a maximum number of unbanked low- and moderate-income individuals to a stable banked status with an insured depository institution. We hope to accomplish this goal through the development of financial products and services, including education and counseling, that can serve as replicable models in meeting the financial services needs of unbanked individuals without the need for ongoing public subsidies.

Under First Accounts, financial institutions are encouraged to create low-cost accounts for unbanked families and to help bring more ATM's to safe places in low-income communities. Treasury's First Accounts initiative was launched this past December 27 with a published notice of funds availability, a NOFA, in the *Federal Register* inviting applications for First Accounts grants.

First Accounts applicants were required to propose, at a minimum, low-cost electronic, checking, or other types of accounts, either directly, if the applicant is an insured depository institution, or indirectly through a partnership with one or more insured depository institutions. Applications were due March 20 and a wide variety of eligible entities did, in fact, apply for grants. In total, Treasury received 231 applications from 38 different States.

During the last several weeks, a team of reviewers have been busy completing our review of the applications. This competitive review process involved evaluating the applications based on a number of different criteria including: the likelihood of success, the extent to which a project is replicable and can become self-sustaining, as well as the applicants' experience and track record, and management capability.

After careful consideration, yesterday, we announced our selections for First Accounts. The 15 awards totaling $8.3 million promise to directly assist over 35,000 unbanked low- and moderate-income individuals in opening bank accounts, and hopefully, hundreds of thousands more by becoming successful models which can be replicated in other communities. A complete list of grant awardees is attached to my testimony for inclusion in the record.

Chairman SARBANES. It will be included in the record.

Ms. BAIR. Thank you, Mr. Chairman.

The First Accounts grant awards are going to nonprofits, insured depository institutions, insured credit unions, a community development financial institution, a faith-based organization, and a foundation. The projects are very innovative and focused on a wide variety of unbanked people, including youth, new entrants to the workforce, recent immigrants, Native Americans living on reservations, people living in public housing, and families using child care facilities.

All involve a significant degree of financial education. For instance, providing unbanked individuals with free checking or savings accounts upon completion of a financial education course and/

or providing ongoing counseling and education support services once the unbanked individual has established an account.

Nine of the pilots involve partnerships with employers in the low-income areas as a means of reaching out to unbanked employees, as well as being able to provide lower-cost account services by building upon the employer's relationship with a financial institution. Eight would expand access by installing ATM's in low-income areas, and one promises to establish two new branches in underserved areas. Most feature electronic access to account services through ATM cards.

Treasury's role in the First Accounts Program will not end with its selection of grant recipients. Treasury's ongoing involvement with First Accounts will include evaluating the programs for progress and success, deliverables, and effectiveness on a regular basis. In addition, Treasury will receive periodic reports from the grant recipients. Once we have data on the success of programs, the Administration will consider the cost-effectiveness of continuing First Accounts or other similar types of programs.

Before concluding, let me also highlight a number of other initiatives that Treasury is working on related to the unbanked. We have a number of efforts underway aimed at improving financial education, including the establishment of a new Office of Financial Education that will develop and implement financial education policy initiatives and will coordinate Government programs.

This Office will also be responsible for Bank on Your Schools, a partnership between schools and financial institutions that will involve providing students with their own free savings accounts and giving them hands-on experience working at a financial institution.

Another topic that is often overlooked in the discussion of the unbanked is the remittance industry. The Inter-American Development Bank estimates that Latin American immigrants living in the United States send an average of $200 to their native countries about seven to eight times a year. These remittances have reached a level that surpassed $23 billion last year, about one-fifth of total worldwide remittances. Most immigrants send remittances through a small number of alternative financial services providers and lack of competition in the remittance industry has contributed to higher remittance costs.

With our encouragement and support, however, more and more traditional financial institutions and credit unions are recognizing that there is a concrete opportunity to attract a diverse consumer base by offering low-cost remittance products. Major financial institutions that have recently approved new, lower-cost remittance products include Wells Fargo, Bank of America, and Citigroup.

In closing, I would like to commend the efforts of the many banks, credit unions, and community- and consumer-based entities and groups, many of which are represented on the panel that will follow me this morning, who have been working for many, many years to address the problems faced by the unbanked segment of the population.

Expanding access to financial services is a bipartisan issue that contributes to improved financial well-being among many low- and moderate-income individuals. Opening an account at an insured depository institution provides the account holder with a number of benefits: The opportunity for wealth building; lowering costs for financial services; security; knowledge of and familiarity with the fundamentals of personal finance; and the chance to build a credit history and qualify for credit on reasonable terms. Because of these benefits, Treasury is committed to promoting policies that will give unbanked individuals both access and choice in establishing traditional account relationships with insured banks and credit unions.

That concludes my statement and again, I thank you very much for the opportunity to testify this morning and to let you know what we have been doing to implement this important program.

Chairman SARBANES. Well, thank you very much. We are pleased to have this update.

I understand that, in the course of making the grants you just announced, that you received 231 applications from 38 States requesting about $130 million in response to the December notice of funds. Is that right?

Ms. BAIR. That is correct.

Chairman SARBANES. Of course, you had limited money available. You were able to make 15 grants, totalling slightly more than $8 million. So there is obviously a tremendous potential out there, a lot of people seeking to participate in the program. I am very concerned about the amount of money that is being made available. I know the budget request this year was only for $2 million for the First Accounts initiative. What do you have left down there at the moment? About $2 million?

Ms. BAIR. We have about $1.5 million. There was also $300,000 earmarked for Alaska ATM's, and $100,000 earmarked for Metropolitan Family Services in Chicago. So subtracting that, I think, we have—plus the $8.3 million just awarded yesterday—about a million and a half left.

We need to hold some of that back for administrative costs. Obviously, there needs to be grant administration oversight of the grant-making process. We want to do research and evaluation of the pilots that we are funding because we think one of the great value-added benefits to this program is being able to highlight the success stories and publish them and bring attention to them, so that we can encourage other financial institutions and groups and others involved in this to replicate them.

We are also considering with the money we have left over as to whether it would help to do a national survey specifically targeted on the unbanked population to further explore what types of products and services best meet their needs.

The Fed's Survey of Consumer Finances, which you referenced, is the best existing survey on that subject. We have been talking with some in the community field and with academics to see whether there would be value-added for that survey.

We could take some of that remaining money and use it for perhaps one more grant application. There was $2 million in the 2002 appropriation, and as you say, another $2 million has now been requested in the 2003 appropriation. And certainly, we have a number of meritorious applications in the pipeline that remain unfunded right now because we gave out what we felt we had to give out right now.

Chairman SARBANES. Well, I know that the Administration marches in lockstep once the OMB makes its decisions. But I take it that if we worked hard here in the Congress to boost the money in the coming budget for this purpose, that would not distress or upset you.

Ms. BAIR. My sense is that I really cannot speak to that because I think resources are scarce. I think this is a policy objective that the Administration strongly shares. But there are a lot of competing policy resources right now, unfortunately. So, I would have to stand by the $2 million that has been requested in the Administration's budget.

Chairman SARBANES. I do not want to make things difficult for you this morning, but let me ask you this question. You had 231 applications. You picked 15 of them.

Ms. BAIR. That is right.

Chairman SARBANES. If we were doing a curve of the quality of the applications, presumably, the 15 would be in the very top category.

Ms. BAIR. That is right.

Chairman SARBANES. How many more would have been in the top category if you had the money, of the 231? Or is this clearly the top category and then we go to the next category?

Ms. BAIR. No.

Chairman SARBANES. If so, how many are in the next category?

Ms. BAIR. Right. My sense is that there is a progression and that there are a number of—off the top of my head, I could not give you precise numbers. We used a rating system, a scoring process that was published in the NOFA last December. But there was a fairly steady gradation. There were a number of other grant applications that were very close to the point rating cut-off that we had based on the amount of money.

Chairman SARBANES. Would you say half of them? Maybe, a quarter of them?

Ms. BAIR. Jean Whaley is here, who was our principal staff person in charge of this. Jean, do you know off the top of your head?

[Pause.]

About a third, she said.

Chairman SARBANES. About a third of the total were in the quality category, so to speak.

Ms. BAIR. Yes.

Chairman SARBANES. So that would be about 75 or so of the 231. Is that right?

Yes. Okay. Now let me ask you this question. The CDFI fund, which is under your jurisdiction, has made a big difference, I think, in the ability of their members to reach out to the unbanked. It has enabled community development credit unions to open branches in, for instance, the farm worker community in California.

Ms. BAIR. Yes.

Chairman SARBANES. The South Bronx, the lower East Side of New York. It has enabled the credit union that serves the Navajo and other reservations to add electronic services. Actually, my colleague, Senator Johnson, in his Subcommittee, is planning a hearing on the needs of Native Americans next month to examine that particular question.

So there are other ways you can encourage this objective. Here, I am suggesting working through the CDFI fund. Now, again, we have a problem there in terms of its budgetary allocations. But do you perceive that the CDFI's are an effective instrument for trying to achieve this objective of low-cost banking services?

Ms. BAIR. There was a CDFI among the award grantees. Yes.

Chairman SARBANES. I was thinking not so much there, but—because you have a separate pot of money for the CDFI's.

Ms. BAIR. Just focused on expanding——

Chairman SARBANES. Whether there is a way you can use that to encourage the CDFI's to move into this area.

Ms. BAIR. It is an interesting idea. I think, certainly, there is a lot of high value-added in targeting some measure of CDFI award-making toward expanding access and creating sustainable ongoing community-based financial institutions in economically distressed regions. So, I think, yes, it is very consistent with the CDFI fund's overall mission and one we would certainly be open to exploring with you about whether we should have a more clarified focus of their award-making.

Chairman SARBANES. My time is up. I am going to yield to Senator Crapo. Let me ask this final question. How much time do you think you need before you can take a reading on whether this is cost-effective, whether the 15 grants you have put out are showing positive results?

Ms. BAIR. I would say at least 12 months. This is a hard population to reach. And the beginning effort will be marketing outreach and identifying unbanked individuals. And also, a lot of the awards require financial education in advance of actually opening the account, which I think is a good approach because a lot of the unbanked communities are previously banked. But because they did not have the adequate financial education and skills to know how to manage a bank account, they got in trouble with overdraft fees or what have you, and terminated their banking relationship.

So, we want to give them adequate lead time to do the outreach, the marketing, the financial education, establish the accounts, before we evaluate whether they are successful or not. I would say that you want to give them at least 12 months.

Chairman SARBANES. Sheila, I wish we had enough money or could get enough money to have more than 15 trying this thing.

Ms. BAIR. I understand.

Chairman SARBANES. Particularly in light of what I understand, that you would put about a third of the 231 applicants into the top category, quality category, because I am worried that when we do 15, then everyone says, well, let's wait to get the results from the 15.

I am not sure that is a broad enough effort or sample or pilot to give us a chance to really take a reading. Out of 15, if you have three or four that flop, so to speak, that is a fairly large number out of 15 and you would be judging the program in too narrow a focus.

So, I think we need to give some thought to how we can engineer perhaps a second round so we broaden the number of pilot projects that are out there, both in terms of the kind of groups and also geographically, so you get a better spread. Let's try to think together about how we might do that.

Ms. BAIR. All right.

Chairman SARBANES. Senator Crapo.

Senator CRAPO. Thank you very much.

I probably should know the answer to this question, but Ms. Bair, can you tell me what criteria are utilized to determine which grants are successful or are awarded, as opposed to those that do not qualify?

Ms. BAIR. We put a high focus on results and we really pushed the applicants to give us a number of how many unbanked individuals they thought they could get into stable banking relationships with their programs, and then also demonstrate with reasonable specificity how their program would lead to those results.

I think probably the numbers that we have, the 34,000 or so, is probably a low estimate because we told them in advance, we want to know exactly how many unbanked individuals you are going to be able to put into sustainable banking relationships, and as part of the evaluation process, we will be holding you to that. So, I think they were probably conservative in their estimates. We are hoping that many more than the 34,445 that we have tallied up as part of the original round of grants will take place.

We also put a high premium on whether the pilots that we were funding could be replicable in other cities, assuming its success. And also, whether they would be self-sustaining because I think there is general agreement that this is a good expenditure of Government resources to fund pilots, but some concern about having an ongoing, certainly a permanent subsidy program. So the more that we could encourage self-sustaining pilots, we think is in everybody's interest. We also scored high for those that demonstrated that type of promise.

Chairman SARBANES. How many extra points were given if your proposal encompassed the State of Idaho?

[Laughter.]

Senator CRAPO. At this point, many, I am sure.

[Laughter.]

Ms. BAIR. I would hasten to add that my review of the grant applications, the names of the entities, as well as the States, were redacted. So, I was operating blind with regard to both.

Senator CRAPO. Well, we will have to get you the code.

Ms. BAIR. I guess, yes.

[Laughter.]

Senator CRAPO. The question I have in my mind actually relates to this, though, because I am guessing that there is probably a difference on the grant applications and on the issues between urban and rural areas.

Ms. BAIR. Yes.

Senator CRAPO. And I would also guess that if you were focusing on the ability to reach certain large numbers of people, that urban areas would have a distinct advantage in success in the grant application process. I do not know that. As I indicated, Idaho was successful in being part of at least a regional grant.

But the question I have is, is there any focus on the urban/rural distinction? Is there any effort to try to make sure that rural areas do get adequate representation in the program?

Ms. BAIR. I think that was adequately factored in because six of the 15 are in urban areas, six are in rural areas. So, yes, you are right. The urban areas have a greater concentration of the community that we are trying to reach, it might be easier in terms of just from a numbers perspective. But there are other qualifying criteria that the proof is in the pudding, so to speak, because six of the pilots are in rural areas.

Senator CRAPO. I appreciate that and I would just encourage you to look further at it. It may be that we would want to expand and provide other alternatives or opportunities to try to reach rural areas because, frankly, a number of the rural areas might just be disqualified because they do not have an institution that would be able to participate in the grant application.

Ms. BAIR. Right.

Senator CRAPO. So there may be some further thinking that we need to apply to the question of how to get these services further out into the rural areas. I appreciate your attention to that.

Ms. BAIR. Absolutely.

Senator CRAPO. And again, that is all I have. But I just want to also thank you very much for the effective attention and work that you have been giving to this.

Ms. BAIR. Thank you.

Chairman SARBANES. Thank you very much.

We have been joined by Senator Stabenow. Debbie, we are happy to yield to you.

STATEMENT OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman. I was speaking on the floor and unable to get here sooner. But I did want to come and thank you for having this hearing.

Ms. Bair, we are very happy——

Chairman SARBANES. I did not realize you were speaking on the floor. Therefore, I wasn't put in the dilemma of whether we should recess the Committee hearing.

[Laughter.]

Senator STABENOW. It would have been very nice if the Chair had recessed so that people could watch with baited breath.

[Laughter.]

But understanding the conscientious nature of the Chair of this Committee and the numerous meetings he holds every day——

[Laughter.]

In all seriousness, it is wonderful to have you here. I also want to welcome on our second panel, Mr. Michael Barr, who is from the University of Michigan, Assistant Professor of Law. We are pleased and proud that the Chairman would have the wisdom of having the expertise of someone from Michigan. And since my son graduated from the University of Michigan—although I have to say that I graduated from Michigan State——

[Laughter.]

So, we are a divided family. But it is wonderful to have you here as well.

We have been, of course, looking at a variety of issues that deal with financial literacy, predatory lending, now with those who are unbanked, do not feel comfortable, whether it is racial, cultural, other kinds of issues that come into play for us in terms of barriers.

But I am wondering if you have identified regulatory or legal barriers to reach out to those that we are talking about today that are considered unbanked. And if you have suggestions for legislative changes for the Committee in which we could address this question and, hopefully, help make our financial institutions, banking institutions, more accessible to those who need them.

Ms. BAIR. That is an interesting question, Senator, and I would like to give it some further thought. No specific legal or regulatory barriers come to mind, but I would like to give that some thought. I think our focus has been more to try to provide incentives and raise public awareness and awareness among financial institutions of the importance of reaching out to this community and thinking outside of the box, if you will, thinking innovatively about how to reach out to this community and how to redesign basic products and services so they are more conducive to the unbanked population of people coming into the banking system for the first time with little experience about how banks work, how a bank account works.

So that has been the main thrust of our efforts. And I will say that I think, as evidenced by the applications that we received, as well as some of the innovations that some of the major banks in the remittance field have taken, which I mention in my testimony.

I think banks and credit unions have been extremely responsive. They have been doing a lot of good work already and we want to partner with them and community groups to continue that.

Senator STABENOW. I would agree that oftentimes, we are not talking about a legislative fix and we appreciate your leadership and much of what we talked about with the question of financial literacy is really the private sector that has been coming together through a variety of means, Jump$tart and a number of different coalitions that are really reaching out and working in our schools and so on.

Ms. BAIR. That is right.

Senator STABENOW. Even predatory lending, this whole question of financial literacy and giving information to people, really involves a partnership.

Ms. BAIR. That is right. That is really true.

Senator STABENOW. So, I know that we need to be doing that. I also know, though, that in both of those areas, there is a role in terms of setting some kind of standards or expectations or encouraging, and so on.

Ms. BAIR. Right. I agree.

Senator STABENOW. You may have already addressed this, and I apologize if you did in your testimony. But I am wondering how the Department of the Treasury plans to track the success of the First Accounts, and if there are certain measurements in place to track the progress of the programs and if you are going to be reporting back in terms of what has worked and not worked, certainly that is very helpful to us.

Ms. BAIR. Yes. There are ongoing reporting requirements. We will be very hands-on in our monitoring of these grants.

I think, again, we are very excited. We had a number of high-quality applications. I am very optimistic that the grant applications that we have currently funded, we may be able to fund a few more, are going to produce some significant progress, in terms of bringing unbanked individuals into the mainstream banking sector.

So, we will be working with them, closely monitoring, as well as providing analysis of what has worked, what does not work, and publicizing that, so that other institutions and other communities can replicate the models that are successful.

In more detail, in terms of the detailed requirements, it is addressed in my written testimony, the auditing requirements and the reports that they are required to file.

Senator STABENOW. Thank you.

I finally would just say, Mr. Chairman, that Michigan is a very large, very diverse State, large urban areas, many, many small communities, from the southern border up to the Upper Peninsula.

I hear concerns everywhere in Michigan—I do not hear it only, although it is a very critical issue in our urban areas. But I have heard the same kinds of needs and concerns in small towns in Upper Peninsula, Michigan, or down in Benton Harbor St. Joe and southwestern Michigan.

So, I appreciate and encourage you to look broadly at ways to deal with those who are unbanked, whether they live in a small rural community or they are in the city.

Ms. BAIR. Having grown up in a town in southeast Kansas of 12,000 people, I am very sensitive to that. And thank you. That is good input to have. We will.

Senator STABENOW. Thank you, Mr. Chairman.

Chairman SARBANES. Thank you very much. I had one other point I wanted to touch on. And that is, I was very pleased to see the reference in your statement about the question of remittances.

Ms. BAIR. Yes.

Chairman SARBANES. We certainly welcome the focus by the Treasury on this issue.

We held a hearing on that issue in this Committee and had some very, very good testimony, which I am sure you reviewed. And I noticed that President Bush, when he met with President Vincente Fox in Monterey back in March, only 6 weeks ago, in the joint statement, United States–Mexico statement, which they issued, they talked about the Partnership for Prosperity. And they said: "We welcome the partnership's action plan of concrete and innovative initiatives on housing, agriculture, infrastructure, remittances, communications, development, financing, and information technology."

Then they state: "Lowering the cost to Mexicans and Mexican-Americans in the United States of sending money home so that their families get to keep more of their hard-earned wages."

We have a terrific opportunity here. I think there is a problem. We have a chance now, if we really work at it, and I commend you for the effort that you have taken, to really get these elements of the population that are kind of on the outside in, where they can participate like everybody else. Then they get the benefits of the competition that the rest of us enjoy, and also the various consumer protections that are written into that aspect of the financial industry.

Ms. BAIR. That is right.

Chairman SARBANES. I agree with you. I noticed in your statement: "Offering remittance features as a part of basic bank accounts can be an important marketing tool in reaching out to unbanked migrant workers."

I think if we can get the industry over the transition period and, in a sense, the start-up costs, they may well find that this is a good market to develop. We certainly hope so, because that would sit on its own base in the economic terms.

Ms. BAIR. That is right. Three major banks have already stepped up to the plate on this and we are very pleased. Their remittance products are about half of what people typically pay at a money transmitter. We think the answer to this question is more competition, encouraging financial institutions to get in and provide products and try to service this market as well.

As you noted, as I said in my testimony, we think another advantage—again, we want people to have choices. We do not want to tell them what to do. We just want to enhance their choices.

But an advantage of choosing to use a mainstream financial institution is that you can also establish a bank account and start building up a credit history and establish a relationship that could go into later getting reasonably-rated car loans or home loans.

Instead of using the fly-by-night operations for your lending needs, you have experience in stable relationships with a lending institution where you can go for your credit needs. So, in the long term, we think that is definitely an area of promise.

Chairman SARBANES. Of the grant awards—I did not count how many, but more than a few, at least—are working through the National Credit Union Foundation.

Ms. BAIR. That is right.

Chairman SARBANES. Which, in turn, is collaborating with—well, in the instance that Senator Crapo was particularly interested in, the Washington Credit Union League. I also feel that this is an opportunity for the credit union movement—and we are going to have a credit union representative on the next panel—to deliver, in a sense, on what has been part of, at least historically, the credit union movement.

Ms. BAIR. Right.

Chairman SARBANES. So, we are greatly encouraged by that.

Ms. BAIR. I think credit unions have, and will continue to play a very important role in this.

Chairman SARBANES. Debbie, did you have anything else?

Senator STABENOW. No, thank you, Mr. Chairman.

Chairman SARBANES. Ms. Bair is there a question we did not ask that you wish we would asked, because you had an answer you wanted to give?

[Laughter.]

