October 8, 2009

Report of FDIC's Advisory Committee on Economic Inclusion February 5, 2009 Meeting

On February 5, 2009, the FDIC's Advisory Committee on Economic Inclusion ("Advisory Committee") met to explore strategies to increase access to the financial mainstream. Improving access to banks and other mainstream financial institutions can enable households to safely conduct financial transactions at a reasonable cost and provides households with opportunities to save, build a good credit record, borrow, and invest. However, the Advisory Committee is concerned that current economic problems – record foreclosures, declining household net worth, the largest annual decrease in jobs since World War II, and what is emerging as a reshaping of our financial system – will force more households to leave the financial mainstream, and may discourage mainstream institutions from reaching out and serving unbanked and underbanked consumers.

Estimates vary regarding the actual number of households that are not fully participating in the mainstream financial system. However, a commonly cited statistic shows that more than 10 million U.S. households are "unbanked" because they do not have a bank account.[1] Moreover, many more households are considered "underbanked" in that they continue to rely on non-bank, alternative financial services providers for their financial needs, often at a very high cost.[2] There are underserved households at all income levels; however, a large body of research shows that lack of participation in the financial mainstream is more common for low- and moderate-income (LMI) households.[3]

During the meeting, the Advisory Committee examined the findings of the FDIC's Survey of Banks' Efforts to Serve the Unbanked and Underbanked, including the challenges to reaching out to the underserved, and policy and practical approaches to overcoming those challenges.[4] Additionally, the Advisory Committee heard from a number of experts from banks, community groups, and other organizations on specific products and strategies aimed at underserved and LMI consumers. Many of these experts are also active in the FDIC's Alliance for Economic Inclusion (AEI), a grass roots initiative of organizations in 11 markets across the country that works to

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[1] Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach and Kevin B. Moore, Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, vol. 95, pp. A1-A55 (February 2009) available at http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf.

[2] "The CFSI Underbanked Consumer Study: Underbanked Consumer Overview & Market Segments Fact Sheet" Center for Financial Services Innovation, June 8, 2008, available at http://www.cfsinnovation.com/underbanked-study-detail.php?article_id=330525. This report indicates that unbanked and underbanked households together may total 40 million.

[3] See, for example, The New York City Department of Consumer Affairs, Office of Financial Empowerment, "Neighborhood Financial Services Study: An Analysis of Supply and Demand in Two New York City Neighborhoods" (June 2008) available at http://www.nyc.gov/html/ofe/downloads/pdf/NFS_Compiled.pdf and Ellen Seidman, Moez Hababou, and Jennifer Kramer, The Center for Financial Services Innovation, "Getting to Know Underbanked Consumers: A Financial Services Analysis" (September 2005) available at http://www.cfsinnovation.com/managed_documents/seg.pdf.

[4] See http://www.fdic.gov/news/news/press/2009/pr09015.html for the survey's executive summary.

improve access to the financial mainstream. The AEI has been tremendously successful thus far, with nearly 1,000 members and over 85,000 accounts opened to date.[5]

The purpose of this report is to relay views of Advisory Committee members on the issues and challenges discussed at the February meeting. The Advisory Committee met on July 30, 2009 and received and approved this report. The Advisory Committee is aware that the FDIC does not have the ability to directly implement or influence all of the issues and challenges set forth below, particularly those related to legislation. Members of the Advisory Committee hope that this report will spark discussion of how best to serve underserved consumers who may be struggling, particularly in the current economy. The purpose of the Advisory Committee is to provide the FDIC with advice and recommendations on important initiatives focused on expanding access to banking services by underserved populations. As Advisory Committee members, we believe that it is crucial for policymakers and others to consider the impact on the underserved population as decisions are made regarding broader responses to this nation's economic problems. We would like to take this opportunity to thank the staff at the FDIC, notably Rae-Ann Miller, Roberta McInerney, Ruth Amberg, Luke Reynolds and Bob Mooney, for their excellent support in moving this work forward.