Ms. BAIR. Mr. Chairman, your questions have been very thorough. And again, I just appreciate the opportunity of coming and talking with you about what we have been doing at Treasury. We support the program. We are happy to get it up and running, and we are enthusiastic about the kinds of results that it will produce.

Chairman SARBANES. Terrific. We appreciate what you are doing.

Ms. BAIR. Thank you.

Chairman SARBANES. Thank you very much.

If the next panel could come and take their places at the table.

[Pause.]

I think it is fair to say that our second panel here today brings a wealth of knowledge and experience to the issue of providing greater access for unbanked Americans and bringing them into the financial mainstream. We are very appreciative to the members of this panel for their willingness to participate in this hearing and to join with us in the effort.

I am going to go straight across the panel and we will reserve the questions until we have heard from all five panelists. I think that is the most efficient and expeditious way to proceed. Instead of introducing everyone now, I will simply introduce each person as we come to their turn.

So, Michael, we will start with you. Michael Barr is an Assistant Professor of Law at the University of Michigan Law School. Where he teaches banking and financial institutions law. From 1997 to 2001, he served as the Deputy Assistant Treasury Secretary for Community Development Policy, where he was active in a wide range of issues regarding access to capital and financial services, including the creation and implementation of Treasury's ETA accounts and the First Accounts concept, which we have been discussing earlier this morning with Sheila Bair.

We have worked closely with Michael over the years and very much appreciate his abilities and his dedication. We are very pleased, Michael, you are here today. We would be happy to hear from you.

STATEMENT OF MICHAEL S. BARR
ASSISTANT PROFESSOR OF LAW
UNIVERSITY OF MICHIGAN LAW SCHOOL

Mr. BARR. Thank you very much, Chairman Sarbanes and Senator Stabenow. I appreciate the opportunity to be here today to discuss how to bring more Americans into the financial services mainstream.

Access to basic financial services is critical to success in the modern American economy. Yet today, nearly 10 million households lack the most basic financial tool—a bank account. Twenty-two percent of low-income families, over 8.4 million families earning under $25,000 a year, do not have an account.

The consequences of not having access to mainstream financial services can be severe.

First, the unbanked face high costs for basic financial services. For example, a worker earning $12,000 a year, slightly more than the Federal minimum wage, would pay $250 annually just to cash payroll checks at a check cashing outlet, in addition to fees for money orders and other common transactions. Nearly 80 percent of checks cashed at check cashing outlets are payroll checks, and another 16 percent are Government benefit checks. These checks could be directly deposited into bank accounts with significantly lower payment systems costs.

The cost of these basic financial transactions can also undermine public initiatives to move families from welfare to work, and to make work pay through the Earned Income Tax Credit. For example, one survey found that 44 percent of EITC recipients in inner-city Chicago used check cashing services to cash their Government refund check.

Second, low-income families need to save for injuries or for job losses, as well as for key life events, such as buying a home, saving for their children to go to college, or entering old age. Yet low-income families, particularly those without bank accounts, often lack any regular means to save. Bank accounts can be important entry points for the provision of regular savings plans for low-income workers, for example, through payroll deduction.

Third, the unbanked are also largely cut off from mainstream sources of credit. Without a bank account, it is more difficult and more costly to establish credit to qualify for a loan.

While the financial system works extraordinarily well for most Americans, many low- and moderate-income individuals face a number of barriers to account ownership.

First, regular checking accounts may not make economic sense for many low-income families. Consumers who cannot meet account balance minimums pay high monthly fees, and most banks levy high charges for bounced checks. Banking institutions may also charge high fees for money orders or other instruments that typical consumers do not often use. Studies confirm, though, that many of the unbanked would become banked if they found a product that worked for them.

Second, many unbanked persons may not qualify for conventional bank accounts. Nearly seven million people have had accounts closed for past problems, such as writing checks with insufficient funds or failing to pay overdraft charges. A private clearinghouse keeps records of these problems for 5 years, during which time these individuals will be unable to open a conventional checking account at most institutions. While some persons undoubtedly do pose an undue risk for account ownership, many of these individuals could responsibly use bank accounts.

Moving forward, banks could offer accounts contingent on completion of financial counseling and offer electronically-based accounts with automatic money orders, and without check-writing privileges, the kinds of accounts that pose little risk of overdraft.

Third, while many communities contain adequate numbers of banking institutions, in some low-income communities, banks, thrifts, and credit unions are not as readily accessible to potential customers. Low-income central city neighborhoods have fewer bank offices per capita than higher-income ones and similar patterns persist for ATM's. For example, in New York and Los Angeles, there are nearly twice as many ATM's per capita in middle-income zip codes as there are in low-income zip codes.

Fourth, the financial institutions may be reluctant to expend the resources for research, product development, bank personnel training, marketing and financial education, necessary to expand financial services to low-income individuals.

Some progress has been made in recent years in expanding access to financial services. The period 1995 to 1998 marked a decline in the percentage of low-income families who are unbanked from 25 to 22 percent. This decline in the percentage of unbanked may reflect in part strong economic growth in the late 1990's.

In addition, Treasury's EFT '99 Program has meant that direct deposit of Federal benefits into bank accounts has increased as a percentage of all Federal benefit payments from 58 percent in 1996, before EFT '99, to 76 percent in 2001. This increase reflects an increase in direct deposit to existing accounts, as well as an increase in the number of Federal benefit recipients who have been able to obtain bank accounts.

Moreover, Treasury has launched the Electronic Transfer Account, ETA, a low-cost electronic account for Federal benefit recipients. Nearly 600 banks, thrifts, and credit unions are offering ETA's at over 18,000 locations nationwide. Over 28,000 benefit recipients have opened these ETA's thus far, and new ETA account holders are being signed up at a rate of over 1,000 per month.

More recently, a number of banks, thrifts, and credit unions have begun to experiment with a variety of products designed to serve the needs of low-income individuals, and you will be hearing more about those from other panelists this morning.

Treasury's First Accounts initiative could play an important role in fostering innovation to reduce costs, lower risk, and democratize access to financial services for low-income families.

As Assistant Secretary Bair has testified, the results from the first round of funding are very impressive. But only a sustained commitment to the program will provide financial institutions with sufficient incentive to make the necessary investments to serve low-income households.

Banks, thrifts, and credit unions could experiment under First Accounts with a wide variety of techniques. Transaction accounts with debit cards but no checks reduce risks by preventing accounts from being overdrawn, lower the cost of processing each transaction, expand availability more cheaply than branches, and decrease the risk to public safety, as the Chairman has noted.

Banks could offer savings features including payment of interest or separate savings buckets within accounts. Banks can provide convenient and low-cost means to pay bills, for example, through automated money orders. And as the Chairman pointed out, recent efforts to reduce the cost of sending remittances abroad holds special promise for bringing immigrant communities into the banking system.

The First Accounts initiative has the potential to spur "leap-frogging" in technology for low-income families. To offer a few examples that could be subjected to the test of market feasibility: Providers of the network infrastructure for debit and credit cards might explore how low-income customers could be served on shared technological platforms. E-finance can increasingly be made available to the poor at Internet kiosks. And companies expanding the use of cellular telephones to transact financial services for high-income clientele could also focus attention on expanding banking products for the low-income market currently utilizing prepaid cellular telephones.

Finally, First Accounts can also help to spur employer-driven strategies to move toward banking services. Employers can reap significant benefits from moving their workers to direct deposit, driving down payroll processing costs, increasing take home pay for workers, and reducing theft or fraud associated with checks. Employers can reach their employees with financial education relatively cheaply. And financial institutions can deploy debit-card-based payroll systems for their clients' employees, providing direct deposit into low-cost electronic banking accounts and systemic savings programs for low-income workers.

In conclusion, First Accounts and related initiatives can help to transform financial services for low-income families. Such a transformation is a key to promoting greater economic opportunities for low-income communities.

Thank you.

Chairman SARBANES. Thank you very much, Michael.

Our next panelist, Fran Grossman, is Executive Vice President of Shorebank, the Nation's oldest and largest community development bank, a legend in its own time, if I may say so.

Ms. GROSSMAN. The older I get, we should be first, not oldest.

[Laughter.]

Chairman SARBANES. Yes. Shorebank has been at the forefront of efforts to connect the unbanked to mainstream financial institutions and to facilitate ongoing savings and asset accumulation in low-income households.

We are very pleased that you are here today, Ms. Grossman. We would be happy to hear from you.

STATEMENT OF FRAN GROSSMAN EXECUTIVE VICE PRESIDENT SHOREBANK ADVISORY SERVICES

Ms. GROSSMAN. I am very, pleased to be here. I thank you very much for this opportunity.

Shorebank is a bit of a legend in its own time and sometimes people think we are much bigger than we are and we can accomplish much more than we actually can. In terms of this hearing, the critical issue is that Shorebank is the first and largest community development financial institution in America, which means it has $1.3 billion in assets. It is not that big.

But the real issue for here, which I will get to when I talk about First Accounts, is that we have been using a financial institution as a catalyst for the community for 30 years. We are still at it using slightly different ways, slightly different models, but the bottom line is 30 years later, we are still at it. To me, that is the secret of what we have to be doing as a Nation.

Our belief is that we can help make changes in communities better by using a financial engine, a bank, as a means to make things happen. We use our financial resources, our smarts, our contacts. It is wonderful to be on this panel with two other people from Chicago, both of whom are from different parts of the spectrum, one from the Woodstock Institute and Bank One. We work closely with both. We do not always agree, but we agree on the goal, and we are going to get there, I hope, in my lifetime.

Today, actually, I am speaking not only as a banker, but also as an inner-city school teacher, a preschool teacher, a social worker, a community worker in public housing, a neighbor, a friend, a member of a religious institution, a mother, a mother-in-law, and especially as a grandmother. All of this has made me a pragmatic optimist.

I am actually very proud to be here with people like you who want to figure out how to make sure that more people have access to this country's financial industry.

I want to thank you for having these hearings and I want to thank Sheila Bair and the Treasury Department for the creation, and Michael Barr's work on the development of the First Accounts initiative. I also want to thank Judy Kennedy and NAHHL for working with us on this. And mostly, I want to thank you, Senator Sarbanes, for holding this hearing and shining the spotlight on this issue.

To me, it is very exciting that the Department of the Treasury is doing this. Clearly, we are all here because we want to figure it out. I am especially concerned with encouraging people in saving and I always want to be sure that there is an understanding between savings and transactions, because they are different issues, and sometimes we get them mixed up.

It doesn't mean one doesn't lead to another, but I think the goal is to have savers, which is to say that the more people save, the richer our country becomes in many ways. The richer people are and the more they can do, the better their future is and, therefore, our future as a Nation will be.

Michael pointed out that about the 10 million people who do not have bank accounts. He also noted seven million who were at one point banked and are no longer banked, 22 percent earn under $25,000. So, I will not go into that.

But what we sometimes forget is all of those poor people who do save. My grandmother was a widow, a very young widow with three little kids. She had a job as a secretary many, many years ago, and she saved like mad. She was frugal. She kept the string, the wrapping paper, the like. She had money all over the house, whether it was in the flour bin or the refrigerator—actually, in those days, she did not have a refrigerator. The best one we liked was in the encyclopedia under M for money.

[Laughter.]

She did not go to a bank. Why didn't she go to a bank? First of all, she did not trust them. There were men there. She did not want anyone knowing what she had. And I often think that if she had put some of that money in the bank, what would have happened? We would have been rich with the compounding interest. And that is the message in a sense that we have to give people.

So, I think that there are many, many reasons why people do not bank. Some of them are language. Some of them are ethnicity. Some of them are cultural. Some of them are race. Some of them are age.

I was thinking when I flew in this morning. I arrived and asked where was the hearing and the woman said, go across the hall. I am sitting in this room behind you and all these nice little young men and women are walking through and I am just sitting there waiting. Like what is going on here?

Here I am a well-educated woman, experienced with, high SAT scores. I did not go to the University of Michigan, but I did get in.

[Laughter.]

It never occurred to me to ask. I finally got up to go to the bathroom and I saw somebody and she said, you are supposed to be over here. And I thought what it must be like—I am so intimidated by being here. I am a grown-up and I am smart and I am educated, what is it like for those who have not had my opportunities?

So, you begin to see what happens to people who, when they go into a new place, they are scared, maybe a little defensive and guarded. They think they are going to be disrespected and if somebody looks at them the wrong way or asks them the wrong question, they feel especially inadequate. We have a lot of work to do.

My concerns actually with First Accounts are the ones that you raised. I think it is a fabulous program. I think the potential is marvelous. I am concerned that we are so result-oriented on issues that are so, so hard, what we want—are fast solutions. We want to do it today. We want to have the problems solved. We want the most results.

We have to be disciplined, and that is me as a mother and a teacher speaking. This takes time. We have to have standards. But we have to manage our expectations to the size of the problem. Some of the best applications on paper may not be the best. They may need to be reworded or need rethinking.

We know how easy it is to hire somebody to write a good grant, to write things. We really have to think seriously about how are we going to dig deep and find the innovative and the creative programs and work on making them work. It is going to take time and we have to know that not all of our ideas are workable. And of course, I have gone way off.

Let me just tell you a little bit about what Shorebank has done over the past 6 years.

All of our branches in Chicago but one, which is in a small building downtown, are in poor neighborhoods, as are our branches in Detroit, as well as throughout Michigan.

We focus significant energy on serving the unbanked. We have experimented with new products, delivery systems, and outreach strategies. One of our recent new products was introduced in 1998, that was something called the Individual Development Accounts. Those are known as IDA's. It is a savings account that is like a 401(k) in a shortened form. It is matched dollar-for-dollar for low-income families saving to buy a home, start a small business, or an education.

To date, we have opened more than 600 of these accounts. We have trained hundreds in money management techniques and witnessed the marvelous effects of this program. But in a sad way, one of our best successes was our own employee who got into the program, saved enough for a downpayment for a house, and all of a sudden realized that she should have a 401(k).

In some sense, we did not even look into our own house to see what we as employers, what each individual here can do to help other people to understand. We have to model, all of us, every day.

Another one that we are very proud of is the Extra Credit Savings Program. This leverages the power of the Earned Income Tax Credit, which we think is possibly the largest antipoverty program in the country.

Beginning 3 years ago, we opened our bank lobbies in the evening to volunteer tax preparers. Working families wanted to have their taxes done for free and personal bankers were on hand to open accounts. All they had to do was to have their money transferred electronically to the account. They did not have to keep it in there, but they had to have it transferred electronically.

That year, more than 60 percent of the people who showed up had no bank accounts. After receiving their refund, more than half continued the account. But half did not and that is important. We have to acknowledge what works and what we have to work harder at. Some of them arranged to have their paychecks automatically deposited. Others kept savings and signed up. It was a small but significant growth and each year that we do it, it gets better. Over the past years, we have opened 350 accounts with tax refunds totalling more than $250,000. We have also helped others throughout the country replicate this program.

We think we should fully leverage the power of the Earned Income Tax Credit to institutionalize the link between tax systems and financial services. Just like Motor Voter. You go in, you get your driver's license, you register to vote. If you go in and have somebody help you prepare your taxes, you should be able to open a bank account at the same time. So, I ask your support for these kinds of acts. IDA has been successful. It is not the answer. It is one answer to a hard question.

Also, having been a CRA officer for a large bank, I can tell you CRA works, in some ways the same way. It is the strength and the importance that people like you give to CRA that make the banks say, "Oh, this is important. They like that. We are going to do it."

As you know, things happen when the spotlight is shined on them.

So, in conclusion, I guess my main message is it is important that we have reasonable expectations and that we do not get caught up in a numbers game of results. We have to give this time. We have to make commitments. It is like raising children. I do not think it is ever over.

[Laughter.]

But with all of our hard work and working together from different angles, we can succeed in broadening financial opportunities and making our country the kind of country we want to live in.

Thank you.

Chairman SARBANES. Well, thank you very much. We can see from your testimony why Shorebank is such a dynamic institution.

Since you mentioned the CRA, I would be remiss if I did not acknowledge the tremendous contribution that Michael Barr made when he was at the Treasury when we were working on that issue here in the Congress. I want to again express my appreciation to him for that.

Our next panelist is Jaye Morgan Williams, who is the Senior Vice President and Managing Director of Community Investment for the Nation's sixth largest bank holding company, Bank One Corporation. Bank One Corporation, very much to its credit, is partnering with numerous nonprofit organizations, employers and others, to reach out to the unbanked with a number of innovative initiatives.

Ms. Williams, we are very pleased to have you here today. We would be happy to hear from you.

STATEMENT OF JAYE MORGAN WILLIAMS SENIOR VICE PRESIDENT AND MANAGING DIRECTOR OF COMMUNITY INVESTMENT BANK ONE CORPORATION

Ms. MORGAN WILLIAMS. And I am equally pleased to be here.

Chairman Sarbanes, Senator Stabenow, I appreciate the opportunity to be here today on behalf of Bank One to discuss our commitment to helping American families gain access to the financial services mainstream and to share some of our experiences in doing so. We are particularly proud to share this panel with some of our Chicago colleagues, Marva Williams from the Woodstock Institute, and Fran Grossman from Shorebank. We have worked with both of those institutions over the years. They are very dedicated to this problem and they have actually been a source of inspiration to Bank One, as well as many other Chicago organizations and others in the banking system.

Our commitment to the so-called unbanked stems from our core belief that helping families gain access to the banking system is good for these families. It is good for individual communities. It is good for the national economy. And it is actually good business for Bank One. We believe it is good business both in the near-term and the long-term.

Before describing some of our programs, I would like to briefly summarize what we at Bank One have learned as we have pursued our commitment to helping families enter into the mainstream of financial services.

First and foremost, the programs that you will hear about today are works in progress. As hard as we try, we are just beginning to understand the multitude of reasons that 10 million American families are unbanked. Devising programs that succeed is often a matter of trial and error. We are proud of our efforts and we are actually humble about our errors, which often teach us the most.

Second, financial literacy, as you have heard today, is essential for a successful banking relationship and credit relationship. We believe we can trace our biggest disappointments in these programs to instances when "the cart was put before the horse," that is when low-income participants entered into banking or credit relationships with too little understanding of the fundamentals of consumer finance. We at Bank One believe that financial literacy training is absolutely critical to the success of programs servicing the unbanked.

Third, partnerships are essential. Our partnerships with community groups, advocacy organizations, and community banks are essential to mounting programs that reach the unbanked population in a meaningful way. This is not a battle that can be won with a go-it-alone strategy.

I would like to now briefly discuss four of our current programs for bringing more American families into the mainstream. I would like to first turn to Bank One's Alternative Banking Program, our ABP Program, which we are proud to participate in through the Chicago CRA Coalition, an organization represented by one of my co-panelists, the Woodstock Institute.

The ABP offers checking accounts designed to appeal to the low-income, unbanked customers. These accounts differ from our traditional accounts in that they are easier to qualify for and less expensive to maintain. Applicants may be approved with no credit history, or little credit history, or with borderline credit history. An account can be opened with a balance of only $10, as opposed to $250, which is generally what is expected for minimum account openings, and may be held with actually no balance at all.

But as is true of all of our programs for the unbanked, customers must be educated in the basics of consumer finance in order to succeed. For this reason, we conduct workshops in the "ABC's of Banking" in neighborhoods around Chicago that surround the banking centers that offer the products.

We are encouraged by the results we are seeing. Since we rolled out the program in March of 1999, every single ABP account holder would have been an individual who would not have been eligible for a traditional Bank One account, due to the lack of credit. Yet, the average checking account balance is $1,100 and the average savings account balance is $1,600. We are actually very proud of the results and we absolutely believe these accounts represent significant savings opportunities for low-income individuals.

Many who are unbanked, as you have also heard today, have even a more basic concern, and that is personal safety. This is the concern underlying our Communities Banking for Safety Program. It is a program we offer in partnership with the Dallas City Police Department and the Mexican Consulate and other local banks. Bank One participates in ongoing community meetings to promote trust in the United States banking system among immigrants.

In conjunction with this outreach effort, we have made it easier for Mexican immigrants to qualify for banking accounts. As with the Chicago ABP account, applicants with no or minimal credit history may qualify for deposit accounts. And in deference to the special needs of immigrants, Bank One expanded the list of acceptable forms of ID to include the Mexican Consulate ID, called the "Matricula," instead of a driver's license or a Social Security card. The Matricula is accepted everywhere that Bank One does business.

It might surprise some Members of the Committee to learn that many of the unbanked Americans actually work in regular paying jobs. We see the workplace as a very promising arena for financial education, as well as initiating banking relationships. Last fall, in Dallas, we initiated a pilot as part of an ongoing program to promote Bank on the Job. Through employers, we are offering low-income employees free checking accounts if they sign up for direct deposit of their paychecks. At the same time, representatives of Bank One's Community Investment Department provide on-site financial literacy training in many subjects including budgeting, managing accounts, savings, and homebuying.

Our Paycard Program is another workplace initiative that we undertake in partnership with employers. The program allows companies to pay unbanked employees through a Bank One Visa stored value card. Bank One is currently marketing this product to the employees of some of our large corporate customers, and we are enthusiastic about the promise for the product.

Before concluding, I would like to use this opportunity to recognize the leadership of the Treasury Department and this Committee in addressing the problem of the unbanked. Chairman Sarbanes, you have done so much to raise the profile of this issue and to support the efforts to resolve it. The Treasury Department has also demonstrated an ongoing commitment to bringing unbanked Americans into the mainstream.

In conclusion, we emphasize Bank One's commitment to helping 10 million American households who are outside the financial mainstream become full participants in the American economy through banking relationships. We hope that the experiences we share with you today in terms of our product offerings will add to our collective understanding of what does work and what does not work, and that other institutions will take advantage of this knowledge.

I think it is most important to share what we consider the most important lesson with this Committee, and that is addressing the needs of the unbanked population will require a sustained team effort involving mainstream financial institutions, community institutions, advocacy groups, as well as the Government. It will require diverse programs, trials and error, and constant monitoring, reevaluation, readjustment, and product redesign.