PRODUCT, POLICY, AND REGULATORY ISSUES

1. **Defining a national shared government/industry goal to lower the number of underserved households should be considered**. A national task force comprised of representatives across the financial services industry as well as senior representatives of federal bank and thrift agencies could be charged with formulating and overseeing a broad national plan to decrease the level of underserved households. This effort would need to rely on reliable and readily reported statistics on the number of unbanked households in the U.S. The statistics can be based on the results of a new survey effort regarding underserved households that was conducted jointly by the FDIC and the U.S. Census Bureau as a supplement to the Census Bureau's Current Population Survey in January 2009.[6] To ensure reliable statistics going forward, collecting information about underserved households could be made a regular part of the Current Population Survey.

2. **Mainstream financial institutions should be encouraged to provide safe and reasonably-priced alternatives to traditional bank accounts for underserved and LMI consumers.** Charges associated with overdrafts can make traditional transaction accounts too costly for underserved and LMI consumers. Additionally, minimum balance requirements and limited functionality make traditional savings accounts unattractive to many underserved consumers. A more appropriate "starter" account for underserved individuals would likely restrict the writing of checks, not allow overdrafts, and be fee-based, rather than require a minimum balance. Ideally, the account should allow for direct deposit of paychecks and other income streams and provide an efficient

[5] See http://www.fdic.gov/consumers/community/AEI/ for a summary of the FDIC's AEI.
[6] The survey results are currently being analyzed.

method for automatic savings. Banks, consumers, and others have reported that prepaid debit card technology is a useful platform for delivering starter accounts to the underserved.

3. **Reasonably priced credit products that meet the emergency cash needs of underserved and LMI populations should be encouraged.** Because underserved and LMI households often do not qualify for or are not aware of traditional bank loan products, they frequently turn to products offered by non-bank, alternative financial services providers for their short-term credit needs or incur substantial overdraft fees. Payday loans, car title loans, pawn loans, and similar products often cost much more than bank loan products, and repeated use of these products can lead to interest and fees that are much higher than the original amount borrowed. Similarly, some traditional bank loan products, such as high-rate credit cards or repeated use of fee-based overdraft protection programs, can be difficult for underserved and LMI consumers to manage. A more appropriate credit product for these consumers could be a reasonably priced, small-balance bank loan. Ideally, these loans would also feature realistic repayment periods, longer than a pay cycle, and could be linked with savings products or delivery of financial education.[7]

4. **Saving by LMI and underserved consumers should be encouraged, particularly through products that make saving automatic.** LMI consumers not only have low incomes, but often have few or no assets because virtually all of their income is needed to support household expenses. Without even a small financial cushion, it is extremely difficult to overcome temporary setbacks, let alone build for the future. A simple, effective, and automatic way to encourage saving is to promote direct deposit of payroll or other income streams (such as tax refunds). Further, allowing consumers to split these deposits into multiple accounts enables LMI consumers to create a savings habit and build an emergency financial cushion by setting aside at least a small amount of their paycheck or other income. Incorporating emerging technologies – such as stored value cards, mobile phone technologies, or social networking applications – into automatic savings products should be encouraged where feasible and safe for consumers.

5. **More emphasis on the service test in Community Reinvestment Act (CRA) evaluations of banks that serve underserved and LMI populations should be considered.** The way a bank receives positive consideration under CRA for serving LMI and underserved consumers in its assessment area is dependent upon the size of the bank. Currently, in general, consideration of service activities is only mandatory for institutions

[7] To explore alternatives to costly short-term credit products, the FDIC is conducting a two-year pilot project to identify effective and replicable business practices to help banks incorporate affordable small-dollar loans into their other mainstream banking services. Banks participating in the pilot have reported that they believe their small-dollar loan programs are an important way to serve their communities and create goodwill for their banks. Most of the bankers view small-dollar loan programs as a long-term strategy intended to attract customers and create relationships. See the Small Dollar-Loan Pilot Program available at http://www.fdic.gov/smalldollarloans/ for a summary of the pilot.

subject to large bank procedures under the CRA.[8] For institutions subject to the "intermediate small bank" procedures, the extent to which the bank provides services under the community development test is evaluated for responsiveness to community development needs. Banks evaluated under small bank procedures that meet all of the standards for a "Satisfactory" rating under the lending test may request evaluation of the bank's record of providing branches and other services to achieve an overall "Outstanding" rating. Mandating the service test for banks of all sizes may provide additional clarity and regulatory incentives to serve LMI and underserved consumers.