We believe it will be hard work, but we believe that we can all be successful if we work together. We thank the Committee for inviting us to share our experiences and appreciate having the opportunity to listen to our panel members and some of their experiences as well.

Thank you.

Chairman SARBANES. Thank you very much. It was extremely helpful to have had the benefit of the report of what Bank One Corporation is doing. You have been doing some very innovative programs and we appreciate that very much.

We will now hear from Ms. Marva Williams, who is the Vice President of the Woodstock Institute, a renowned nonprofit organization formed in Chicago 29 years ago to promote community reinvestment and economic development in low-income and minority communities through both research, public education and technical assistance.

Actually, Ms. Williams recently completed an analysis of the development of bank accounts and financial literacy training for lower-income, unbanked consumers. And so, we are very pleased you are here with us. We would be happy to hear from you.

STATEMENT OF MARVA E. WILLIAMS
SENIOR VICE PRESIDENT
WOODSTOCK INSTITUTE

Ms. WILLIAMS. Thank you very much, Mr. Chairman. I want to thank you and the other Members of the Senate Banking Committee for inviting me here to talk about a topic that is very dear to me—providing opportunities for lower-income people to join the financial mainstream. And I am also very pleased to join my fellow Chicagoans, Fran Grossman and Jaye Morgan Williams, as well as Michael Barr and Rufino Carbajal on this panel today.

The Woodstock Institute, in partnership with several Chicago area banks, is promoting the establishment of lifeline banking for lower-income people to establish deposit products, to improve their financial literacy, and to develop assets. The Woodstock Institute has a 29 year history of policy research, public education, and technical assistance to promote access to safe and sound credit. We also have a specialized knowledge of lower-income families' use of basic financial services.

We believe that lifeline banking is crucial for consumers. It is the foundation for building and developing assets. And also, as Senator Sarbanes mentioned earlier, people who do not have a relationship with a mainstream financial institution also pay higher transaction costs to cash their checks, as well, as to pay their bills.

However, as Michael Barr has said, there are many challenges that lower-income people face when developing a relationship with a mainstream financial institution. There is the problem of limited access. There has been a decline in the number of bank branches in lower-income communities per capita. Costs can also be prohibitively expensive for lower-income people. Credit status can also be a problem. Some banks conduct credit checks, as well as scoring for applicants, so that consumers with little or no credit or a slightly borderline credit rating can be disqualified from establishing a bank account.

Trust is also a major issue. Some unbanked consumers may have attempted to access bank services in the past and been repelled for a variety of reasons. In addition, poor communication regarding account guidelines can lead to misunderstanding. Further, many recent immigrants distrust financial institutions or may have concerns about immigration issues.

As Jaye Morgan Williams listed, financial literacy is also a major issue. Lifeline banking requires significant education. Without the skills to manage accounts, consumers may be faced with high fees for nonsufficient funds and other transactions. In addition, some consumers may need assistance when accessing electronic banking.

The last challenge I would like to mention this morning is related to lack of information and poor marketing. Many banks have affordable accounts that are appropriate for lower-income consumers. However, those accounts are not well marketed.

Based on these challenges, the Woodstock Institute has identified what we think are some of the key characteristics of a lifeline checking account product. They include flexible ID, such as utility bills or the Matricula card, which is an identification card that is issued by the Mexican Consulate. And I am very happy to hear that Bank One is accepting that. Also, flexible or no credit checks.

We are also concerned about the cost of the accounts, so we would like to see no minimum balances, no monthly service fees, as well as no additional charges to see a teller.

And the last characteristic is the promotion of direct deposit of paychecks and Government benefits. We think that this is a major entree for many lower-income people into the banking system.

I would just like to say a word for a minute about what we call intermediate products. Checking account products may not be suitable for all consumers. They may instead prefer a savings account and an affordable way to pay their bills. However, very few financial institutions provide or market affordable ways to pay utility bills and other bills.

There are two Chicago-based institutions—the North Side Community Federal Credit Union and First Bank of the Americas, which offer electronic bill payment services. Customers can pay their utility bills and other bills for as little as 30 cents.

I would also like to mention that these financial institutions have affordable options to payday loans, which has become a major problem in many lower-income communities. And they also provide inexpensive ways for people to transfer money to their relatives in Mexico.

Now, I would like to provide three examples of projects that the Woodstock Institute has worked on.

First of all, I would like to talk about the alternative banking program which is offered by Bank One. We have been very pleased with that partnership and believe that the alternative banking program has made a major difference for many lower-income people.

However, the Alternative Banking Program is only available at eight branches in the city of Chicago, and we recommend that Bank One extend that program to reach more unbanked consumers in Chicago and other markets that Bank One operates in.

Our second area is financial literacy partnerships. We have developed relationships with several Chicago-area banks. These efforts have resulted in the integration of financial literacy programs within each bank's retail banking division.

Several bank-community partnerships have been established or strengthened through this work as well. And most importantly, the banks that we have been working with provide an opportunity for workshop participants to open accounts and to develop a relationship with customer service representatives.

Third, the CDFI Fund has played an integral role in expanding lifeline banking opportunities by providing grants and investments to CDFI's. CDFI's have a track record of providing financial services in distressed urban and rural communities.

One example is the Northeast Community Federal Credit Union which is located in San Francisco. Organized in 1981, this credit union is committed to meeting the unmet financial needs of lower-income community residents, many of whom are recent immigrants or refugees from societies where financial institutions are not trustworthy or accessible. Further, some people are concerned that maintaining a deposit account might violate citizenship or immigration regulations. Northeast Community works with local community organizations to provide information about U.S. financial institutions and it also allows consumers to establish accounts with flexible and alternative forms of identification.

There are five lessons that I would like to share this morning that we have developed as a result of our relationships with banks and other organizations.

The first lesson is the importance of program marketing. Marketing strategies should be developed by banks in relationships with community-based organizations and with other organizations that are involved in consumer issues.

The second lesson is financial literacy. Banks should work in partnership with the community and other organizations to provide information on basic banking.

The third lesson is the importance of bank staff. I think a major component of the success of these programs is the enthusiasm and expertise of bank staff and the value of courteous, front-line staff cannot be overstated.

The fourth lesson is in account disclosures. Account disclosures should be translated from legalese into standard language so that they are understandable for consumers at all reading levels. In addition, many of these materials should be translated into Spanish and other languages as appropriate.

Our fifth lesson is related to reducing costs for banks. It is important to consider how banks can cut costs and provide basic financial services. Most retail account products are not profitable. One banker told me that financial institutions make 80 percent of their profit on retail products from 20 percent of their customers.

Some ways we would like to suggest to reduce overhead and other service costs include promoting phone banking, which can cut costs for financial institutions, as well as consumers, and also to increase electronic access to banking. This option may require extensive financial literacy training, but we believe that in the long-term, that it is beneficial for the financial institution, as well as for the consumer.

In closing, I would like to thank the Committee for inviting me here today to share my experiences on lifeline banking. This is a topic that is very near and dear to me.

Expanding lifeline banking is essential to improving the financial personal health of millions of Americans. I am confident that with the sustained efforts of the Treasury Department, financial institutions, and community organizations we can shrink the number of unbanked consumers in this country.

Thank you very much for this opportunity and I would be pleased to answer any questions you may have later.

Chairman SARBANES. Well, thank you very much. It is extremely helpful testimony.

I want to say to all the panelists that the written statements that you have submitted will be included in full in the record. I had a chance to go through them, not in the detail that I hope to do subsequently to this hearing, but I do recognize the significant effort that was put into preparing these statements and they are going to be enormously helpful to us in terms of the ideas you have put forth and also the way you have outlined the existing situation. We do appreciate the effort that obviously went into them.

Our concluding panelist is Mr. Rufino Carbajal, who is the Manager of the West Texas Credit Union—we are breaking out of the Chicago monopoly here.

Ms. GROSSMAN. We will count West Texas as the Midwest.

[Laughter.]

Chairman SARBANES. The West Texas Credit Union, is a State-chartered credit union with 11,000 members located in El Paso, Texas. They have made a special effort to reach out to minority populations by offering a range of products that meet their particular needs, including, as I understand it, lower-cost remittances.

Mr. CARBAJAL. Correct.

Chairman SARBANES. Mr. Carbajal, we would be happy to hear from you.

STATEMENT OF RUFINO CARBAJAL, JR.
MANAGER, WEST TEXAS CREDIT UNION
ON BEHALF OF
CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Mr. CARBAJAL. Thank you very much, Chairman Sarbanes. My regards to our Senator, Senator Gramm, who is not with us today. I am honored to be here this morning——

Chairman SARBANES. He was not able to make this hearing, but he particularly wanted to express his appreciation for the work that you are doing there in El Paso.

Mr. CARBAJAL. Thank you.

I am honored to be here this morning to present testimony on the plight of the unbanked and the underserved. I am Manager of the West Texas Credit Union, a $34 million credit union that serves about 11,000 members in El Paso, Texas. I am here on behalf of the Credit Union National Association.

I am extremely pleased that the major focus of this morning's hearing is the implementation of the First Accounts Program, particularly in light of yesterday's announcements of the awards by the Treasury Department. We are gratified that Treasury has reached out to credit unions to apply for the First Accounts that many may be included as recipients of the grant awards.

I am especially excited that West Texas Credit Union is a participant with CUNA National Credit Union Foundation and the El Paso Credit Union Affordable Housing Credit Union service organization is a grant recipient.

Our grant of $92,504 will connect 4,000 unbanked low- and moderate-income individuals in El Paso and El Paso County to insured credit union accounts over a period of 2 years. Other grants to credit unions will provide over $2.85 million to credit unions in 12 other States, reaching a potential of thousands of unbanked individuals. We are extremely grateful to have been chosen to receive these grants and look forward to making this program a huge success.

Shifting to another important issue, I am proud to say that West Texas Credit Union has been offering its members the opportunity to wire money back to Mexico. We use the World Council of Credit Unions service called International Remittance Network, IR*Net*®. This service saves our users at least one-third the cost of using the high-cost money transfer agent.

While many credit unions are leading the way in ensuring that immigrants have access to affordable remittance and financial services, these efforts would be significantly enhanced if Congress allows credit unions to provide their service to nonmembers within the field of membership. I am very excited that the House of Representatives has initiated legislation to do just that.

I am equally proud that West Texas Credit Union is one of many credit unions that are among the leading providers of Individual Development Accounts. Chairman Sarbanes' announcement of this hearing referred to the inability of the unbanked to acquire financial assets and save for the future. If ever there was a product developed to serve exactly that purpose, it is the IDA. And if ever there was an institution developed to provide those accounts, it is the credit union, whose mission of "People Helping People" fits perfectly with the goals of the IDA. We look forward to the passage of the bill that will expand incentives for the IDA's.

West Texas Credit Union, in partnership with the El Puente Community Development, began offering IDA's in October 2001. Once a participant reaches his or her goal, El Puente CDC will authorize the withdrawal of the funds. But before the funds are withdrawn the account holder must complete a course in financial literacy.

Legislation currently before Congress would greatly enhance the number of IDA accounts in existence. The Savings For Working Families Act has been introduced both as a free-standing bill and incorporated within other legislation. I urge the Senate to support this very important initiative.

Credit unions recognize that it is necessary to offer some form of financial literacy training to successfully integrate the unbanked into the financial mainstream. That is why they have traditionally made financial education a part of their mission. Credit unions provide financial information and training to members on a one-to-one basis, and actively work in the schools to teach personal finance skills to children and teenagers. CUNA has formed a partnership with the National Endowment for Financial Education to teach the High School Financial Planning Program® to high school seniors across the Nation.

Another exciting program offered by the West Texas Credit Union is our Affordable Housing Program. With the grant money from CUNA's National Credit Union Foundation and the Texas Credit Union League, the State Credit Union Foundation, eight credit unions located in El Paso, Texas, chartered and wholly-own the El Paso Affordable Housing Credit Union Service Organization. The AHCUSO is an affordable mortgage and homeownership counseling agency whose mission is to provide financial literacy and homeownership counseling to thousands of low-income El Paso residents.

The AHCUSO has partnered with the El Paso Housing Authority and has committed $1.8 million to the financing of affordable homes, of which approximately $500,000 has been closed. HUD provides downpayment assistance, and the financing and servicing is being done by the AHCUSO.

Credit unions also recognize that consumers and their members must give viable options to avoid the traps of predatory lenders.

Credit unions have stepped up their efforts to combat predatory lenders in neighborhoods by offering affordable alternatives for both payday loans and mortgage loans. Regrettably, however, the demand for these payday loans continues to increase and there are now more payday loans across the country than there are credit unions.

Finally, CUNA applauds Chairman Sarbanes and other Members of the Committee for your commitment to eliminate predatory lending practices through the introduction of "The Predatory Lending Consumer Protection Act of 2002." We look forward to reviewing the details of the bill and working with the Committee staff to support the passage of an effective antipredatory lending law.

In conclusion, I have witnessed firsthand that poor people want to work and know that even with a little bit of savings, they can grow and thrive. Whether it is through the First Accounts Program, affordable housing programs, enhanced IDA's, expanded opportunities to serve their communities, or financial literacy, credit unions stand ready to meet this very important challenge.

I thank you again for the opportunity to offer the views of credit unions on this very important topic.

Chairman SARBANES. Thank you very much, sir. We very much appreciate your being here with us today and the role that the credit union movement is playing in this field.

I have just a few questions to put to the panel and then we will draw to a close.

The Federal Reserve, in its 1998 survey of consumer finances, said that 48 percent of families—in other words, almost half, without a checking account, had previously owned a checking account at some time in the past. I was really brought up short by that figure. Here we are, talking about the unbanked. They do not have a checking account. And then we discover that half, at least according to this survey, previously had checking accounts. They were in the banking system. Now, what is behind this? Why did they drop out of the banking system and how much of a problem are they in terms of bringing them back in?

It is one thing to say, well, these people have never been in the banking system for a lot of reasons, and you address that. It seems to me a somewhat different problem to say, well, these people were in the banking system and they got out of it. Does anyone want to address that? Michael?

Mr. BARR. I am happy to start. That is quite a critical issue in terms of bringing low-income families into the banking system.

The individuals who have been in the banking system and have come out might fall into, roughly speaking, two groups, those who have had problems with the system and voluntarily exited, and those who have exited because their accounts have been closed because of problems with not being able to manage their finances in a way that permits them to avoid writing checks with insufficient funds, primarily, but also because of not paying overdraft charges, or in some cases, fraud.

I think it is important in looking at the unbanked not to think of them as an homogenous group, but as different segments of the market.

Individuals who effectively have had credit problems with the system can still be brought back into the banking system. The question is, under what circumstances? And I think the tentative answer is that there are products and services that can be offered in a reasonably safe way, even to people who have had problems in managing finances in the past. Those are primarily accounts that do not have check-writing privileges, in which withdrawals can be done on an on-line debit basis. Automated money orders can be provided. And the risk of overdraft is negligible, with some technical exceptions for small institutions, those that use a different batching process. But for most institutions, accounts can be provided with very little risk of overdraft.

So, I think those kinds of products could be quite attractive—both to people who have had problems and have involuntarily exited, and to people who have had problems and been effectively kicked out—and at lower cost and less risk to financial institutions.

The second major component of the answer is financial education. And I think our panelists have all been uniform in believing that financial education is an important part of the answer.

Chairman SARBANES. Does anyone else want to answer that?

Ms. GROSSMAN. We have about 40,000 to 50,000 accounts. The vast majority of the accounts are people in low- and moderate-income.

And I realize I have to go back—I was writing down to do homework. One of our larger costs is the closing of accounts and the waiving of fees.

For us, it is a big problem and I think Michael has hit it. It is not simple. The economy goes down. People need money. It is very easy to be mad at your bank and therefore, you are going to write a bad check because you have to be mad at somebody—why not a bank?

But there are a variety of reasons and I think it is a real challenge to recognize that we have to have products and ways to deal with them that are not punitive, that do not demean people, and yet, still keep them so we do not lose money, so that it becomes a very unprofitable business.

And I am going to talk to Michael later. I think we really need to look at just some of the data and see what happens to those 40,000, 50,000, what the costs are, what the fee waivers are, and begin to look at other institutions in the same way, because I think you have hit on a real hidden issue.

Chairman SARBANES. Let me ask this question, and I would like to get all the panelists to respond to this. Can the unbanked market be profitably served by financial institutions? In other words, can this all be done in a way that makes it economically self-sufficient? If we are really serious about getting the unbanked in, are we going to have to produce an underwriter from somewhere? What is the answer?

Ms. WILLIAMS. Well, I am not a banker, but I do have an opinion about that question, of course, as you might expect I would.

[Laughter.]

According to experts that I have talked to, most retail products are not profitable. Retail products are offered to consumers to make them loyal customers of a bank and to enable the bank to cross-sell other products.

Chairman SARBANES. You mean as a general proposition.

Ms. WILLIAMS. Right.

Chairman SARBANES. Yes, not just for the unbanked.

Ms. WILLIAMS. That is right, in general. And one of the advantages that we found through the Alternative Banking Program at Bank One is that the bank has been able to cross-sell products. They have sold Alternative Banking Program customers car loans, installment loans, home mortgages, certificates of deposits, and other products. And so, that is the first thing to consider in terms of profitability.

I think it is also important to consider electronic banking alternatives. There are a number of new technologies that are being evolved. There are smart ATM's that can do all kinds of financial functions. There are ways to pay bills electronically. There are automatic money order machines that can also cut costs.

Mr. CARBAJAL. Excuse me. Speaking from the credit union side of it. Our credit union has been a low-income designated credit union for many, many years. We deal with the low income, which, El Paso is, unfortunately, one of the poorest metropolitan areas in the Nation.

I feel that our credit union has been successful. I believe that there is a niche out there. We just need to understand these types of people. You have to understand that it is a high-volume, labor-intensive type of operation. But the benefits are there. If you know how to deal with the under-served, I think there is some financial benefits for the institution in the long run. So, I feel that there is. There is a lot that we can do out there for those people, and I think it can be profitable.

Chairman SARBANES. Ms. Morgan Williams.

Ms. MORGAN WILLIAMS. I guess I would like to start off by suggesting that I think that they have to be profitable. I think it is a very important question and it is an important aspect of this issue that we have to stay focused on.

The reason we have to stay focused on it is that, in order for this to work, it needs to be sustainable. We have to make sure that both the product design and the product offerings are offered in a way that allows us to do well while we are doing good. It is important that they are profitable because you will increase the level of interest and the level of participation in the financial services industry, if we can keep an eye toward profitability.

What is important, though, is that the R&D efforts are fairly significant. So when we look at supplemental support or subsidy support, it should really be in the early stages of product development and product design.

Our objective with the ABP is to transition those accounts to mainstream accounts. We do a once-a-year look at the end of 12 months, how many of these accounts would be appropriate to transition to mainstream accounts? We would expect those to move into our traditional banking products.

Chairman SARBANES. Does anyone else want to add anything?

Ms. GROSSMAN. Yes. I think there are segments of the market that are profitable. But I also, having been experienced in private banking, some of it is accommodation. We accommodate private bank customers. We make loans to them. We do weird things for them. We do not lose money, but we do not make money in the large private banks, in the major banks.

So when you make a loan to a son-in-law or a cousin or you open an account for somebody's housekeeper, those are accommodations, and you look at the whole relationship and you say, well, we are really making money.

The question becomes, I think it is the R&D. It is also beginning to think about them differently. Who are we accommodating? Will the State government put more money into an institution where they can make money on fees and services if they offer certain kinds of things? Are there ways of being creative and saying, we want it done, but we know that it is not going to serve the same kind of profit?

It is not going to lose money, but it may not have the same return on equity as the other parts of the bank, and that means that the people who are doing that do not necessarily get the same kind of importance within the bank. So, I think we have to think about it very clearly and be honest that it is not as profitable as other businesses, but it does not lose money.

Mr. BARR. Treasury research suggests that banks can serve the unbanked profitably on an ongoing basis. Electronic bank accounts offering debit card transactions can be profitably offered for fees of under $3.00 per month. Savings features, automated money orders or bill payment, and other electronically-based products can also be offered profitably at low fees that would be affordable and desirable for the unbanked. At least initially, Governmental support will be needed for financial institutions to make the necessary investments in research and development, expanded distribution, and training and marketing. Account opening costs will likely also need to be supported in the short-term as an incentive, in order to reduce the time it will take banks to recoup initial account opening costs. Financial education is not a function that banks will fund over the long-term, and will continue to need Governmental support for some time.

Chairman SARBANES. Can employers impact on this and are any of them doing it?

Suppose you had an employer who said to a bank that was his bank, I really want all my employees to have an account. And I am setting out to try to accomplish that as their employer.

Now, first of all, I do not know whether under State law, I guess, I would have to look into this. I should know the answer, I guess, whether an employer can say to all his employees, you are going to get your payment by an electronic transfer into a bank account, which everyone tells me is the cheapest—the Government now is doing that, in order to save money. And presumably, employers could save money.

Now whether they can do that under existing law—how does a very large employer have to pay his employees? Does he actually have to give them a check or a payment under State law, or can he put it directly into a bank? I presume he can do that if the employee wants him to do that. But suppose the employee does not want to do that. Does anyone know the answer to that? You are the professor of law.

Mr. BARR. Yes. But, unfortunately, not of State employment law. There is no Federal rule and I do not know any State banking rule that would touch on that issue. A lot of employers are in fact using direct deposit today. Employers, I think you rightly point out, are a critical part of how we can move forward to reach the unbanked.

Direct deposit of payroll is an important way in which low-income workers can have access to the banking system. And as you point out, it is less expensive for employers in terms of their payroll.

I know within the Federal Government, we saved 42 cents a payment to move electronically from checks. It is certainly a greater efficiency for the payment system. It increases take-home pay for their workers if their workers are not having to go to a check cashers. A lot of check cashers have mobile vans that go to large work sites and charge quite large sums to cash what could be easily converted into a payroll check. So, I think that it is an extraordinary opportunity to reach quite a large number of unbanked individuals at scale quickly.

Ms. MORGAN WILLIAMS. Most large companies offer electronic banking or direct deposit to their employees. And I would say, by and large, 80 percent of their employees partake in that. The challenge for employers is to the financial services options that an employee might choose because, generally, the direct deposit is with that corporation's bank. But most corporations participate in it. Our Bank at Work Program is one where we encourage employers, actually smaller employers, to encourage their employees to pursue banking relationships and direct deposits. Then the Paycard, the Value Card, is the other option that employers can offer to a community of employees that might not otherwise use banks.

Chairman SARBANES. Right. Now one of the things we are interested in which relates to this is financial literacy. And the Committee has held hearings on financial literacy. I am very pleased, of course, that the Treasury is now establishing a new office the Office of Financial Education.

I did not get to ask Sheila Bair about that, but she has been active in that as well. It will be under the Assistant Secretary for Financial Institutions. It will be headed by a new Deputy Assistant Secretary. They have this Financial Education Initiative on Bank on Your Schools, a partnership with the schools.

We think this is all extremely important. And it also becomes relevant as we address predatory lending, although I do not think that education can take the place of appropriate legislation or regulation. I think it has to be part of a package to try to do that.

Now, Ms. Morgan Williams, as I understand it, you all have a very active educational program. Is that correct?

Ms. MORGAN WILLIAMS. Yes, that is correct.

Chairman SARBANES. Could you just again kind of outline that very quickly for us?

Ms. MORGAN WILLIAMS. Sure. In all the markets we operate in, and we are in 15 States across the country, we have approximately 50 individuals who are specifically focused on understanding both the product needs and the program needs of the communities we operate in. And those tend to be low- and moderate-income community focus. In each of those markets, we offer either paper-based or electronic-based financial literacy programs. They teach basic financial management, credit repair, homebuying counseling, a full stream of financial services options.

In some markets, we offer financial literacy in high schools, where we are teaching high school students the appropriate thoughts around budgeting and planning as they prepare to leave high school and think about adult responsibilities around literacy.

I also am responsible for the bank's community development activities in affordable housing. We offer financial literacy programs with faith-based organizations and in senior projects, where we have been a project participant. But we have a broad array of products and programs and services and a number of individuals who participate in delivering those.

Chairman SARBANES. Good.

Mr. Carbajal, what do you all do?

Mr. CARBAJAL. Yes. As a matter of fact, we have the same basic programs that they have in the city of El Paso. We work with the El Paso high schools.

Very encouraging, though, is that this grant that we just received is going to be used for this purpose, to go out there to the unbanked, the under-served, and try to educate them.

What we have done is we have partnered up with nonprofit institutions in El Paso, such as Project Bravo, YMCA, and those agencies or those nonprofit organizations, to help us educate our people in El Paso.

I guess we have become a community-chartered credit union last year and I think that is going to give us the ability to be able to go out and reach more into the community, whereas, before, we were only limited to the members that we were serving. So, we are looking forward to that and with the program that we have put into place, we got it going at the beginning of the year. We have already put some homes out there for the low income and we are doing a lot of educating, or adding education to our community.

Chairman SARBANES. Good.

Well, this has been a very good panel and we are extremely appreciative to you. We look forward to staying in touch. I hope we can call on each of you in the future for further counsel as we continue to try to address this issue.

As I indicated in my opening statement, I think that it is an extremely important issue. It is very rewarding to see people who have kind of been on the outside, not all of a sudden, but slowly transition into becoming part of the system.

I know you encounter that in the course of your daily work and I really commend all of you for what you are doing, and we thank you very much for coming today.

Ms. GROSSMAN. Thank you.

Mr. BARR. Thank you.

Chairman SARBANES. The hearing stands adjourned.

[Whereupon, at 12:08 p.m., the hearing was adjourned.]

[Prepared statements and additional material supplied for the record follow:]

PREPARED STATEMENT OF SHEILA C. BAIR

ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS
U.S. DEPARTMENT OF THE TREASURY

MAY 2, 2002

Introduction

Chairman Sarbanes, Senator Gramm, and distinguished Members of the Committee, I appreciate the opportunity to appear before you this morning to talk about the unbanked and to bring you up to date with respect to First Accounts, a grant program administered by the Treasury Department, which is designed to help "unbanked" low- and moderate-income individuals establish banking relationships with Federally regulated and insured financial institutions. Mr. Chairman, I commend you for focusing a national spotlight on this critical issue of expanding consumer access to mainstream financial services by convening today's hearing, as well as the hearings you held earlier this year on the remittance industry and financial education. The policy objective of First Accounts is embraced by Members of both parties. It is of great importance to me personally, to the Treasury Department, and to the Bush Administration.

Secretary O'Neill recently noted that: "We must work to ensure that all Americans have the knowledge and tools to build their own financial security. Ownership, independence, and access to wealth should not be the privilege of a few. They should be the hope of every American." Establishing a bank account at an insured depository institution is one of the basic tools necessary for individuals to build their own financial security. Expanding low- and moderate-income Americans' access to mainstream banking services is very much in line with the compassionate conservatism of President Bush to give all Americans the chance to fully participate in the benefits of our free economy. In a recent speech, President Bush defined this compassionate conservatism, by saying "It is compassionate to actively help our fellow citizens in need. It is conservative to insist on responsibility and results." Consistent with this philosophy, we have strived to direct First Accounts funding to those initiatives which can be replicable, self-sustaining, and most importantly, promise to bring the greatest number of "unbanked" individuals into bank accounts.

Background

Who are the unbanked? While most Americans have the comfort of keeping their money at insured depository institutions, other Americans use financial services of a different sort. They cash checks at a neighborhood storefront and pay bills in cash or with money orders. Easy and convenient perhaps, but often expensive, dangerous, and not economically productive. Simply put, the unbanked are people who do not have a banking relationship with a traditional financial institution, such as a commercial bank, a savings and loan association, or a credit union.

Although there are few statistics available regarding the true size of the unbanked population in the United States, some estimates indicate that as many as 1 in 10 families, or approximately 10 million households, may not have bank accounts.[1] According to a January 2002 report, surveys have found that the groups most likely to be unbanked are lower-income households, households headed by African-Americans and Hispanics, households headed by young adults, and households that rent their homes.[2]

Given the estimated size of the unbanked population in the United States, an obvious question is why do so many people remain outside of the mainstream banking system? Are they shut out of the system or have they made a conscious choice to *not* do business at traditional financial institutions? Surveys on this issue reveal varied responses to these questions.[3] Some individuals who are unbanked cite financial reasons; they say that bank fees or minimum balance requirements are too high. Other unbanked individuals suggest that they choose to remain unbanked because the types of accounts offered by traditional financial institutions do not meet their needs. For example, a person may not write enough checks or have enough month-to-month savings to make it worthwhile to maintain an account. Attitudes toward banks also appear to be a factor as a large number of people surveyed indi-

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[1] Michael H. Moskow, *Fostering Mainstream Financial Access: www.chicagofed.org/unbanked,* Chicago Fed Letter, Number 162 (Feb. 2001)(*http://www.chicagofed.org/publications/fedletter/2001/cflfed2001__162.pdf*).

[2] John P. Caskey, *Bringing Unbanked Households Into the Banking System,* Capital Xchange (Jan. 2002) (*http://www.brook.edu/dybdocroot/es/urban/capitalxchange/article10.htm*).

[3] *Id.*

cated that they are not comfortable dealing with banks or letting them know their private financial information.

Advantages to Being "Banked"

An individual should have the right to choose where he or she will seek financial services. The right to choose, however, is an illusory right if people do not have accurate and complete information that will enable them to make educated decisions and access to a range of financial service providers.

The unbanked typically pay higher costs in the form of transaction fees for financial services than individuals with banking relationships. Recent Treasury research indicates that a minimum wage worker can pay an average of $18 per month for cashing paychecks at a check casher.[4] A Social Security recipient would pay an average of $9–$16 a month to cash his or her risk-free Government check. Relying on alternative service providers as a source of credit is equally or more expensive. Annualized interest rates for loans from pawnshops, car-title lenders, payday lenders, and small loan companies can be as high as 100 to 500 percent.[5]

Individuals also face heightened safety and security risks as a result of having to conduct all financial transactions in cash. Carrying large amounts of cash is dangerous and keeping cash at home is risky. There have been a number of recent news stories describing how criminals have specifically targeted unbanked immigrants for robbery as they leave check cashing outlets because of the likelihood that these individuals are carrying a significant amount of cash.[6] Other articles cite cases of people losing their life savings in fires because they kept it hidden in their homes in the form of cash.[7] Unlike traditional depository institutions, alternative financial services providers cannot offer their customers deposit account products. Deposit accounts at insured financial institutions offer a safe place to keep money until the depositor is ready to spend it.

Let me emphasize that we do not question the validity of products offered by alternative service providers. They can offer the advantages of immediacy and convenience, for which the providers charge a premium. We do believe, however, that low- and moderate-income Americans should have choices, and those choices should include the ability to establish an account at a mainstream financial institution such as a bank, thrift, or credit union.

Finally, establishing a banking relationship is taking a first step toward building a promising future. Individuals lacking basic financial services may have a reduced ability to manage their finances, and may be limited in planning and saving for the future. Without a banking account, it is nearly impossible to establish a sound credit record, which in turn is necessary to qualify for a car loan, home mortgage, or small business loan at reasonable rates. A traditional banking relationship offers the account holder an opportunity to become familiar with fundamental financial concepts that are critical in asset building and bank accounts provide a tool to help families fulfill their savings goals and manage their money.

Treasury Initiatives

Through the First Accounts Program, Treasury is funding initiatives to connect unbanked low- and moderate-income individuals to mainstream financial services. The paramount goal of First Accounts is to move a maximum number of unbanked low- and moderate-income individuals to a banked status with an insured depository institution. We hope to accomplish this goal through the development of financial products and services that can serve as replicable models in meeting the financial services needs of unbanked individuals without the need for on-going public subsidies. Under First Accounts, financial institutions are encouraged to create low-cost accounts for unbanked families and to help bring more ATM's to safe places in low-income communities.

Additional goals of the program include the provision of financial education to unbanked low- and moderate-income individuals to enhance the sustainability of the new financial relationships. We will also undertake research to evaluate the success of the funded projects and to understand what products, services, educational initiatives, marketing techniques, or incentives are needed to achieve the goals of the First Accounts Program. Treasury has great hope that the pilot programs funded through First Accounts will serve as replicable, self-sustaining models for achieving

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[4] Moser, *supra* note 1.

[5] Caskey, *supra* note 2.

[6] *CU's Testify Provisions of the Patriot Act Could Harm Immigrants,* Credit Union Journal (Feb. 25, 2002).

[7] Angela Shah, *Money in the Bank: Accounts Helping Wary Immigrants Park Cash Safely, Send It Home, The Dallas Morning News* (Aug. 19, 2001).

the goal of moving a significant number of unbanked individuals into banking relationships with insured depository institutions.

There are a number of reasons that individuals remain unbanked, including a lack of low-cost account products; a lack of convenient access; a perception of unprofitability; an individual's prior account problems; and a lack of customer financial literacy. First Accounts provides an opportunity and an incentive for entities to offer real solutions regarding the supply of and demand for traditional banking products and services in unbanked segments of the population. For example, nonprofit organizations may provide consumer financial education. Employers may provide convenient access. Financial institutions may demonstrate the profitability of serving previously unbanked customers through the development of new products designed to meet the needs of low- and moderate-income Americans.

Treasury's First Accounts initiative was launched this past December 27 with a published notice of funds availability, a NOFA, in the *Federal Register* inviting applications for First Accounts grants.[8] The amount currently available is approximately $8 million to fund projects that can serve as models to connect unbanked low- and moderate-income individuals to mainstream financial services.

First Accounts applicants were required to propose, at a minimum, low-cost electronic checking, or other types of accounts either directly (if the applicant is an insured depository) or indirectly through one or more insured depository institutions. The NOFA put particular emphasis on trying to reach unbanked employees through their employers, as well as encouraging arrangements whereby employees can obtain account services building from services already provided by their employers' financial institutions. Applications were due March 20 and a wide variety of entities were eligible, and in fact did, apply for the grants. The applicants included nonprofit organizations, insured credit unions and banking institutions, community development financial institutions, for-profit businesses, State agencies, Indian tribal governments, local governments, financial services electronic networks, and others. In total, Treasury received 231 applications from 38 States. Eighty-nine percent of the proposed projects proposed to expand access of affordable financial services, 58 percent proposed to develop new financial products and services, and 88 percent proposed to educate unbanked individuals, employers, and institutions.

During the last few weeks, we have been busy completing our review of the applications. The competitive review process involved evaluating the applications based on a number of different criteria including: likelihood of success, reasonableness of approach, extent to which a project becomes self-sustaining, extent to which projects are replicable, timeliness of rollout and estimated timeframe to achieve objectives, performance goal setting, applicant's experience and track record, and management capability. The application reviewers dedicated many hours to assessing the applications and preparing their recommendations, considering not only those factors listed above, but also geographical and institution diversity.

After careful consideration, the Treasury Department is announcing its selections for First Accounts grants. The 15 awards totaling $8,357,234 promise to assist 35,445 "unbanked" low- and moderate-income individuals in opening accounts at insured depository institutions. A complete list of grant awardees is attached to my testimony for inclusion in the record.

The First Accounts grant awards are going to nonprofit organizations, insured depository institutions, insured credit unions, a community development financial institution, a faith-based organization, and a foundation. The awardees will carry out projects that provide financial literacy training, connect individuals to insured accounts, develop low- or no-cost products and services, and increase access to financial services through installation of automated teller machines. The projects are focused on a wide variety of unbanked people, including youth, new entrants to the workforce, recent immigrants, residents of low-income communities, residents in rural areas, native Americans living on reservations, people living in public housing, and families using child care facilities. Awardees pledge that the funded projects will cause 35,445 unbanked people to move to a banked status with an insured depository institution.

Grant recipients will be targeting unbanked people in 25 States: California, Colorado, District of Columbia, Georgia, Idaho, Iowa, Illinois, Kentucky, Maryland, Michigan, Montana, New Jersey, New York, Nevada, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming.

Information on the 15 projects awarded grants and on First Accounts can be found at *www.treas.gov/firstaccounts.*

[8] 66 Fed. Reg. 66,975 (Dec. 27, 2001).

Treasury's role in the First Accounts Program will not end with its selection of grant recipients. Treasury's on-going involvement with First Accounts will include evaluating the programs for progress, deliverables, and effectiveness on a regular basis. In addition, Treasury will receive periodic reports from the grant recipients. Once we have data on the success of programs, the Administration will consider the cost-effectiveness of continuing First Accounts or other similar types of programs.

Another Federal program that is supported by the Administration and shares First Account's goal of encouraging the unbanked to move into the mainstream financial services sector is the Electronic Transfer Account (ETA) Program. The ETA Program, which is administered by Treasury's Financial Management Service, provides low-cost electronic bank accounts to Federal benefits recipients. To date, the ETA is offered in every State, the District of Columbia, and Puerto Rico through appoximately 600 banks with more than 16,000 branch locations. Treasury plans to continue to examine the benefits of the ETA Programs and, if necessary, make recommendations to the Administration and Congress on how to coordinate its ETA efforts with First Accounts to ensure that the unbanked receive valuable services in the most cost-effective manner.

Let me also highlight a number of other initiatives that Treasury is working on related to the unbanked. First, we have a number of efforts underway that are aimed at improving financial education. As part of our long-term commitment to improve financial education for all Americans, we are establishing a new office at Treasury. The Office of Financial Education (OFE) will be under the leadership of the Assistant Secretary for Financial Institutions and will be headed by a new Deputy Assistant Secretary. OFE will develop and implement financial education policy initiatives, and will oversee and coordinate our outreach efforts.

One of Treasury's financial education initiatives is "Bank on Your Schools," a partnership between schools and financial institutions that will promote financial education in low- and moderate-income areas. This initiative will encourage financial institutions to open student-run branches in high schools. Students will get hands-on experience running a bank or credit union, and they will learn about financial issues. We have been meeting with the major financial institution trade groups and gathering information to develop ways to expand these programs into low- and moderate-income communities. Through "Bank on Your Schools" programs, young people gain actual experience in opening and managing a bank account that can be carried over into their adult lives.

Another topic that is often overlooked in the discussion of the unbanked is the remittance industry. The Inter-American Development Bank estimates that Latin American immigrants living in the United States send an average of $200 to their native countries an average of seven to eight times per year.[9] These remittances have reached a level that surpassed $23 billion last year—about one fifth of total worldwide remittances.[10] If current growth rates are maintained, cumulative remittances could reach $300 billion by 2010. Most immigrants send remittances through a small number of alternative financial services providers. Lack of competition in the remittance industry has contributed to high remittances costs. Although remittance charges have declined in the past 2 years, they still range from $15 to $26 for a typical $200 remittances. The cost varies depending on the type of institution used to send the money and the country where the money is being sent, but can often exceed 20 percent, when transmission fees and losses on the exchange rate are both factored in.

But this is changing. With our encouragement and support, more and more traditional financial institutions and credit unions are recognizing that there is a concrete opportunity to attract a diverse consumer base by offering low-cost remittance products. Offering remittance features as part of basic bank accounts can be an important marketing tool in reaching out to unbanked migrant workers. One important product that banks and credit unions can offer that money transmitters cannot is a Federally insured checking or savings account. This can lay the foundation for new customers to save and build assets, establish a banking relationship, and learn about important tools in personal finance. At the same time, the increased competition should result in lower remittance costs. We support any efforts made to make the process of sending remittances more affordable for the people who use it—most of whom are low-wage earners according to available data.

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[9] *Remittances to Latin America and the Caribbean,* Multilateral Investment Fund/Inter-American Investment Bank (Feb. 2002) (*http://www.iadb.org/mif/website/static/en/study3.doc*).

[10] *Id.*

Conclusion

In closing, I would like to commend the efforts of the many banks, credit unions, and community- and consumer-based entities and groups—some of whom are represented on the panel that follows me this morning—who have recognized the problems faced by the unbanked segment of the population and undertaken initiatives to bring these individuals into the financial mainstream.

Expanding access to financial services is a bipartisan issue that contributes to improved financial well-being among many low- and moderate-income individuals. Opening an account at an insured depository institutions provides the account holder with a number of benefits: the opportunity for wealth building; lower costs for financial services; security; knowledge of and familiarity with the fundamentals of personal finance; and the chance to build a credit history and qualify for credit on better terms. Because of these benefits, Treasury is committed to promoting policies that will encourage unbanked individuals to establish traditional account relationships with insured banks and credit unions.

To accomplish this goal, Treasury has focused on both educating individuals about the benefits of being banked and persuading depository institutions to expand and tailor services for this underserved segment of the population. First Accounts addresses both of these goals. In addition, by developing replicable and sustainable models, the achievements of the First Accounts grant recipients do not have to be limited by the parameters of the original proposals. Other entities hopefully will see the success stories, and establish similar types of programs to serve the needs of a segment of the unbanked population that they may be uniquely qualified to reach. As a result, Treasury hopes that the effects of the First Accounts Program will reach far beyond the initial group of pilot programs.

Thank you for the opportunity to appear here today. I look forward to working with the Committee on these issues in the future.

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FIRST ACCOUNTS

Last Updated January 27, 2003

Summary of May 2002 Grant Awards

The Treasury Department announced its selections for First Accounts grants on May 1, 2002. The 15 awards totaling $8,357,234 will assist 35,445 “unbanked” low- and moderate-income individuals in opening accounts at insured depository institutions. The awardees were selected from among 231 applications from 38 States. Those applicants requested $129,895,034.

The funds for First Accounts grants result from appropriations in the Consolidated Appropriations Act, 2001 and the Department of Transportation and Related Agencies Appropriations Act, 2001. The purpose of the appropriations is to develop and implement programs to expand access to financial services for low- and moderate-income individuals. Treasury published a notice of funding availability on December 27, 2001, inviting applications for projects that would move a maximum number of “unbanked” low- and moderate-income individuals to a “banked” status with an insured depository institution. The deadline for application submissions was March 20, 2002. In just over 1 month, a team of reviewers scored the 231 applications on eight criteria: reasonableness of approach; likelihood of success; self-sustainability; model qualities; timeliness; performance goal setting; experience of participating entities; and management capability.

The First Accounts grant awards are going to nonprofit organizations, insured depository institutions, insured credit unions, a community development financial institution, a faith-based organization, a local government, and a credit union foundation. The awardees will carry out projects that provide financial literacy training, connect individuals to insured accounts, develop low- or no-cost products and services, and increase access to financial services through installation of automated teller machines. The projects are focused on a wide variety of unbanked people, that is, youth, new entrants to the workforce, recent immigrants, residents of low-income communities, residents in rural areas, native Americans living on reservations, people living in public housing, families using child care facilities.

Grant recipients will be targeting unbanked people in 25 States: California, Colorado, District of Columbia, Georgia, Idaho, Iowa, Illinois, Kentucky, Maryland, Michigan, Montana, New Jersey, New York, Nevada, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming.

The paramount goal of First Accounts is to move a maximum number of unbanked low- and moderate-income individuals to a banked status with an insured depository institution through the development of financial products and services that can serve as replicable models in other communities without the need for ongoing public subsidies.

Information on the 15 projects awarded grants follows.