6. **Better calibration of standard risk management tools and bank policies to measure the actual risk of serving underserved and LMI consumers should be strongly encouraged.** Some banks have policies that prevent them from opening any accounts for consumers who do not meet certain criteria, such as a minimum credit score or who fail commercially available credit screens, like ChexSystems™.[9] While these policies may be appropriate to limit risk in credit or transaction accounts, banks should review whether exceptions are appropriate for savings accounts and other bank products that foster asset-building, particularly for underserved and LMI consumers.

LEGISLATIVE ISSUES

7. **Tax-based and other incentives for banks and others that serve underserved and LMI consumers should be considered.** A common barrier banks and other companies cite for not doing business with underserved and LMI consumers is the lack of potential for profit. Unlike customers typically serviced by banks, underserved and LMI consumers are frequently unable to keep large account balances and often do not qualify for most mainstream credit products. Therefore, it can be difficult for banks to recapture the cost of acquiring and maintaining underserved and LMI consumers. One solution discussed could be a tax credit designed to offset at least a portion of these costs. This could be an important monetary incentive for banks and others to pursue these consumers. Other monetary incentives could involve reducing compliance reporting requirements for certain laws and regulations to reduce costs for service providers, while maintaining important safeguards for individual consumers and the financial system at large.

8. **The unintended consequences of certain banking laws on underserved and LMI consumers should be reviewed.** Funds availability laws, in particular, may adversely

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[8] 12 U.S.C. § 2903(a). For purposes of CRA, a "large" bank is currently one with assets over $1.109 billion. Intermediate small bank means a small bank with assets of at least $277 million and less than $1.109 billion. 73 Fed. Reg. 78153 (December 22, 2008).

[9] "The Chex Systems, Inc. network is comprised of member Financial Institutions that regularly contribute information on mishandled checking and savings accounts to a central location. ChexSystems shares this information among member institutions to help them assess the risk of opening new accounts." See The Consumer Debit Resource available at https://www.consumerdebit.com/consumerinfo/us/en/index.htm for more information.

affect some consumers.[10] These laws have been enacted to ensure the safety and transparency of the federal payments system. However, for some underserved and LMI consumers, funds availability laws may not be fully understood and curtail the ability to immediately access their funds, causing them in some cases to use check cashing services as an alternative to bank accounts. Carefully designed "carve-outs" to funds availability laws or other laws, as appropriate, might be considered to minimize adverse affects on underserved and LMI consumers.

9. **Instituting a universal curriculum of financial education in schools should be adopted.** Research has revealed that financial education programs can positively affect consumers' money management attitudes and behaviors and improve their overall financial condition.[11] Yet, most current financial education programs are "reactive" in that they are delivered after consumers have become financially troubled. Mandating financial education in schools, perhaps by conditioning promotion to the next grade level on its successful completion, could prevent many consumers from encountering financial difficulties. At the same time, it is important to remember that financial education should be provided at "teachable moments" over a person's lifetime, as a single financial education course in school, while important in starting positive habits at an early age, is not sufficient to help consumers navigate the complex, changing financial marketplace as they make financial decisions years later.

10. **A distinct federal entity whose mission would be protecting all consumers, including underserved and LMI households, from potentially harmful financial products should be adopted.** Similar to the U.S. Consumer Product Safety Commission, the government should establish an agency to set a floor for guidelines related to consumer disclosure, collect and report data about the uses of different financial products, review new products for safety (with a focus on those most likely to cause serious harm, such as major credit products), and require modification of problematic products before they can be marketed to the public. The agency should review credit, deposit, and other financial transaction products. It should also exercise jurisdiction over life insurance and annuity contracts. In effect, the agency will evaluate these products to eliminate the opaque practices that make some of them far more problematic than others, and ensure that none pose unacceptable risks to consumers.

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[10] Federal funds availability laws and regulations are set forth at 12 U.S.C. §§ 4001-4010, 12 U.S.C. §§ 5001-5018, and Federal Reserve Board Regulation CC at 12 C.F.R. pt. 229. Some states also have funds availability laws.

[11] See Susan E. Burhouse, Angelisa M. Harris, and Luke W. Reynolds, FDIC Quarterly, Quarterly Banking Profile, Second Quarter 2007, "Banking on Financial Education," Volume 1, Number 2 (June 2007), available at http://www.fdic.gov/bank/analytical/quarterly/2007_vol1_2/FDICQuarterlyV1N2_web.pdf.