FIRST ACCOUNTS GRANT AWARDS—May 2002

California

Juma Ventures in San Francisco, California, has been selected to receive a First Accounts grant in the amount of $250,000. The grant funds will be used to connect 505 unbanked low- and moderate-income youth in San Francisco to accounts at insured depository institutions over 2 years. Juma Ventures is collaborating with Citibank to expand an Independent Development Account Program, offer banking and literacy training to youth employed in its six for-profit social enterprises and connect them to accounts, and begin a pilot in a high school. The pilot will use media-based banking literacy training to give unbanked high school students a practical knowledge of banking. The students will have the opportunity to open a low-cost checking or savings accounts with electronic access. The program will be expanded to additional schools in future years. Additional funding and in-kind contributions are coming from the Friedman Foundation, Hewlett Foundation, Merrill Lynch Foundation, private donations, and Citibank.

Colorado

Mile High United Way in Denver, Colorado, has been selected to receive a First Accounts grant in the amount of $1,267,500. The grant funds will be used to connect 2,375 unbanked low- and moderate-income individuals in the Denver metropolitan area to insured accounts at insured depository institutions over 2 years. Mile High United Way is collaborating with Wells Fargo-West to provide low- and no-cost bank products including Individual Development Accounts and financial management and economic literacy training. The project will reach out to the unbanked population through employers and through community-based organizations that include labor unions, faith-based and immigrant-serving organizations, and workforce development public agencies. Four area employers have committed to be involved in promoting the low- or no-cost bank products to employees. The project takes advantage of existing relationships between individuals and their employers and community-based organizations. If successful, the initiative will be expanded to five metropolitan areas in the State. Additional funding and in-kind contributions are coming from Wells Fargo-West, Mile High United Way, Rocky Mountain Mutual Housing Association, and Del Norte Neighborhood Development Corporation.

Georgia

DeKalb County Extension Service in Decatur, Georgia, has been selected to receive a First Accounts grant in the amount of $271,000. The grant funds will be used to connect 330 unbanked low- and moderate-income individuals in Decatur, Atlanta, and south central DeKalb County to insured accounts at insured depository institutions over 2 years. To implement the project, the Extension Service has formed The DeKalb Collaborative consisting of DeKalb County Workforce Development Department, Decatur High School, Decatur/DeKalb Housing Authority, Columbia Village Residential Properties, New Leaf, Women's Bureau, Stakeholder Partnerships Education and Communication, Decatur First National Bank, Wachovia Bank, Bond Community Federal Credit Union, and Branch Banking & Trust. The project will provide consumer education workshops in English and Spanish and issue certificates to those completing the curriculum. The certificates are taken to one of the four banking partners to open a low-cost banking account. "Lunch and Learn" sessions will be held with local employers; the DeKalb County government is committed to participate. The project focuses on education in small groups over an extended period of time, working through the partnering agencies and it focuses on choice of banking establishments. The DeKalb County Extension Service and the DeKalb Workforce Department are making in-kind contributions.

Iowa

The Institute for Social and Economic Development in Coralville, Iowa, has been selected to receive a First Accounts grant in the amount of $301,000. The grant funds will be used to connect 265 unbanked low- and moderate-income individuals in 16 census tracts in Des Moines to insured accounts at insured depository institutions over 2 years. Called "Bank On It!", the project will provide 8 hours of financial literacy training, assistance to identify and resolve obstacles to opening a bank or credit union account, and links to other asset-building programs to help meet family economic goals. Graduates will receive a certificate they can take to a partnering institution—Bankers Trust, Wells Fargo, Iowa State, Financial Plus Credit Union—or another institution. Graduates can receive assistance for 6 months to assure keeping their account in good standing. The focus is on partnerships forged between social organizations and banks to overcome obstacles to accounts. Banking partners will present the last training session of the financial literacy training. The emphasis is on resolving problems, on building a firm financial knowledge, and maintaining the accounts. Additional funding is coming from the Annie E. Casey Foundation, Milbank Memorial Fund, and American Express Foundation.

Illinois

The Center for Law & Human Services in Chicago, Illinois, has been selected to receive a First Accounts grant in the amount of $686,566. The grant funds will be used to connect 1,000 unbanked low- and moderate-income individuals in Chicago and Detroit to insured accounts at insured depository institutions over 2 years. The project is a partnership of The Center for Law & Human Services, Accounting Aid Society, Shorebank, National Consumer Law Center, and Consumer Federation of America. The project will attract individuals who will have their tax returns prepared free-of-charge and allow them to open bank accounts into which their income tax refund can be deposited. First, individuals open a savings account, followed by financial education and an opportunity to open a checking account. Year-round financial literacy classes are offered to provide the necessary skills to maintain and manage the new accounts. The project focuses on using the earned income tax credit and free tax preparation to encourage opening accounts. Each of the partners is making in-kind contributions to the project.

Kentucky

Members First Federal Credit Union in Louisville, Kentucky, has been selected to receive a First Accounts grant in the amount of $130,000. The grant funds will be used to connect 600 unbanked low- and moderate-income individuals in 64 census tracts in Jefferson County, Kentucky, and Belle, West Virginia, to insured accounts at insured depository institutions over 1 year. The project will provide accounts with no minimum balance and no monthly fee. An automated teller machine will increase access in the West Virginia location. The project focuses on educating consumers about regular savings, working with limited resources, and understanding the true costs and benefits of financial services. Additional funding is contributed by the credit union and by foundations.

Michigan

The Mission of Peach Housing Counseling Agency in Flint, Michigan, has been selected to receive a First Accounts grant in the amount of $592,654. The grant funds will be used to connect 660 unbanked low- and moderate-income individuals in Genesee, Oakland, Saginaw, Lapeer, and Shiawasee Counties to insured accounts at insured depository institutions over 2 years. The project will be implemented by a partnership of Mission, Fifth Third Bank, Genesee County Family Independence Agency, and local small businesses. Individuals will receive education, banking access, and counseling support during their transition to using banking services. The project will install three ATM's within the five counties to increase access to financial services. The focus of the project is on unmarried, under-employed, and unemployed persons. Additional funding and in-kind contributions are coming from Fifth Third Bank, Michigan State University Interns, and Michigan State University Community and Economic Development Program.

Montana

Native American Development Corporation, a community development financial institution in Billings, Montana, has been selected to receive a First Accounts grant in the amount of $425,812. The grant funds will be used to connect 290 unbanked low- and moderate-income individuals on Wind River, Crow, Northern Cheyenne, and Flathead Reservations to insured accounts at insured depository institutions over 2 years. The project will promote financial literacy, giving 20 hours of college credit or TANF credit, award certificates accepted by the CDFI, and provide free checking and savings accounts. Three automated teller machines will be installed to increase access to financial services. The project focuses on employers' involvement at three levels: employed participants will seek direct deposit with their employers; employers with five or more employees participating in the project will join the Coordinating Team; and the Coordinating Team will serve as advisors to the project. Additional funding will come from First Interstate Bank and J.M. Cozzens.

New York

National Credit Union Foundation in Washington, DC, in collaboration with the New York Credit Union Foundation has been selected to receive a First Accounts grant in the amount of $765,806. The grant funds will be used to connect 2,100 unbanked low- and moderate-income individuals in rural and metropolitan counties of New York State—Albany area; New York City; Buffalo/Niagara area; and Tompkins, Washington, Warren, and Saratoga Counties—to insured accounts at insured depository institutions over 2 years. The New York Credit Union League, working with five credit unions, Cornell University, and Cornell Cooperative Extension will provide low-cost accounts to individuals new to the workforce at urban, metropolitan, and rural credit unions. This is an employer-based project in which employers will identify employees and provide training space for an educational component—the WorkForce Development Initiative—delivered by Cornell Cooperative Extension. Four portable automated teller machines will be used for education. The project focuses on new workforce entrants.

Additional funding and in-kind contributions will be coming from the New York Credit Union Foundation and the New York State Credit Union League.

North Carolina

Latino Community Credit Union in Durham, North Carolina, has been selected to receive a First Accounts grant in the amount of $1,334,000. The grant funds will be used to connect 6,600 unbanked low- and moderate-income individuals in two North Carolina regions to insured accounts at insured depository institutions over 2 years. The project will open two branches of the Latino Community Credit Union to provide low-cost electronic accounts, on-site financial education, an employer outreach program, and special deposit products to meet the needs of Latino immigrants. The project focuses on Latino immigrants in nonurban areas of the State. The State Employees' Credit Union is making an in-kind contribution to the project.

Ohio

Fifth Third Bank in Columbus, Ohio, has been selected to receive a First Accounts grant in the amount of $760,863. The grant funds will be used to connect 1,000 unbanked low- and moderate-income individuals in south, near east, near north, and west sides and the north east quadrant of Columbus to insured accounts at insured depository institutions over 2 years. The Bank is collaborating with the Ohio CDC Association, The Ohio State University Extension Center, Homes on The Hill, Columbus Neighborhood Housing Services, MiraCit Development Corporation, South Side CAN, and Northside Development Corporation in "Community Partners Banking on the Unbanked." The project will provide financial and economic literacy training, install three automated teller machines, and connect individuals to Totally Free Checking accounts. Four public-sector employers—City of Columbus, Central Ohio Transit Authority, Columbus Metropolitan Housing Authority, and Columbus Public Schools—are committed to market the program to their employees. The project is a collaborative, city-wide model to reach unbanked persons throughout the community. Additional funding and in-kind contributions are coming from Fifth Third Bank.

Texas

National Credit Union Foundation in Washington, DC, in collaboration with El Paso Credit Union Affordable Housing, a credit union service organization, has been selected to receive a First Accounts grant in the amount of $92,504. The grant funds will be used to connect 4,000 unbanked low- and moderate-income individuals in El Paso and El Paso County to insured accounts at insured depository institutions over 2 years. The service organization will work with eight credit unions to reach out and engage unbanked persons in their areas to low-cost electronic checking and savings accounts. In addition, a homeownership counselor located at each credit union will explain how to take advantage of account features. Additional funding and in-kind contributions are coming from National Credit Union Foundation, Texas Credit Union Foundation, and the eight participating credit unions—El Paso Area Teachers Federal Credit Union, El Paso Bell Federal Credit Union, Fort Bliss Federal Credit Union, Golden Key Federal Credit Union, Government Employees Credit Union of El Paso, Mountain Star Federal Credit Union, and West Texas Credit Union.

Wisconsin

Legacy Bank in Milwaukee, Wisconsin, has been selected to receive a First Accounts grant in the amount of $342,467. The grant funds will be used to connect 500 unbanked low- and moderate-income individuals in Milwaukee to insured accounts at insured depository institutions over 1 year. The bank has established an alliance with the Child Care Directors' Group and the Early Childhood Council of Milwaukee to bank child care providers, providers' employees, and the parents served by the providers and to give on-going support and services to ensure the sustainability of the banking relationship. Three automated teller machines will be installed, including one at a child care facility used by 1,500 adults weekly. The project focuses on the child care industry and on maintaining accounts that are established. In addition to conducting seminars on how to use bank products, Legacy Bank will monitor accounts weekly. Problematic customers will be invited for additional education and counseling with Family Services of Milwaukee and the University of Milwaukee-Wisconsin Extension. Additional funding is coming from Legacy Bank.

Mid-Atlantic Region

Boat People S.O.S. in Falls Church, Virginia, has been selected to receive a First Accounts grant in the amount of $604,492. The grant funds will be used to connect 1,120 unbanked low- and moderate-income individuals in the District of Columbia; Northern Virginia; Suburban Maryland; Camden, New Jersey; Philadelphia, Pennsylvania; and Hampton Roads, Virginia to insured accounts at insured depository institutions over 2 years. The project will target Vietnamese refugees and immigrants in the United States for less than 10 years and individuals 60 years of age and over to open bank accounts with its partner Citibank, which is offering no-charge or low-charge checking accounts and workshops on financial literacy. Individuals will receive free tax counseling and tax return preparation and individual development account enrollment, if eligible. Beginning in the mid-Atlantic States, the project will spread to 12 locations across the United States. Local partnerships of community-based organizations will continue the activities. Citibank and volunteers from the community-based organizations are making in-kind contributions to the project.

Northwestern Region

National Credit Union Foundation in Washington, DC, in collaboration with Washington Credit Union League has been selected to receive a First Accounts grant in the amount of $532,570. The grant funds will be used to connect 14,100 unbanked low- and moderate-income individuals in California, Nevada, Washington, Oregon, Idaho, Montana, North Dakota, and Utah to insured accounts at insured depository institutions over 18 months. The project will provide basic consumer financial education and the individuals will develop responsible, low-cost, trusting relationships with mainstream financial institutions. Participants will also gain access to affordable international money transfer services at greatly reduced costs through the credit unions using IR*Net*®. The project will be implemented through a network of experienced financial specialists in each of the eight States. Twenty-seven credit unions are participating. The project focuses on financial literacy in rural areas as a means of connecting individuals to insured accounts.

PREPARED STATEMENT OF MICHAEL S. BARR

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UNIVERSITY OF MICHIGAN LAW SCHOOL

MAY 2, 2002

Chairman Sarbanes, Ranking Member Gramm, and distinguished Members of the Committee, I appreciate the opportunity to be here today to discuss how to bring more Americans into the financial services mainstream.

My testimony today is based on my experience serving as Deputy Assistant Secretary of the Treasury for Community Development Policy, and research undertaken with the assistance of the Ford Foundation as a nonresident Senior Fellow at the Brookings Institution and now an Assistant Professor at the University of Michigan Law School.[1]

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[1] See generally, M. Barr, Access to Capital and Financial Services in the 21st Century: Five Challenges for the Bush Administration and the 107th Congress, *http://www.brook.edu/urban/capitalxchange/article4.htm,* reprinted in 16 Notre Dame Journal of Law, Ethics & Public Policy 101 (2002). I am exploring the issues raised in this testimony in greater detail in an academic article in progress, "Banking the Unbanked," the research for which is being funded by the Ford Foundation and supported by the Brookings Institution.

The Unbanked

Access to basic financial services—owning a bank account, having the tools to manage household finances, and being able to save for the future—is critical to success in the modern American economy. Yet today, nearly 10 million U.S. households—9.5 percent of U.S. households—lack the most basic financial tool, a bank account. Twenty-two percent of low-income families—over 8.4 million families earning under $25,000 per year—do not have either a checking or savings account.[2]

The consequences of not having access to mainstream financial services can be severe.

First, the "unbanked" face high costs for basic financial services. For example, a 2000 Treasury study found that a worker earning $12,000 a year would pay approximately $250 annually just to cash payroll checks at a check cashing outlet,[3] in addition to fees for money orders, wire transfers, bill payments, and other common transactions. Regular payments with low credit risk that could be directly deposited into bank accounts, with significantly lower payment systems costs, form the bulk of checks cashed at these check cashing outlets: nearly 80 percent of checks cashed at check cashing outlets are regular payroll checks, and another 16 percent are Government benefit checks.[4]

The costs of these basic financial transactions can undermine public initiatives to move families from welfare to work, as former welfare recipients often lack access to the banking system, and pay high fees to cash their checks. High cost financial services can also diminish the effectiveness of the Earned Income Tax Credit (EITC), a tax incentive that rewards work and helps bring families out of poverty. One survey found that 44 percent of a sample of EITC recipients in inner-city Chicago used a check cashing service to cash their Government refund check. EITC recipients, lacking savings or access to other forms of short-term credit, are also likely to use high-cost refund anticipation loans.

Second, low-income families need to save to cushion themselves against personal economic crises, such as injury or loss of a job, and to save for key life events, such as buying a home, sending their children to college, or entering old age. Yet low-income families, particularly those without bank accounts, often lack any regular means to save.[5] Bill Gale of the Brookings Institution has shown that, after controlling for key factors, low-income households with bank accounts were 43 percent more likely to have financial assets than households without bank accounts.[6] Moreover, the tax system, through which the bulk of Government savings benefits are provided, largely subsidizes savings for higher-income households. The Treasury Department estimates that more than two-thirds of tax expenditures for pensions go to households in the top 20 percent of the income distribution, while the bottom 40 percent get only 2 percent of the tax benefit.[7] Most low-income workers work for firms without savings plans or are themselves not covered by such plans.[8] Bank accounts can be important entry points for the provision of regular savings plans for low-income workers, for example, through payroll deduction.

Third, the unbanked are also largely cut off from mainstream sources of credit necessary to leverage their hard work into financial stability. Without a bank account, it is more difficult and more costly to establish credit or qualify for a loan. A Federal Reserve study found that a bank account was a significant factor—more so than household net worth, income, or education level—in predicting whether an individual holds mortgage loans, automobile loans, and certificates of deposit.[9] Account ownership in and of itself is no panacea, however; even low-income individuals with bank accounts often lack savings, and turn repeatedly during the year to pay-

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[2] A. Kennickell et al., Recent Changes in Family Finances: Results from the 1998 Survey of Consumer Finances, Federal Reserve Bulletin, January 2000.

[3] Survey of Non-Bank Financial Institutions, U.S. Department of the Treasury, April 4, 2000.

[4] Check cashers focus on these checks to reduce credit risk. These operations often require extensive efforts to reduce risk of fraud, and credit risk from checks from unknown and/or small employers.

[5] See generally, S. Beverly & M. Sherraden, Institutional Determinants of Saving: Implications for Low-Income Households and Public Policy, Journal of Socio-Economics.

[6] W. Gale & S. Carney, Asset Accumulation Among Lower-Income Households, prepared for Benefits and Mechanisms for Spreading Asset Ownership in the United States, Ford Foundation Conference, December 1998.

[7] P. Orszag & R. Greenstein, Toward Progressive Pensions: A Summary of the U.S. Pension System and Proposals for Reform," background paper for "conversation on Coverage," Pension Rights Center, Washington, DC, July 24–25, 2001. Hereinafter, Orszag & Greenstein.

[8] Id.

[9] J. Hogarth and K. O'Donnell, Banking Relationships of Lower-Income Families and the Governmental Trend Toward Electronic Payment, Federal Reserve Bulletin, July 1999.

day lenders, who charge on average 474 percent APR.[10] Thus, strategies to bring the unbanked into the financial services mainstream need to include initiatives designed to increase savings for short-term financial stability and improve access to less expensive forms of credit where appropriate, as, for example, with overdraft protection or account-secured loans.

Barriers to Banking

While the financial system works extraordinarily well for most Americans, many of the low- and moderate-income individuals face a number of barriers to account ownership.

First, regular checking accounts may not make economic sense for many lower-income families.[11] Consumers who cannot meet account balance minimums for a checking account at a bank pay high monthly fees, and most banks also levy high charges for bounced checks that low-income families with little or no savings face a high risk of paying and can ill-afford. Financial institutions may also charge high fees for their money orders or other products that their typical customers do not often use.

Studies have confirmed that many of the unbanked would become "banked" if they found a product that worked for them.[12] In fact, the unbanked have responded to account products tailored to their needs. For example, Banco Popular of Puerto Rico introduced Accesso 24, an electronic account, with no minimum monthly balance, free direct deposit, unlimited ATM access, and a low monthly fee. The bank has enrolled tens of thousands of customers in the product since 1995.

Cultural issues and reluctance to use banks may matter, but many of the unbanked already use, or have used, the banking system. Nearly half the unbanked, according to one study, use banks, thrifts, or credit unions to cash checks,[13] although the figure may be significantly lower in some inner-city communities.[14] Between 48 and 70 percent of the unbanked have had an account at a financial institution at some time in the past.[15]

Second, many unbanked persons may not qualify for conventional bank accounts because of past problems that these persons have had with the banking system. Nearly seven million individuals are currently recorded as having had their accounts closed for prior problems, such as writing checks with insufficient funds or failing to pay overdraft charges, in the ChexSystem, a private clearinghouse used by most banks to decide whether to open bank accounts for potential customers.[16] Records of prior problems are kept in the system for 5 years, during which time these individuals will be unable to open a conventional bank account at most banks, thrifts, and credit unions. While some individuals undoubtedly pose undue risk for account ownership, many potential customers could readily and responsibly use bank accounts. Banks could obviate this concern by working with the private clearinghouses to better distinguish among types of past problems; by offering accounts contingent on completion of financial counseling; and by offering electronically-based accounts with on-line bill payment or automatic money orders, and without check-writing privileges, that pose little risk of overdraft.

Third, while many urban communities contain adequate numbers of both banking institutions and alternative financial services providers, in some low-income urban and rural communities, banks, thrifts, and credit unions are not as readily accessible to potential customers as such institutions are in higher-income areas. A 1997 Federal Reserve Board study found that low-income central city neighborhoods have

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[10] See Consumer Federation of America Payday Lender Survey 2000. This APR is the equivalent of a $36 fee for a 2 week, $200 loan. Indiana's Department of Financial Institutions found that consumers took an average of 13 loans per year, 10 of which were rollovers of earlier loans. An Illinois Department of Financial Institutions survey found an average of 10 loan contracts over 18 months.

[11] The 1998 Survey of Consumer Finances asked unbanked individuals why they did not own a checking account. The most cited reasons were not writing enough checks to make an account worthwhile, minimum balances and services charges were too high, not having enough money, and not wanting to deal with banks. The last factor may or may not have solely economic motivations. Id.

[12] ETA Conjoint Research, Dove Associates, May 1999, *www.fms.treas.gov/eta/conjoint.pdf.*

[13] J. Caskey, Lower Income Americans, Higher Cost Financial Services, Filene Research Institute and Center for Credit Union Research, University of Wisconsin-Madison, 1997.

[14] S. Rhine et al., The Role of Alternative Financial Services Providers in Serving LMI Neighborhoods, Changing Financial Markets and Community Development, Federal Reserve Conference, April 5–6, 2001 (only 15 percent of surveyed unbanked households used financial institutions to cash checks in Chicago).

[15] Compare Kennickell (2000) (48 percent) with Caskey (1997) (70 percent).

[16] P. Beckett, Banks Are Using a National Database to Blacklist Customers for Slip-Ups, *Wall Street Journal,* Aug. 1, 2000.

fewer bank offices per capita than higher-income areas and those outside the central city.[17] Similar patterns may persist in the distribution of ATM's: In New York and Los Angeles, there are nearly twice as many ATM's per resident in middle-income zip codes as there are in low-income zip codes, according to 2000 Treasury Department research.

Fourth, financial institutions may be reluctant to expend the resources for research, product development, training, marketing, and education, necessary to expand financial services to lower-income clientele. Financial institutions may need incentives to pursue research and product development with respect to accounts for low-income customers. Further market research would help to define the product needs of low-income families and existing products will likely need to be modified to serve this clientele.

Marketing of new products to low-income persons, and training of local banking personnel, are both critical to the success of any new product development, yet given the expense and the expected low returns, are often not fully pursued even when financial institutions decide to become involved with offering financial services to low-income customers. If the unbanked do not know about the availability of new products and services, they are not likely to seek out financial services at banking institutions. If local banking personnel are not informed about new offerings, the unbanked will find it difficult to open accounts even where local branches are convenient and accessible.

Moreover, at least for a segment of the low-income population, lack of financial education with respect to account ownership, budgeting, saving, and credit management is a significant barrier to personal financial stability. The benefits of financial education are not likely to be fully captured by the financial institution, so such education at any scale will likely need to be funded from sources in addition to the financial institution.

Expanding Access to the Financial Services Mainstream

While important challenges are still largely in front of us, some progress has been made in recent years in expanding access to financial services. The period 1995 to 1998 marked a decline in the percentage of low-income families who are unbanked from 25 to 22 percent.[18] This decline in the percentage of unbanked may reflect in part strong economic growth in the late 1990's that improved the incomes of households at the bottom of the income distribution for the first time in decades.

The Treasury Department's efforts to increase electronic payment of Federal benefits, pursuant to the Debt Collection Improvement Act of 1996,[19] has also helped to spur innovation in this area. Under Treasury's Electronic Funds Transfer (EFT '99) program, direct deposit into bank accounts has increased as a portion of all Federal benefit payments from 58 percent in 1996 to 76 percent in 2001. This increase in benefit payments reflects in part an increase in direct deposit to existing accounts, and in part an increase in the percentage of benefit recipients who have obtained bank accounts.

Moreover, Treasury launched the Electronic Transfer Account (ETA), a low-cost electronically-based bank account for Federal benefit recipients.[20] Under the program, Treasury provides financial institutions offering ETA's with a one-time payment of $12.60 per account to offset the costs of opening the accounts.[21] As of spring 2002, nearly 600 banks, thrifts, and credit unions were offering ETA's at over 18,000 locations nationwide.[22] Over 28,000 benefit recipients have opened these ETA's thus far, and new ETA account holders are being signed up at a rate of over 1,000 per month. The ETA could make faster progress were additional funds made

[17] R. Avery et al., Changes in the Distribution of Banking Offices, 83 Federal Reserve Bulletin 723 (September 1997).

[18] See Kennickell (2000).

[19] Public Law 104–134 (1996).

[20] ETA's are individually owned bank accounts that accept electronic Federal benefit, wage, salary, and retirement payments, and other deposits as permitted by the offering financial institution. Banks may charge up to $3 per month for these accounts. The accounts permit at least four cash withdrawals per month, require no minimum balance, and provide the same consumer protections as other accounts.

[21] Research conducted for the Treasury Department by Dove Associates concluded that the average cost of opening an ETA account is $12.60. Actual costs vary significantly by institution. The $12.60 does not include costs for marketing, training, of education, technology platform changes, or research. Treasury estimates from other account products suggest that marketing ETA's would cost $9 to $11 per account.

[22] The largest banks offering ETA's include Bank One, Bank of America, Fleet Bank, J.P. Morgan Chase Bank, U.S. Bank, and Wells Fargo. The top five ETA providers are Banco Popular de Puerto Rico, Bank of America, Wells Fargo, Union Bank, and U.S. Bank. EFT Exchange, Spring 2002.

available for marketing and training.[23] Anecdotally, banks are reporting that they are also signing up more than three direct deposit relationships into regular banking accounts for every ETA opened.

More recently, a number of banks, thrifts, and credit unions have begun to experiment with a variety of products designed to serve the needs of low-income individuals. As I mentioned, Banco Popular has made great strides in reaching the unbanked of Puerto Rico. In the States, Bank One, as you will hear today, is experimenting with using a broader range of credit criteria for opening accounts. Shorebank has focused on bringing EITC recipients into the banking system.[24] Fleet is working with a nonprofit organization, Doorways to Dreams, to create an Internet platform for low-income savers.

A number of banking institutions, including Wells Fargo, have recently begun to work with the Mexican government to accept Mexican consular identification documents for Mexican immigrants in the United States seeking to open bank accounts. Similarly, recent efforts to reduce the costs of sending remittances abroad, such as Bank of America's dual-ATM card, hold promise for bringing immigrant communities into the banking system. President Bush and Mexican President Vicente Fox have made progress on reducing the costs and increasing the benefits of the nearly $10 billion in annual United States-initiated remittances to Mexico issue an important part of their mutual agenda.[25]

First Accounts

In this regard, Treasury's First Accounts initiative could play an important role in fostering innovation by the financial services sector. With the Government helping to serve as a catalyst, banks can harness technology to reduce costs, lower risk, and democratize access to financial services for low-income families. Transaction accounts with debit cards but no checks can reduce risk to banks and account holders by preventing accounts from being overdrawn; lower the cost of processing each transaction and increase the efficiency of the payments system by reducing paper checks; expand availability much more cheaply than branches; and decrease the safety risk to low-income customers who cash their regular payroll or benefit checks and carry large sums of cash.

The First Accounts initiative grew out of Treasury's research on the financial services needs of the unbanked for EFT '99. Treasury estimated that at least half of the 10 million unbanked households do not receive Federal benefit payments and thus would be ineligible to open ETA's. In addition, banks participating in the ETA program reported that significant numbers of unbanked persons who were not Federal benefit recipients had sought to open ETA's; these persons are part of the likely target market for First Accounts. Treasury research suggests that unbanked persons who do not receive Federal benefit payments are, on average, younger, more urban, more likely to be from a minority community, have larger families, and are more likely to be receptive to signing up for electronically-based accounts than the unbanked Federal-benefit-recipient population.

As initially conceived, the First Accounts initiative had four main components:

First Accounts. Treasury would help to offset the costs financial institutions incurred in offering low-cost, electronic banking accounts to low-income individuals.

Access. Treasury would help to defray the costs of expanding access to ATM's, POS, Internet, or other distribution points in low-income neighborhoods with low access.

Financial Education. Treasury would support financial institution and nonprofit initiatives to provide financial education and counseling to low-income households.

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[23] Funding for the Treasury Department's EFT '99 public education campaign ended in September 2001.

[24] Shorebank is a premier example of a Community Development Financial Institution (CDFI), a specialized financial intermediary serving low-income communities. Of the 553 CDFI's certified to date by the Treasury Department's CDFI Fund, 159 are banks, thrifts, or credit unions offering depository services. In a 2000 survey, 21 CDFI's provided 141,440 checking and saving accounts to low-income customers. These accounts had balances averaging $1,815. These depository CDFI's also offered 985 Individual Development Accounts (IDA's) with an average balance of $395 per account. Testimony of Tony T. Brown, Director, CDFI Fund, Before the Senate Appropriations Subcommittee on VA, HUD, and Independent Agencies, Hearing on fiscal year 2003 Appropriations, April 24, 2002, *www.treas.gov/press/releases/po3037.htm.*

[25] See Partnership for Prosperity, Report to President Vicente Fox and President George W. Bush, Monterrey, Mexico, March 22, 2002, pp. 3–4, 9; See also, Inter-American Development Bank's Multilateral Investment Fund, *www.iadb.org/mif/website/static/en/remit.asp* (describing remittance patterns). The World Council of Credit Unions has developed a project to provide for lower-cost remittances initiated at U.S.-based credit unions. A major barrier is the development of ATM infrastructure in recipient countries.

Research. Treasury would fund research into the financial services needs of low-income individuals and development of financial products designed to meet these needs.

The First Accounts initiative properly focuses on the need for incentives to get financial institutions started in serving low-income households. As discussed above, the costs of research and development, new account opening, expanded distribution, and financial education are serious barriers today to expansion of account ownership. The First Accounts initiative can help to accelerate improvements in this market.

As Assistant Secretary Bair has explained, Treasury has issued a request for proposals under the First Accounts Program in December 2001. The Department received 231 responses from a wide variety of organizations: banks, thrifts, and credit unions; employers and labor and employer organizations; community-based organizations; State and local governments; and others. As reported by the Department, the results of the first round of funding are impressive. The challenge going forward is to continue funding the First Accounts initiative at sufficient levels and for a sufficient time to help transform the market for low-income financial services. Only a sustained commitment to the First Accounts initiative will provide financial institutions with sufficient incentive to make the necessary investments in research, technology platform changes, training, marketing, and education necessary to serve low-income unbanked and underbanked households. Over time, as financial institutions become expert at serving the low-income customer segment, the need for Governmental incentives may become less important.

Banks, thrifts, and credit unions could, under the First Accounts initiative, experiment with a wide variety of techniques to expand access to the unbanked, and to provide an increasing range of services to the underbanked.[26] Low-cost electronic transaction accounts can be attractive to the unbanked and can be offered at reasonable cost.[27] Banks may wish to experiment with accounts with savings features, including payment of interest or separate savings "buckets" within accounts; these features are also likely to be attractive to the unbanked and low-cost.[28] Similarly, low-income individuals need a convenient and low-cost means to pay bills; automated money orders,[29] on-line bill payment, alternative means of foreign country remittance, and other low-cost payment methods can help to reduce the cost of basic transactional services for the poor.

In addition, the First Accounts initiative has the potential to help spur "leap-frogging" in technology for low-income financial services, in analogous ways to how the Internet and cellular telephone technology have permitted developing countries to leapfrog in telecommunications infrastructure. To offer a few examples that could be subjected to the test of market feasibility: With sufficient incentives, providers of the network infrastructure for debit and credit cards, or providers of back-office data and information processing functions for banks and mutual funds, may be induced to explore ways that low-income customers could be served by financial institutions on shared technological platforms. As access to the Internet expands in low-income communities, e-finance can increasingly be made available to the poor at Internet kiosks. Or companies that are exploring ways to expand the use of cellular phones to transact financial services for high-income clientele could be encouraged also to focus attention on expanding banking account access for the low-income market that currently utilizes prepaid cellular phones.

The First Accounts initiative can also help to spur employer-driven (or union-driven) strategies to expand access to banking services. Large employers can reap significant benefits from moving more of their workers to direct deposit of payroll, driving down their payroll processing costs, increasing the effective take home pay for their workers, and reducing problems from theft or fraud associated with checks. Employers can help to reduce costs for reaching their unbanked employees with financial education and marketing of new products. Moreover, many employers have already become active in educating their workers about advanced payments under

[26] Treasury's Notice of Funds Availability (NOFA) issued in December 2001 barred using First Accounts funds for IDA matches or to increase services to those with bank accounts. In my view, neither prohibition is required by the Congressional appropriations, and neither serves an important program interest.

[27] See ETA Conjoint Research, Dove Associates, May 1999, *www.treas.gov/eta/conjoint.pdf* (research summary) and *www.fms.treas.gov/eta/etamodel.xls* (market model); ETA Initiative: Optional Account Features, Dove Associates, June 1998, *www.fms.treas.gov/eta/features.pdf* (waterfall analysis).

[28] Id. Savings features boosted take up rates by up to one-third and accounted for one-quarter of the reason why an individual might sign up for electronically-based accounts.

[29] Caskey (1997) found that 69 percent of surveyed unbanked persons used 10 money orders per year, and 39 percent used more than 30 money orders per year to pay bills.

the EITC. At the same time, financial institutions already provide important payroll and other banking services for employers, and some have been experimenting with employer-focused, debit card-based payroll systems for their clients' employees. These employment relationships may provide a solid foundation for encouraging direct deposit into low-cost electronic banking accounts and systematic savings programs for low-income workers.

Other Initiatives

The Community Reinvestment Act

The Community Reinvestment Act (CRA) also has an important role to play. CRA has helped to expand access to credit for homeownership in low-income communities. The CRA service test, however, which evaluates bank and thrift performance in meeting transaction, savings, and other community needs, has received inadequate attention from bank regulators in CRA examinations.[30] Examiners should focus on the extent to which banks and thrifts are actually attracting low-income customers with innovative retail products and services. Given the importance of technology in serving low-income clients in a cost-effective manner, service examinations should move away from an overwhelming focus on bank branches toward a more qualitative assessment of the extent to which technology-based products are expanding access for low-income persons.

Individual Development Accounts

Bank account ownership can be an important step for low-income families to begin to save, for both shorter-term financial stability and longer-term savings goals. In addition, for intermediate-term saving needs, such as homeownership, college education, or entrepreneurial ventures, Individual Development Accounts (IDA's) are providing a new means for low-income households to save.

Evidence to date suggests that low-income individuals can save if given the opportunity to do so. For example, 44 percent of low- and moderate-income workers participate in 401(k) plans if offered the chance to participate.[31] Some 73 percent of Federal employees earning $10,000 to $20,000 annually participated in the Federal Government's Thrift Saving Plan, and over half of those earning under $10,000 also participated.[32] Similarly, the American Dream Demonstration has been piloting IDA's for low-income individuals. The demonstration has found that low-income individuals in the program were able to save an average of $25 per month (2.2 percent of average income).[33] The demonstration also suggests that financial education, a regular saving program, and matching funds can increase participation and improve retention.[34] Nationwide, there are some 10,000 IDA holders in the American Dream Demonstration and other IDA demonstration programs.[35]

The challenge is to bring these IDA programs to scale. The Savings for Working Families Act, introduced by Senators Lieberman and Santorum, is a promising approach. Under the Act, financial institutions offering IDA's would receive tax credits annually offsetting up to $500 in matching funds and $50 in account administration costs. The current legislation, drafted with an overall cap on accounts, would provide for 900,000 new IDA's at a cost of $1.7 billion.[36] This legislation could help to transform financial services for the poor, by moving from small-scale, nonprofit focused efforts to a large-scale, financial-institution driven financial product that meets the longer-term savings needs of low-income families.[37] As with bank accounts for low-income persons, technology will need to play a central role in driving down the costs of IDA provision.[38]

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[30] See M. Stegman, et al., Creating a Scorecard for the CRA Service Test, Policy Brief #96, The Brookings Institution, March 2002.

[31] Orszag & Greenstein.

[32] Id.

[33] M. Sherradan, et al., Savings and Asset Accumulation in Individual Development Accounts, Center for Social Development, Washington University in St. Louis, 2002.

[34] Id.

[35] Assets, A Quarterly Update for Innovators, Corporation for Enterprise Development, Winter 2002, p. 1.

[36] U.S. Department of the Treasury, General Explanations of the Administration's Fiscal Year 2003 Revenue Proposals, February 2002, pp. 37–38.

[37] The legislation could also be modified to provide for a similar tax credit to financial institutions for providing low-cost electronic banking accounts for low-income persons. Such a tax credit would be the easiest way to bring the First Accounts pilot to scale if the demonstration proves successful.

[38] The Fleet/Doorways to Dreams test of Internet-based IDA programs will prove instructive in this regard.

Financial Education

Studies find that financial education does matter in changing the financial behavior of individuals, particularly low-income persons. Financial education can increase participation in saving plans and increase the level of saving. Financial education, however, can be costly, and education focused on low-income persons is unlikely to be undertaken in a significant way absent Governmental and nonprofit support. The First Accounts pilot currently includes financial education as an eligible use, and it is my understanding that Treasury has recently created a new Office of Financial Education to promote financial literacy.[39] Presumably, a portion of First Accounts funding could be made available to this office to support community-based financial education initiatives focused on account ownership and savings. Experience to date suggests that education initiatives are most successful when they focus on life decisions that the individual is currently facing: for example, how to improve credit standing to purchase a home, whether and how to begin saving for college. The Cleveland Saves initiative sponsored by the Consumer Federation of America can serve as a model for other such programs.

Conclusion

Financial and technological innovation has been a hallmark of U.S. financial markets. Financial institutions can harness that innovation to meet the needs of low-income Americans. The First Accounts initiative is an important part of catalyzing private sector efforts to use financial and technological progress to expand access to financial services for low- and moderate-income families. By helping these families to enter the financial services mainstream, First Accounts and related initiatives can help to transform financial services for low-income persons. Such a transformation is a key to promoting greater economic opportunities for low-income communities in the 21st Century.

PREPARED STATEMENT OF FRAN GROSSMAN

EXECUTIVE VICE PRESIDENT

SHOREBANK ADVISORY SERVICES

MAY 2, 2002

Good morning. My name is Fran Grossman, and I am the Executive Vice President of Shorebank Advisory Services. SAS is the consulting arm of Shorebank Corporation, the Nation's first and largest community development bank holding company with $1.3 billion in assets and operations in Chicago, Cleveland, Detroit, Washington State and the Upper Peninsula of Michigan. In addition, Shorebank assists other development organizations across the United States and around the world. At the heart of our business operations is the belief that we can change communities for the better by matching residents' determination and vision with our financial resources and market knowledge. Over our 30 year history, we have provided more than $1 billion in financing to homeowners and landlords, small business owners and churches, nonprofit organizations and community residents.

I have been involved in community development banking and finance for 20 years. Prior to joining Shorebank in 1999, I was President of Bank of America, Illinois Community Development Corporation, and I initiated and led the community development finance group at Continental Bank and Bank of America, Illinois. Currently I am a board member of the Coalition of Community Development Financial Institutions, the Community Development Bankers Association, and the National Association of Affordable Housing Lenders. I especially want to thank NAAHL for its commitment to working with us to make banking more responsive to low- and moderate-income families.

I also want to thank the Members of the Banking Committee, Sheila Bair and the Treasury Department for your support of the First Accounts initiative and other efforts to bring the unbanked into the financial mainstream. We all are here today because we want to develop initiatives to provide wealth-building opportunities for more Americans. This is no easy task. The First Accounts initiative is a strong first step in recognizing that solutions will be born in large part out of private-sector innovation. But it is only one step along a continuum of initiatives and policies that are needed.

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[39] See Treasury Secretary Paul H. O'Neill, Keynote Address to Jump$tart Coalition for Personal Financial Literacy, April 23, 2002, *www.treas.gov/press/release/po2035.htm.*

Assets are a crucial ingredient in the recipe for financial stability and wealth accumulation. Assets link individuals to mainstream financial institutions and capital markets. This in turn increases access to networks that connect people with jobs and other resources. Many low-income families are already savers, whether or not they have a bank account. But without the connection to a formal financial institution, these families will face more obstacles along the path to longer-term prosperity.

Low-income people with bank accounts are more likely than the unbanked to save regularly, to have a car loan, and to have a home mortgage. Yet at least 10 percent of American families—including 25 percent of African-American and Hispanics—have no bank account. The majority of these unbanked consumers have incomes below $25,000. They say they are uncomfortable in banks, don't trust banks or think that they don't have enough money to open an account. Some have privacy concerns, while others are shut out of the system because of lack of identification or poor credit. As a result, most of them have no assets.

Yet, they are generating positive economic activity. They receive paychecks and tax refunds. Some own cars and homes. Often, they have accumulated significant amounts of consumer debt. Clearly some are saving. They just need an institutional mechanism to facilitate the growth of their assets over the long-term. The rapid growth of the fringe financial services sector suggests that the unbanked have a demand for financial services that is not adequately met by the existing supply. Traditional checking accounts are predicated on consumer liquidity, a luxury poor people do not generally have. Even banks that have one or two products appropriate for modest-income consumers generally lack a full line of products that would enable consumers to build on their initial successes. The location and feel of typical bank branches often are not convenient or comfortable for the poor. And while the financial services industry is quite sophisticated about segmenting upper-income consumers and crafting appropriate marketing messages, little attention has been paid to outreach efforts at the lower end of the income scale.

Over the past 6 years, Shorebank has focused significant energy on serving the unbanked. We have experimented with new products, delivery systems and outreach strategies. One of the first new products we introduced, in 1998, was an Individual Development Account. An IDA is a savings account that is matched dollar for dollar for low-income families saving to buy a home, start a small business or go to college. As one program participant put it, IDA's are "an IRA for the rest of us." To date, we have opened nearly 600 accounts, trained hundreds in money management techniques and witnessed the transformational effects of the program. One participant, a 20 year Shorebank employee, began contributing to the company's 401(k) program after she successfully saved for a downpayment on a house and literally began to see her money grow.

In an effort to increase customer convenience and decrease delivery costs, we have worked with customers who are unfamiliar or uncomfortable with technology to learn how to use ATM cards, point-of-sale machines, and Internet banking. In one of our lobbies, we have installed a freestanding computer with Internet access that customers can use free of charge to check their account online, sign up for an e-mail account, or simply surf the Web.

This morning, I would like to focus on one very promising outreach strategy for bringing the unbanked into the financial mainstream—linking tax refunds with bank accounts. As you know, the Earned Income Tax Credit is the largest Federal antipoverty program, both in terms of dollars and participation levels. In 2001, more than $30 billion was paid out to some 18 million households. The average credit was about $1,600.

The EITC has incredible reach in low-income communities, and Shorebank has sought to harness the power of this popular incentive. Three years ago, we opened our bank lobbies in Chicago to volunteer tax preparers from the Center for Law and Human Services, one of the largest and most successful VITA programs in the country. As working families waited to have their taxes prepared, personal bankers were on hand to open free savings accounts for those who wanted one. No initial deposit was required as long as the customer agreed to have her tax refund electronically deposited into the account. An ATM card was made available, and the account earned interest. We called it the Extra Credit Savings Program.

Through a formal evaluation of the initiative, we interviewed those who opened accounts and we tracked their account usage over time. A copy of the full evaluation will be included in the official record. Let me share some of the key results.

- Twenty percent of all the individuals who had their taxes prepared at the bank agreed to open an account. *More than 60 percent were previously unbanked.* This was a very disadvantaged group of mostly single mothers. Their average income was about $9,000. Nearly one-third were TANF recipients, and 50 percent were Food Stamp recipients.

- When asked why they decided to open an account, nearly half mentioned a desire to save. Six months later, 62 percent said the account had helped them change spending patterns or helped them to save.
- Over time, half of the unbanked used their accounts for something other than short-term storage of their tax refund. Some of them arranged to have their paychecks directly deposited to the account each month. Others saved additional funds or signed up for other bank products.
- The following year, approximately one-third of all participants again used their account to deposit their tax refund.

These positive results encouraged us to continue. Over the past 3 years, we have opened 350 accounts with tax refunds totaling more than $250,000. We also have helped others replicate the initiative across the country. Several of the bank regulatory agencies have embraced the concept and are working to spread the word. Last year, for instance, the IRS partnered with the FDIC to encourage links between tax preparation programs and financial institutions.

Why did the Extra Credit Savings Program work? We found three primary keys to success:

First, the timing of the outreach was critical. People said yes to a bank account because they anticipated having money available.

Second, the size of the refund was important. The larger the anticipated refund, the more likely people were more likely to say yes to a bank account.

Third, technology was crucial for both the consumer and the bank. The combination of an electronically filed tax return and a directly deposited tax refund meant that customers could receive their refund in as few as 8 days. This shortened waiting period comes closer to being competitive with refund anticipation loan providers. Meanwhile, direct deposit and ATM usage reduced transaction costs for the bank.

These lessons, along with our other experiences in this arena, demonstrate the complexity of the issue. Universal access to financial services and wealth-building opportunities is a multifaceted challenge that requires multiple initiatives by both the public and private sectors.

First, we should fully leverage the power of the Earned Income Tax Credit by institutionalizing the link between the tax system and financial services. Just like the Motor Voter law that allows Americans to register to vote while applying for a driver's license, tax refund recipients should be able to sign up for a bank account while having their tax returns prepared. The technology to open accounts electronically already exists and further bolsters the Treasury's goal of increasing electronically-filed returns. Now, we need another line on the 1040 that asks the question, "Do you want a bank account?" and a system to facilitate the transaction.

Second, I ask for your support for the Savings for Working Families Act. Title II of S. 1924 would expand IDA's to 900,000 working families over the next decade, and I hope it will be included in the Finance Committee Chairman's mark on the charity bill. IDA's have been piloted successfully across the country, proving that the poor can and will save when offered an appropriate financial product, a meaningful incentive and adequate information. For many, IDA's are an entry point into the banking system that can lead to full participation in the financial mainstream. By linking financial services to real opportunities for wealth creation, IDA's demonstrate to the uninitiated that a banking relationship is vital to their long-term prosperity.

Third, we must strengthen the CRA service test. CRA has the power to spur financial innovation. Recent studies have confirmed CRA's effectiveness as a catalyst in broadening homeownership and small business opportunities for low- and moderate-income families. But while the lending and investment tests both require quantifiable results, the service test can be met simply by demonstrating that a retail product or service is available to low-income consumers. Rather, financial institutions should be held accountable for the *level* of retail services being provided, and deposit accounts should be subject to a similar spatial distribution analysis as loans.

In conclusion, I hope I have successfully demonstrated that the issue of access to financial services for modest-income families is important, complicated, and solvable. It is important that we have reasonable expectations and see the First Accounts initiative as a step in the right direction. There are no easy answers, but with all of our hard work, we can succeed in broadening financial opportunities for everyone. Thank you for the opportunity to be here today.

PREPARED STATEMENT OF JAYE MORGAN WILLIAMS

SENIOR VICE PRESIDENT AND
MANAGING DIRECTOR OF COMMUNITY INVESTMENT
BANK ONE CORPORATION

MAY 2, 2002

Chairman Sarbanes, Ranking Member Gramm, and Members of the Committee, I appreciate the opportunity to be here today on behalf of Bank One[1] to discuss our commitment to helping American families gain access to the financial services mainstream and to share some of our experiences in doing so. We are particularly proud to share this panel with our colleagues and partners from Shorebank and the Woodstock Institute, whose dedication to this problem has been a source of inspiration and encouragement to us and to others in the banking system. We are also pleased to share the panel with Professor Barr, whose leadership we admired so much at the Department of the Treasury, and with Mr. Rufino Carbajal, Jr., President of the West Texas Credit Union and Member of the Texas Credit Union Commission, whose initiatives in underserved communities in Texas set an example for us all.

Our commitment to the so-called "unbanked" stems from our core belief that helping families gain access to the banking system is good for these families, good for individual communities, good for the national economy, and good business for Bank One, both near and long-term.

But as the other witnesses at this hearing have so eloquently testified, the reasons that more than 10 million American families do not have an insured bank account are complex and varied. So logically enough, there is no "one size fits all" solution for the unbanked population. To devise appropriate programs to help the unbanked population find footing in the banking system requires creativity, adaptability, and above all patience.

Before describing some of our programs, I would like to briefly summarize what we at Bank One have learned as we have pursued our commitment to help bring families into the mainstream financial system:

- *Our Programs are Works in Progress.* As hard as we try, we are just beginning to understand the multitude of reasons that 10 million American families are unbanked. Devising programs that succeed is often a matter of trial and error. We are proud of our efforts and humble about our errors, which often teach us the most.
- *Financial Literacy is Essential for a Successful Banking and Credit Relationship.* We believe we can trace our biggest disappointments in these programs to instances when "the cart was put before the horse," that is when low-income participants entered into banking or credit relationships with too little understanding of the fundamentals of consumer finance. We at Bank One believe that financial literacy training is absolutely critical to the success of programs serving the unbanked.
- *Partnerships are Essential.* Our partnerships with community groups, advocacy organizations, and community banks are essential to mounting programs that reach the unbanked population in meaningful ways. This is not a battle that can be won with a "go it alone strategy."

I would like to now briefly discuss four of our current programs for bringing more American families into the financial mainstream.

The Alternative Banking Program

I would like to turn first to Bank One's Alternative Banking Program, or ABP, which we are proud to participate in through the Chicago CRA Coalition, an organization represented by one of my copanelists today.

The ABP offers checking accounts designed to appeal to low-income, unbanked consumers. These accounts differ from our traditional accounts in that they are easier to qualify for and less expensive to maintain. Applicants may be approved with no credit history, or with a borderline credit history. An account can be opened with a balance of only $10, as opposed to $250 for a traditional account, and may be held with no balance at all.

In exchange for the more flexible credit criteria, ABP accounts do have some modest restrictions. For example, the limit on daily ATM withdrawals is $50 a day, as

[1] Bank One Corporation is the Nation's sixth largest bank holding company, with assets of more than $265 billion.

opposed to $300 for a traditional account, and the funds aren't available until 3 days after deposit, as opposed to 2. The ABP program is intended to be a transitional "starter" account; the goal of the program is to bridge account holders into mainstream financial services. After 1 year of successful account management, an account holder may apply to upgrade to a traditional account.

But, as is true of all of our programs for the unbanked, customers must be educated in the basics of consumer finance in order to succeed. For this reason, we conduct workshops in the "ABC's of Banking" in the neighborhoods surrounding each banking center where the program is offered. These workshops, staged with the help of community groups, offer training in basic skills such as check writing, balancing a checkbook, and family budgeting.

We are encouraged by the results we are seeing. Since we rolled out the program in March 1999, every single new ABP account holder would have been ineligible for a traditional Bank One account, mostly due to lack of credit. Yet, the average checking balance is approximately $1,100 and savings $1,600. We are very proud of this result as it represents significant savings for low-income individuals.

Although the majority of the ABP accounts perform very well, we have learned that applicants with preexisting credit problems are the least likely to succeed. These are the applicants who "put the cart before the horse." We are pursuing better ways to work with applicants who must not only learn the basics of consumer finance, but also must "unlearn" bad habits and attitudes about financial institutions. For example, credit impaired applicants might do better with a more limited account without check writing, and thus without the risk of overdraft.

Communities Banking for Safety

Many who are unbanked have an even more basic concern than financial security—and that is personal safety. A bank account promotes both. Sadly, people who deal only in cash, rather than keeping their money in a bank, put themselves at risk of violent crime. This is the concern underlying our Communities Banking for Safety Program. In partnership with the Dallas City Police Department, the Mexican Consulate, and other local banks, Bank One participates in ongoing community meetings to promote trust in the United States banking system among immigrants. They often have no comparable system in their home countries, and we help them understand the personal risk they take in carrying cash.

In conjunction with this outreach effort, we have made it easier for Mexican immigrants to qualify for accounts. As with the Chicago ABP pilot, applicants with no or minimal credit history may qualify, and, in deference to the special needs of immigrants, Bank One expanded the list of acceptable forms of ID to include the Mexican Consular ID, commonly called the "Matricula," instead of a driver's license or Social Security card. The Matricula is accepted everywhere Bank One does business, not only in Dallas. And another form of ID, the Mexican Voter Registration card, is accepted as a secondary form of ID. We have sought to reassure undocumented immigrants that we are interested in their safety, not their immigration status. Finally, although financial literacy is not formally a part of the police initiative, Bank One offers bilingual training in that subject.

Although the program began just 2 months ago, several hundred accounts have been opened already as a result of these outreach efforts and the more flexible qualification requirements. This means that several hundred individuals and families now have more personal safety and financial security.

Bank on the Job

It might surprise some Members of the Committee to learn that many unbanked Americans work in regular paying jobs in the mainstream economy. We see the workplace as a very promising arena for both financial education and initiating banking relationships. Last fall in Dallas we initiated a pilot as part of an ongoing program known as Bank on the Job. Through employers, we are offering low-income workers free checking accounts if they sign up for direct deposit of their paychecks. At the same time, representatives from Bank One's Community Investment Department provide onsite training in a variety of subjects including budgeting, managing accounts, saving, and homebuying.

One Dallas employer reported to us that a check cashing truck showed up outside his building every Friday, charging his employees as much as 5 percent of their hard-earned paychecks. The employer was only too happy to partner with Bank One and boost his employees' take home pay. We are finding that with proper guidance many employers are beginning to realize that there are benefits for them, too. A financially secure employee is less distracted on the job and more productive.

Although this began as a Dallas initiative, Bank One now provides financial literacy training in Houston, Tulsa, Fort Worth, and several other cities. We hope to expand this program eventually to all of the markets we serve.

Paycard

Our Paycard Program is another workplace initiative that we undertake in partnership with employers. The program allows companies to pay unbanked employees through credit to a Bank One Visa stored value card. Bank One is currently marketing this product to the employees of some of our large corporate customers, including McDonald's and Lowe's. In early summer, we hope to expand this program to middle market companies.

The Paycard has many advantages for the unbanked. First, it allows employees to circumvent the check cashers. Second, the Paycard is safer than carrying cash because it can be replaced if lost or stolen, enjoying the full protection of Visa's security policy. Third, since the Paycard can be used to make online payments, its use helps to bridge the digital divide. Finally, while a Paycard is not the equivalent of a checking account—its holder is still "unbanked"—we believe that it may alleviate distrust in mainstream financial services and lead card holders to seek out a broader relationship with the issuing bank.

The Role of the Federal Government

Before concluding, I would like to use this opportunity to recognize the leadership of the Treasury Department and this Committee in addressing the problem of the unbanked. Chairman Sarbanes has done so much to raise the profile of this issue and to support efforts to resolve it. The Treasury Department has also demonstrated an ongoing commitment to bringing unbanked Americans into the financial mainstream. In 1999, Treasury introduced the Electronic Transfer Account, or ETA. This program, in which Bank One is proud to be an early participant, provides a basic, all electronic account for the receipt of Federal payments, including salaries and retirement benefits. Now, the Treasury Department is building on that earlier effort with its First Accounts Program. As Assistant Secretary Bair has testified, this program awards grants to organizations—not only financial institutions but community groups, employers, labor organizations, and others—that contribute to the goal of bringing basic financial services to the unbanked.

As I said at the outset, partnership is essential to the success of programs that reach the unbanked in meaningful ways. The First Accounts grants will support partners for future Bank One initiatives and will encourage other financial institutions to undertake programs similar to those I have described here today. Involving more institutions and experimenting with different strategies will help all of us bring more American families into the financial mainstream.

Conclusion

In conclusion, we emphasize Bank One's commitment to helping the 10 million American households who are outside the financial mainstream become full participants in the American economy through a banking relationship. We hope that the experiences we have shared with you today will add to our collective understanding of what works and what does not, and that other institutions will take advantage of this knowledge. Perhaps the most important lesson we can share with the Committee is this: Addressing the needs of the unbanked population will require a sustained team effort involving mainstream financial institutions, community institutions, advocacy groups, and Government. It will require diverse programs, trials and errors, and constant monitoring, reevaluation, readjustment, and redesign. It will be hard work. But we believe it can succeed.

We thank the Committee for inviting us to share our experiences.

PREPARED STATEMENT OF MARVA E. WILLIAMS

SENIOR VICE PRESIDENT
WOODSTOCK INSTITUTE

MAY 2, 2002

My name is Marva Williams. I am the Senior Vice President of the Woodstock Institute. I am grateful to Chairman Sarbanes, Ranking Member Gramm, and other Members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs for this opportunity to discuss expanding opportunities for lifeline banking for lower-income consumers. I am also pleased to join my fellow panelists, the Honorable Sheila Bair, Michael Barr, Fran Grossman, and Jaye Morgan Williams.

The Woodstock Institute, in partnership with Chicago-area banks, is expanding opportunities for lower-income consumers to establish deposit accounts, improve their financial literacy, and develop assets. The Woodstock Institute has a 29 year record of policy research, public education, and technical assistance to promote access to safe and sound capital and credit in lower-income and minority neighborhoods. The Institute has a specialized knowledge of lower-income families' use of financial services and has expertise on the quality and quantity of basic retail services that financial institutions provide to lower-income consumers.

Importance of Lifeline Banking

Limited access to the financial mainstream and poor financial literacy skills are major barriers to asset development. Poor financial literacy has a detrimental impact on personal financial management—affecting the consumer's ability to own a home, find employment, buy a car to get to work, purchase life insurance, rent an apartment, or pay tuition. Consumers without a relationship with a mainstream financial institution also pay high transaction fees at check cashers. According to a Woodstock Institute study, check cashers charge up to three times as much as financial institutions for basic financial services but do not provide key services like savings accounts and financial advice. In addition, some check cashers offer predatory services with exorbitant fees, including payday loans.

Lifeline banking is also the foundation of asset development. Consumers need affordable means to cash checks and pay bills. In addition, retail products enable and encourage savings habits and can help build credit.

Challenges to Lifeline Banking

Prior to developing remedies, we conducted research to identify the reasons that lower-income consumers remain "unbanked" or dissatisfied with mainstream financial institutions. These barriers include:

Limited Access: Bank branches have abandoned many inner-city communities. Bank mergers involving institutions with overlapping branch locations have caused a decline in the number of bank branches per capita in lower-income communities as the newly merged institutions close branches to reduce costs. Further, banks often have inconvenient hours and are not accessible on evenings and weekends. Finally, residents of lower-income communities may also have problems accessing automated teller machines (ATM's). Community Reinvestment Act regulations provide an opportunity to promote increased access. The Service Test, which assesses the market penetration of a bank's retail products, record of opening and closing branches, and other factors. The Service Test examination should be strengthened to include an assessment of the income and other characteristics of a bank's account holders to determine if they are meeting the service needs of their assessment area.

Costs: It can be prohibitively expensive for lower-income people to maintain bank accounts. They may face high minimum balances, initial deposits, or even monthly service fees.

Credit status: Some banks conduct credit checks and scoring for their applicants. Consumers with little or no credit or a slightly blemished credit record can be disqualified from opening a bank account.

Trust: Some "unbanked" consumers may have attempted to access bank services in the past and been repelled for a variety of reasons. Some may worry that financial institutions share account information with others, including creditors. In addition, poor communication regarding account guidelines can also lead to misunderstandings for account holders. Some consumers may feel uncomfortable continuing a relationship with a bank that has denied them a loan.

Financial literacy: Lifeline banking requires significant person-to-person training and education on balancing checkbooks, planning monthly finances, using an ATM, etc. Without the skills to manage accounts, consumers may be faced with high fees for nonsufficient funds and other transactions. They might become frustrated and close their accounts. In addition, some consumers are uncomfortable using electronic technologies that are associated with many lower-cost accounts, including ATM's, Point of Sale terminals (POS), and Internet banking.

Lack of information or poor marketing: Many banks have affordable accounts that are directed to lower-income consumers. However, the account features are not well marketed to lower-income communities and to people are not aware of affordable options.

Lifeline Account Features

Establishing checking and savings accounts with traditional financial institutions can be a major challenge for lower-income consumers. The following features of a model lifeline checking account mitigate the barriers that many unbanked consumers face:

- No credit check
- Flexible ID requirements
- Ten dollars or less opening requirement
- No minimum balance
- No monthly service fee
- No teller charges
- Unlimited check writing
- Free withdrawals from bank-owned ATM's
- Promotion of direct deposit of paychecks and Government benefits

Intermediate Products: Checking account products may not be suitable for all consumers. In fact, one of the reasons that people frequent check cashers is that they serve as one-stop-shops for cashing checks and paying bills. However very few financial institutions provide inexpensive electronic bill payment services. The North Side Community Federal Credit Union, a Chicago community development credit union, and First Bank of the Americas allows owners of savings accounts to pay utilities and other bills electronically.

Woodstock Institute Experiences with Lifeline Banking

Bank One Alternative Banking Program: The Woodstock Institute and the Chicago CRA Coalition negotiated a CRA agreement with Bank One when it purchased First Chicago Bank in 1998. In addition to increasing small business and residential lending and community development grants and investments, Bank One agreed to increase services to unbanked consumers. Working with members of the Chicago CRA Coalition, the bank developed the Alternative Banking Program (ABP). ABP is a safe, convenient, and inexpensive alternative to using check cashing services. Customers who do not meet Bank One's traditional credit scoring criteria, due to borderline credit or no credit history, may be eligible to establish an ABP account due to its more flexible credit scoring criteria.

ABP is not a separate banking product—customers have access to Bank One checking and savings accounts that have features similar to a model lifeline account:

- $10 opening deposit
- Low or no minimum balance
- Low or no service fee
- Unlimited check writing
- Unlimited use of Bank One ATM's
- Some free teller transactions, depending on account
- Free financial literacy training

The account features were designed to address many concerns that lower-income unbanked consumers express. It is low-cost, accessible at all Bank One branches and ATM's, and includes the availability of financial literacy classes for account holders. Further, although applicants with a credit history must have suitable credit scores, people with no or borderline credit may open accounts. In exchange for a more flexible credit scoring criteria, the Bank did establish some modest restrictions on the ABP. However, after 1 year, account holders can apply to upgrade their accounts to traditional account products.

The ABP is not only an innovation for Bank One—it is also a means for bank staff to learn more about providing services to lower-income consumers. Therefore, community reinvestment staff held two focus group meetings with account holders to learn how the program was faring. Focus group participants identified several important concerns, including the need for access to telephone banking to obtain information on account balances and withdrawals, and the importance of providing alternative bill payment mechanisms for savings account holders.

ABP has allowed thousands of consumers, many with no credit record, to establish checking and savings accounts. In addition, the Bank has cross-sold other products to ABP customers, including consumer loans, certificates of deposit, and installment loans. ABP has also influenced the establishment of more flexible criteria for other Bank One retail accounts. However, ABP is only available at eight branches in the city of Chicago, and should be expanded to reach more unbanked consumers.

Financial Literacy and Lifeline Banking Partnerships: The Coalition has also developed relationships with Fifth Third Bank, Charter One Bank FSB, and LaSalle Bank. Unlike Bank One, these banks have accounts that meet many of the criteria for lifeline checking accounts. In these cases, the Chicago CRA Coalition helped the banks to (1) develop financial literacy curricula suitable for lower-income consumers, and (2) establish relationships with community partners to identify workshop topics and market and cosponsor workshops.

These efforts have resulted in the integration of financial literacy programs within each bank's retail banking divisions. Fifth Third retail management staff have joined with community reinvestment staff to offer financial literacy programs and have developed several creative marketing and program partnerships with community organizations. Charter One retail and community reinvestment staff have participated in "train the trainer" financial literacy workshops offered by a local cooperative extension office and are currently developing a financial literacy curriculum.

LaSalle and the Coalition developed an exemplary financial literacy curriculum that addresses the financial management concerns of lower-income consumers. The Chicago CRA Coalition also helped LaSalle establish a very fruitful partnership with Chicago Commons. Chicago Commons is a multiservice settlement house that provides job-training services through its Employment and Training Service Center (ETC) to lower-income people moving from welfare to work. The Bank teaches its financial literacy curriculum in eight classes over a period of about 2 weeks. Approximately 32 students participate in each course, which culminates in a trip to a local LaSalle branch where accounts can be opened. The partnership is ongoing.

Community Development Credit Unions: Community development credit unions (CDCU's) focus on providing financial services and loans in lower-income communities. The Woodstock Institute has documented several innovative financial service partnerships developed by CDCU's.

Central Appalachian Peoples Federal Credit Union operates in 23 rural counties that are among the poorest and least educated in the Nation (see Figure 4). Isolated from larger cities, the community is poorly served by traditional financial institutions and unemployment is high. The credit union leverages deposits with Government and private funding to provide much needed access to home mortgages, small business and consumer loans, and deposit services.

Northeast Community Federal Credit Union (Northeast Community FCU) provides a safe place to save for lower-income San Franciscans. Organized in 1981, the credit union is committed to serving the unmet financial needs of low-income community residents, many of who are recent immigrants or refugees from cultures where financial institutions are not accessible or trustworthy. Further, some members are concerned that maintaining a deposit account will violate citizenship or immigration regulations. Northeast Community FCU works with local community organizations to provide financial literacy regarding the practices of U.S. financial institutions. It also educates members about the disadvantages of taking out high cost loans that are heavily marketed in this community.

Since its founding in 1981, Quitman County Federal Credit Union (Quitman County FCU) has focused on reaching its African-American, low-income community base. The membership is largely made up of single women, minorities, and public aid recipients. Quitman County FCU also manages a youth credit union program that not only helps young people save but also encourages them to serve their poverty-stricken community in rural Mississippi. Its members run the Youth Credit Union. They elect their own Board, hold monthly meetings, and operate various committees to manage the credit union's affairs. The Youth Credit Union Program offers financial workshops that explain the hazards of using subprime lenders, manual and computer bookkeeping and accounting techniques, and checkbook balancing among other financial topics.

Lessons in Lifeline Account Programs

Financial Literacy: Barriers related to trust, low financial literacy, and marketing can be addressed through effective financial literacy training. Banks should work in partnership with the community and other nonprofit organizations to provide financial literacy workshops and counseling. The workshops should include the following topics:

- Budgeting and personal finance management skills.
- Tools to make informed decisions when choosing accounts, applying for loans, or credit cards, etc.
- Skills needed to manage accounts, such as balancing checkbooks, managing funds availability timetables, and using electronic banking services.
- Information on investment and savings options.

Program Marketing: Financial institutions' marketing of these new products should include not only information on account features and advantages, but should also include outreach and information on how the products are preferable to check cashers and the other benefits of a mainstream banking relationship. In addition, marketing strategies should be developed with community-based organizations and in cooperation with organizations involved in consumer credit issues. Targeted marketing efforts, such as community newspapers and radio ads, should be considered as well.

Program Diversity: It is also important to understand that there is a diversity of "unbanked" consumers. For instance, minority consumers are more likely than other consumers to be dissatisfied with the quality of their financial services are. When asked by a 1999 survey (conducted by the Metro Chicago Information Center) how well their banking needs were being met, 16 percent of African-Americans and 25 percent of Latinos responded "not too well" or "not at all," compared to only 7 percent of whites. Recent immigrants often experience great difficulty developing savings. Many have poor literacy skills, distrust financial institutions or may have concerns about their legal status that keep them isolated.

Bank Staff: A major component of the success of the program hinges on the enthusiasm of bank staff to work with lower-income consumers. For instance, one of the recruitment techniques is for tellers to encourage people who cash checks at the bank to apply for checking or savings accounts. Banks should use their in-house communication mechanisms to inform staff of new programs and branch managers should hold short orientation meetings with customer service staff explaining the importance of the bank's efforts to address the financial service needs of its community. Management should also set performance goals and incentives.

Reducing Consumer and Bank Expenses: Inexperienced account holders should have accounts that allow some protections from NSF fees. Further, many retail account products are not profitable. According to one expert on financial services, financial institutions make 80 percent of their profit on retail products from only 20 percent of their customers. Therefore, it is also important to consider how banks can cut costs:

- *Phone banking:* Banks should provide information on account balances and other account activity by phone so that account holders can avoid NSF fees. This will also reduce teller expenses.
- *Electronic access:* Banks can also improve services and decrease costs by enabling low-income consumers to conduct financial transactions electronically. Services may include Internet banking, smart ATM's, electronic bill payment and money order machines and debit cards.
- *No overdrafts:* All checks that will cause a negative balance should be returned.
- *Limit withdrawals:* ATM withdrawals should be limited to $50/day.
- *Funds availability:* Account holders may not be able to access funds deposited by check for up to 2 business days. However, immediate access should be allowed for cash and direct or electronic deposits.
- *Second-day approval for new accounts:* To reduce criminal exploitation of lifeline accounts, banks should impose a waiting period of 24 hours to establish new accounts. This will allow the bank to more fully investigate applicants and deter fraud activity.

Account Disclosures: It is important that consumers understand account provisions. Therefore, they should be translated from "legalese" into standard language, making it understandable for readers of all levels. In addition, many of the materials should also be translated into Spanish or other languages as appropriate.

CRA Service Test: In 1995, the Community Reinvestment Act (CRA) was amended to concentrate on bank performance in three areas: lending, investment, and services. Creative and innovative bank products and services, such as the establishment of lifeline accounts and financial literacy workshops, can help a bank achieve a satisfactory rating under the Service Test. Further, the Woodstock Institute encourages the strengthening of the Service Test by requiring banks to collect and report information on the income and race of deposit account holders.

PREPARED STATEMENT OF RUFINO CARBAJAL, JR.

MANAGER, WEST TEXAS CREDIT UNION

ON BEHALF OF

CREDIT UNION NATIONAL ASSOCIATION (CUNA)

MAY 2, 2002

Good morning, Chairman Sarbanes, Senator Gramm, and Members of the Committee. I am honored to appear before you this morning to present testimony on the plight of the "unbanked" and "underserved." I am Rufino Carbajal, Jr., Manager of the West Texas Credit Union, a $34 million credit union serving over 11,000 members in El Paso, Texas. I appear before you today on behalf of the Credit Union National Association (CUNA), which represents over 90 percent of the Nation's approximately 10,400 State and Federally chartered credit unions and their 82 million members.

In announcing this hearing, Chairman Sarbanes indicated that approximately 10 percent of households in the United States are 'unbanked,' and that most of these individuals "predominantly come from low-income households and often must utilize high-cost services offered by fringe financial service providers in order to conduct routine transactions such as check cashing and bill payment. In addition, the 'unbanked' have had a difficult time establishing traditional forms of credit, receiving bank loans, acquiring financial assets, and saving for the future."

I am uniquely positioned to address these concerns. As manager of my credit union for 26 years, I have been a pioneer in and become an authority in serving the underserved. Even when I was the only employee of the credit union, I realized that there was a need to serve the underserved community of El Paso, which is one of the poorest Metropolitan Statistical Areas in the Nation. I originally served the membership of the Tri-State Wholesale Associated Grocers, but after the association ceased operations, Tri-State merged with West Texas Credit Union. Our field of membership now serves many blue-collar workers, such as those in the garment industry and the Ysleta Del Sur Pueblo reservation. Over the years, I have served as a mentor for many credit unions even smaller than ours, and I have been a consultant for credit unions in Guatemala and for the World Council of Credit Unions (WOCCU).

My testimony this morning will focus not only on the efforts of West Texas Credit Union to serve the underserved, but on those of credit unions across the Nation as well. I will describe several programs designed to attract and retain the unbanked, including efforts to help credit unions get involved in the First Accounts Program.

First Accounts

I am pleased that a major focus of this morning's hearing is the implementation of the First Accounts Program.

CUNA is strongly committed to the principle of access to financial services by consumers, including those of modest means, and supports the First Accounts Program, which is designed to make basic financial institution accounts available to low- and moderate-income consumers.

According to the Federal Reserve Board's 1998 Survey of Consumer Finances and the Treasury Department's Notice of Funds Availability regarding First Accounts, almost 1 family in 10 in this country does not have a share draft/checking account or a savings account. These families generally have annual incomes of less than $25,000.

There are many reasons why an individual may not have an account with a financial institution. These include lack of awareness about the importance of efficient management of their financial resources—however meager—and how institutions, like credit unions, will provide financial counseling, education, and guidance to help individuals develop financial plans to maximize their funds and plan for the future. Financial education is a hallmark of the credit union system and credit unions offer such education through a variety of programs that are described throughout my testimony.

Individuals, such as immigrants, may also be reluctant to approach a financial institution because they fear they lack proper documentation. This may become even more problematic as the Treasury Department implements the "Know Your Customer (Member)" rules under the USA PATRIOT Act. We urge Congress and Treasury to ensure these rules will not have a chilling effect on the ability of immigrants to fully participate in our society, including through the use of financial institutions. We further urge Congress and Treasury to allow institutions to rely on documents such as Matricula issued by the Mexican Embassy's local offices in this country to verify an individual's identity.

Without access to these very basic services, such individuals are severely limited in the choices they have to conduct the business of their daily lives. They are likewise disadvantaged in preparing for the future. Recognizing there is a role for the Federal Government to play in helping to address this situation, Congress has appropriated $8 million for the First Accounts Program implemented by the Treasury Department.

Under the program, Treasury will provide grants to eligible entities, such as insured credit unions, to offer low-cost savings and share draft/checking accounts to low- and moderate-income consumers. Such accounts could be offered electronically, such as through an ATM, and ideally would also be accompanied by financial education to encourage the use of the account and highlight its advantages.

We are gratified that Treasury has reached out to credit unions to apply for the First Accounts. CUNA President & CEO Dan Mica and the senior staff met with

Assistant Secretary for Financial Institutions Sheila Bair in March, and she strongly encouraged credit unions, as well as other financial institutions, to seek grants through First Accounts.

In fact, West Texas Credit Union is one of 39 credit unions in 13 States included in the application of CUNA's National Credit Union Foundation. Over 2 million unbanked consumers reside in communities served by this application. The Foundation has requested $3.7 million to fund a program that will provide banking services to over 28,000 unbanked consumers over a period of 24 months. Participating credit unions have pledged to invest $1 million into our First Accounts Program.

The Foundation's First Accounts Program covers a vast array of approaches. Some credit unions, notably those in New York and Michigan, have formed strategic partnerships with universities (Cornell University and the University of Michigan) to provide the financial literacy components of the program. The credit unions will provide the financial services.

The Foundation's First Accounts Program has several themes: (a) there is a strong orientation toward serving the unbanked African-American and Latino consumer; (b) the application covers urban communities of Los Angeles, Seattle, Portland, and New York to rural communities located in South Dakota, Iowa, and Idaho.

The Foundation's application also attempts to reach out to several distinctive audiences. For example, in Iowa an applicant will seek to use first accounts funds to provide financial services to the large influx of Bosnians and Hispanics through community partnerships. In Michigan, the applicant will use first accounts funding to provide financial services to persons with disabilities and other low-income individuals.

In short, the Foundation program model is rich in creativity, diverse in categories of persons who will be served, and national in scope.

Remittances

You may recall this Committee's hearing on February 28 regarding the status of international remittances. CUNA and WOCCU submitted a statement for that hearing's record which provided details about the desperate need for affordable remittance services, the difficulties in providing these services, and the industry-leading efforts of credit unions in this area.

As you learned from that hearing, there is a growing population of Hispanic and other individuals in this country who for one reason or another are not able to utilize traditional financial institution services. These individuals frequently send their hard-earned pay to their parents, children, brothers, and sisters in Mexico or other homelands. Those who do not have access to a credit union or other financial institu-tion must use wire services that charge outrageously high fees to execute the transaction.

I am proud to say that West Texas Credit Union has been offering its members the opportunity to wire money back to Mexico and uses the WOCCU service called International Remittance Network (IR*Net*®). This service saves our users at least one-third the cost of using a high-cost money transfer agent. Our credit union has many individuals in our field of membership with familial ties to Mexico, and we know they send funds to relatives in Mexico using wire transfer services that charge as much as 28 percent of the amount transferred. By providing IR*Net*® services, we offer members an inexpensive way to wire money to family in Mexico, or in 42 other countries, at an affordable price. For peace of mind, members also receive a free 3 minute phone call to inform the recipient of the transfer. The program has shown moderate success.

CUNA's February 28 statement noted that while many credit unions are leading the way in ensuring that immigrants have access to affordable remittance and financial services, these efforts could be significantly enhanced if Congress would amend the Federal Credit Union Act to allow credit unions to provide these services to nonmembers within the field of membership. I am very excited that the House of Representatives has initiated legislation to do just that. H.R. 3951, "The Financial Services Regulatory Relief Act of 2002" provides credit unions the authority to sell travelers checks and cash checks for nonmembers within their field of membership. And H.R. 4612, "The Expanded Access to Financial Services Act," would allow the same authority, as well as provide credit unions the opportunity to provide wire transfer and money order services to nonmembers within the field of membership.

Having the authority to cash checks and provide wire transfer services to nonmembers within the field of membership would further enhance the ability of credit unions to reach the "unbanked" and "underserved" and provide an affordable and financially sound alternative to high-cost payday lenders. It would allow credit unions to play an even more important role in combating predatory lending practices. And by getting the "unbanked" in the door with these services, we would hope to gain their trust, respect, and loyalty so that they would join the credit union as full-fledged members.

Individual Development Accounts (IDA's)

I am proud that West Texas Credit Union is one of many credit unions that are among the leading providers of Individual Development Accounts (IDA's). Referring again to Chairman Sarbanes' announcement of the purpose of this hearing, one of the issues referred to was the inability of the "unbanked" to acquire financial assets and save for the future. If ever there was a product developed to serve exactly that purpose, it is the IDA. And if ever there was an institution developed to provide these accounts, it is the credit union, whose mission of "People Helping People" fits perfectly with the goal of IDA's.

IDA's are savings accounts with the added benefit of matching funds by Government and private organizations. Participants must meet certain requirements such as, income qualification (usually 200 percent below the poverty level), and attendance at educational sessions. Each participant sets a savings goal for a specific purpose. The funds can only be used for the purposes of buying a first home, education, and/or to start a small business.

West Texas Credit Union, in partnership with El Puente Community Development Corporation (CDC), began offering IDA's in October 2001. El Puente CDC is a nonprofit organization. It provides new sources of social, educational, and economic opportunity such as enterprise development, bilingual on-the-job training and access to technology, and promotes community revitalization through building the capacity of individuals and families to decide and design their futures. Once a participant reaches his or her goal, El Puente CDC will authorize the withdrawal of the funds for the above-stated reasons. But before the funds are withdrawn the account holder must complete a course in financial literacy.

Legislation currently before Congress would greatly enhance the number of IDA's in existence within credit unions and other financial institutions. The Savings For Working Families Act (SWFA) has been introduced both as a free-standing bill and incorporated within other legislation. The House has passed its charitable giving bill, which includes the SWFA, while S. 1924, the CARE Act, includes it in the Senate. The CARE Act is currently pending before the Finance Committee. Essentially, the SWFA would provide tax credits for matching funds to IDA's, dramatically increasing the market for IDA's. I urge the Senate to support this very important initiative.

Financial Literacy

Credit unions recognize that it is necessary to offer some form of financial literacy training to successfully integrate the "unbanked" into the financial mainstream. We also believe that similar to a "continuing education" requirement for many professionals such as doctors and lawyers, consumers require similar continuing financial education to help them navigate the many pitfalls and opportunities available to them. As detailed in CUNA's statement for the record of this Committee's February 6 hearing on Financial Illiteracy, that is why credit unions have traditionally made financial education a part of their mission. Credit unions, including West Texas, provide financial information and training to members on a one-to-one basis. Many credit unions, including West Texas, actively work in schools to teach personal finance skills to children and teenagers. CUNA has formed a national partnership with the National Endowment for Financial Education (NEFE) to teach the High School Financial Planning Program® to high school seniors across the Nation. And financial literacy is another aspect of providing Individual Development Accounts (IDA's), described above, which are also available through many credit unions in addition to West Texas.

Throughout the course of the year, we participate in several programs that bring financial awareness to our members. Every spring we organize a Credit Fair. We bring together the Consumer Credit Counseling Services and the Credit Bureau of El Paso to advise members on building and maintaining good credit. Other topics include the following: learning to be debt free, how to live within your means, and how to save for the future. We have a good turn out every year and our members show gratitude for the added convenience of bringing these services to them.

In order to promote International Credit Union Day, in October, and National Credit Union Youth Week, in April, we have participated in local high school presentations. In these presentations we teach the importance of financial literacy to our youth. We cover topics such as, "Time Is On Your Side," which explains the benefits of saving at an early age. Money management is emphasized. We review a "good" credit report and a "bad" one, while explaining why it is important to maintain "good" credit. Students, as well as teachers, are grateful for our involvement with the youth.

Every quarter in our bilingual newsletter we include articles that increase our members' financial awareness. We try to tackle issues that are of interest to our members and affect our community.

Affordable Housing Program

In the year 2000, a study was performed by a group of professors from New Mexico State University. The study indicated that a substantial market exists in El Paso County for affordable housing which is not being served. As previously mentioned, El Paso is one of the poorest Metropolitan Statistical Areas in the Nation.

With grant money from CUNA's National Credit Union Foundation and the Texas Credit Union League State Credit Union Foundation, eight credit unions located in El Paso County, Texas, chartered and wholly own the El Paso Affordable Housing Credit Union Service Organization (AHCUSO). The AHCUSO is an affordable mortgage and homeownership-counseling agency. AHCUSO's mission is to provide financial literacy and homeownership counseling to thousands of low-income El Paso county residents.

The AHCUSO has partnered with the El Paso Housing Authority and has committed $1.8 million to the financing of affordable homes, of which approximately $500,000 has been closed. HUD provides down payment assistance, and the financing and servicing is being done by the AHCUSO.

Presently, negotiations are going on with Fannie Mae in an effort to get them to relax their underwriting criteria in order to provide more affordable housing to the El Paso community.

Credit Unions Combat Predatory and Payday Lenders

Over the past decade, high-cost credit facilities, such as payday lenders and subprime mortgage lenders, have flourished across the country, particularly in the underserved areas. Unfortunately, many of these lenders incorporate predatory practices into their programs, such as exorbitant fees and interest rates, frequent "flipping" of the loans to needlessly increase costs, undisclosed balloon notes and unnecessary insurance premiums.

Credit unions have stepped up their efforts to combat predatory lenders in neighborhoods by offering affordable alternatives for both payday loans and mortgage loans. A "payday loan" refers to the use of a post-dated check to receive a small loan until the next payday. Generally, the annual percentage rate for a payday loan is more than 400 percent.

The demand for these payday loans continues to increase, and *there are now more payday lenders across the country than credit unions.*

To reverse this disturbing trend, credit unions have developed affordable alternatives to the high-cost payday loan. For example, some credit unions offer their members up to $300 at 18 percent with up to 6 months to pay back the loan, as long as the member has direct deposit. Some credit unions offer emergency loans, for specific purposes, with no fees or interest attached. Some credit unions have opened facilities in underserved neighborhoods to offer not only small unsecured loans, but also low-cost check cashing, affordable money orders, bill-paying services, bus tokens, and free credit counseling.

Credit unions also have developed a variety of subprime lending programs to help consumers build credit, get into homes with as little as 1 percent down, and pick up smart credit habits as they reduce their loan rates. For example, one credit union program offers subprime loans at 2 percent or 4 percent above normal rates, depending on collateral. The credit union drops this subprime rate to the prime rate when the borrower has made 12 on-time payments.

Another credit union program offers its subprime borrowers several ways to reduce their interest rates. For example, attending one consumer credit counseling class reduces the rate by ½ percent; attending more than one class will reduce the rate by 1 percent; depositing $15 a month into a savings account for a year reduces the rate by ½ percent; and for each year the debt does not increase, the rate drops 1 percent.

In cities like El Paso, predatory lending practices have reached epidemic proportions. Credit unions are uniquely positioned to help combat these practices, particularly if given additional tools to do so.

Finally, CUNA applauds Chairman Sarbanes and other Members of the Committee for your commitment to eliminating predatory lending practices through the introduction of "The Predatory Lending Consumer Protection Act of 2002." We look forward to reviewing the details of the bill and working with the Committee staff to support the passage of an effective antipredatory lending law.

Conclusion

In conclusion, on behalf of CUNA, I am grateful for the opportunity to have commented on the plight of the "unbanked" and "underserved" and how West Texas Credit Union and credit unions across the country are trying to reach out and bring them into the financial mainstream. There is no more pressing need in my opinion, for it is only through economic opportunity that we can solve many of the problems facing our Nation's poorest and most deprived individuals. I have witnessed first-hand that poor people want to work and know even with a little bit of savings they can grow and thrive. Whether it is through the First Accounts Program, affordable housing programs, enhanced IDA's, expanded opportunities to serve their communities, or financial literacy, credit unions stand ready to meet this very important challenge.

STATEMENT OF CLIFFORD N. ROSENTHAL

EXECUTIVE DIRECTOR

NATIONAL FEDERATION OF COMMUNITY DEVELOPMENT CREDIT UNIONS

MAY 2, 2002

The National Federation of Community Development Credit Unions (NFCDCU) is a nonprofit association that represents those credit unions with the specific mission of serving low- to moderate-income communities. Many of the people served by our credit unions come from the ranks of the "unbanked." They are people whose "life savings" sometimes hover in the double digits, who live from paycheck to paycheck and cannot afford the high fees that most banks would charge customers with their modest balances. Some are recent or longstanding immigrants.

Our 215 member community development credit unions (CDCU's) are found in 40 States, the District of Columbia, and Puerto Rico. They serve more than a million people living in urban, rural, or reservation-based communities. They have served unbanked American communities for as long as 70 years.

In the last decade, several Federal initiatives have begun to aid CDCU's in our work of providing financial services to the unbanked. The Community Development Financial Institutions (CDFI) Fund, in particular, has made a dramatic difference in the ability of some of our credit unions to reach out far more widely to the unbanked. CDFI Fund assistance has enabled them to open branches in places like San Francisco's Tenderloin district (Northeast Community FCU), in a farmworker community of Watsonville, California (Santa Cruz Community CU), in the South Bronx (Bethex FCU) and the Lower East Side (Lower East Side People's FCU) of New York City. It has enabled a county-wide credit union in Mississippi (Quitman/Tricounty FCU) to add two more counties to its service area, and has enabled a credit union that serves the Navajo and other reservations to add electronic services. Many of these changes would have been impossible without the CDFI Fund. For this reason, it is vital that the Senate Banking Committee, in reviewing service to the unbanked, add its voice in support of increased appropriations for the CDFI Fund.

The First Accounts Program through the U.S. Treasury is an intriguing and a potentially important initiative. Our organizations, like many others, applied to the First Accounts initiative of the Treasury Department. Regardless of whether we are successful, we commend the Treasury Department for encouraging creative, diverse approaches to delivering services to the unbanked. Since this is the first effort of its kind, we will look forward with interest to the results of the Treasury Department's award program. Inevitably, revisions and more precise targeting of the program will be required after the initial round. But we encourage the continuation of this significant effort.