

EFT Requirements of the Debt Collection Improvements Act of 1996 and the Use of ETAs

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Testimony written and presented by Margot Saunders, also on behalf of Consumer Federation of America, Consumers Union, U.S. Public Interest Research Group

Madame Chairwoman and Members of the Committee, the **National Consumer Law Center**¹ thanks you for inviting us to testify today regarding the implementation of EFT-99 and its effect on the unbanked recipients of federal payments. We offer our testimony here today on behalf of our low income clients, as well as the **Consumer Federation of America**,² **Consumers Union**,³ and the **U.S. Public Interest Research Group**.⁴ This is an issue in which we are all vitally interested.

Treasury has accomplished a considerable amount on EFT 99 in the past few years. Treasury has established an excellent waiver system by which federal recipients can opt out of electronic payments and the Department has aggressively ensured that no recipient is led to believe that it is necessary to have a bank account in order to receive federal payments -- which was a real problem in the early stages of this program. The design of the ETA account is also excellent in many ways, but flawed in others. The ETA account is appropriately open to all federal recipients regardless of credit status; the account appropriately limits fees for basic services, and prohibits attachment of exempt benefits from the claims of judgment creditors. However, the account is defective in that it does not provide any payment mechanisms for recipients, does not limit charges for additional services, and is clearly not attractive to the banks because they are not marketing it, as is evident from the fact that only 11,000 recipients currently use it. Treasury should also be applauded for its comprehensive grass-roots education efforts to provide basic financial literacy information to low income and unbanked federal recipients.⁵

However, Treasury has failed to finish the job - it still must regulate the check cashers and other payment service providers in their delivery of federal benefits. In 1999, Treasury took the first step in this process by publishing an Advance Notice of Proposed Rulemaking ⁶ ("ANPRM") on the issue. In that ANPRM Treasury publically acknowledged the legal justification and the moral imperative for regulating access to federal benefits through alternative payment service providers. To provide comprehensive information and analysis to Treasury for its consideration of the ANPRM, the National Consumer Law Center and Consumer Federation of America conducted exhaustive research among our local legal services programs and affiliated local consumer organizations. Our comments were joined by twenty other state and national organizations representing low and moderate income consumers. More importantly, our comments drew from information supplied by our affiliates in twenty four states.⁷

ETA Accounts Do Not Meet the Statutory Mandate for Protection of Unbanked.

When EFT-99 was first passed,⁸ in all of the discussions in Congress and within the Treasury Department, the 10 million unbanked recipients of federal benefits were noted.⁹ According to Treasury, as of April, 2001, there were only slightly more than 11,000 ETA accounts established.¹⁰ **This means that only one tenth of one percent of the population for whom the ETA account was designed is currently using it.** Something is wrong.

As representatives of low and moderate income consumers, with close ties to communities across the nation, we can affirm to you certain facts. One, the lack of success for the ETA account is not because mainstream financial institutions have changed their patterns and are now providing services to many of the remaining 9,989,000 federal recipients. Two, banks and other mainstream financial service providers continue to segregate their services for low income customers. Three, much of the problem stems from the fact that Treasury has allowed check cashers and other alternative financial service providers to deliver the necessary services to many low income federal recipients.

While Treasury has mandated that federal payments will only be deposited into bank accounts established in the name of the recipient, that does not adequately protect recipients. Too many federal recipients have signed up to receive their federal payments through check cashers and other fringe bankers. **This means that although the federal payment is deposited into a federally insured financial institution it can only be accessed through the check casher.**

The recipients who have signed up with the payment service providers to receive their federal payments have only gained additional costs and lack of choice each month as to where to cash the check.¹¹ These recipients have also become excellent prospects for the other high cost products of the payment service provider, such as payday loans,¹² rent to own contracts, pawn transactions, sales of lottery tickets, and liquor. The result is that the federal payment simply ensures that the recipient becomes a captive customer of that fringe banker, without any realistic opportunity to go elsewhere if treated unfairly.

Payment services providers should not be supported by the federal government and permitted to be conduits for federal payments. As this non-regulated industry is allowed to be a conduit of federal payments, the financial problems in the low income communities continue to be ignored. Consider just two examples from the many supplied in our comments to Treasury's ANPRM:

Miami, Florida

Of the ten check cashers and rent to own dealers contacted in Miami, eight ¹³ have the capacity to set up electronic accounts. The terms vary. The majority charge a percentage fee plus a flat monthly fee. The percentages vary between 1% and 10% of the check amount. The flat fee is between \$3 and \$5 monthly. In one example, the recipient's federal check is deposited in the store's own bank which charges the recipient \$1.50, plus

\$10 per \$500 of the benefit check amount. Thus, for no extra convenience or services, the recipient's total monthly cost on a \$500 benefit check is \$11.50.

This store also allows recipients to establish Western Union accounts. For each federal benefit deposited to one of these accounts, \$14 is deducted from the account. All the recipient gets for this fee is the ability to receive their benefits in one lump sum at any Western Union outlet.

Philadelphia, Pennsylvania

There are a number of alternative providers of electronic access to federal benefits in Philadelphia. Each one seems to be vying to be the most expensive.

At one check casher, opening the account is free, and the monthly service fee is \$10.95, plus \$2.95 for each benefit deposited. A recipient who receives two benefit checks, for example Social Security and SSI, would pay monthly fees of \$16.85, totaling \$202.20 annually. For an additional \$1 a month, recipients can access their money through other ATMs. It is unknown what the ATM charges are. As of April, 1999 there were no payday loans yet, but the company was working to establish these in conjunction with the federal payments. This is despite the fact that payday loans are illegal in Pennsylvania.

At another provider, there is also no fee to establish the account. The monthly fee is 2.5% of each benefit deposit. The use of any ATM other than the place the arrangement was entered into requires a surcharge of \$1.50, in addition to the foreign bank's fee (which are in the range of \$1.00 to \$3.00). Assuming a recipient receives benefits totaling \$500 a month, and has three withdrawals, two of which are at places other than this check casher's (with a foreign bank surcharge of \$2.00), the cost per month would be $\$12.50 + \$3.50 + \$3.50 = \19.50 , or 3.9% of the benefit amount. Annual costs would be \$234.00.

One program in Philadelphia is offered through both check cashers and pawnbrokers. This program provides a cornucopia of high priced financial services, many of which appear to be illegal under state law. Opening this electronic account is free. After the fixed monthly charge of \$2.50, the additional monthly charges vary based on the type of access desired:

- 1) If the client only uses the payment service provider through whom the account was established, the money can be withdrawn in increments at a cost of \$1.00 for each withdrawal.
- 2) If the client wants an ATM card, the "silver" card costs \$10.95 a month -- in addition to the \$2.50 fixed monthly fee. In addition to the \$1 to \$3 surcharge imposed by the banks' ATM machine (there is no home bank ATM for these customers), the check casher receives a fee of \$2.00 per transaction. Each ATM withdrawal will cost recipients between \$3.00 and \$5.00.

3) For the client who desires to borrow against the federal benefit, there is a "gold" card at a cost of \$20.95 a month, in addition to the \$2.95 a month. The transaction fees are the same as for the silver card. But we do not know the fees for the credit extension on the federal payment.[14](#)

Under this program, the client is required to sign a form stating that the monthly statements required by the Reg E [15](#) to be provided by the bank are sent to the check casher. No phone number is available to recipients who have questions about their benefits or their accounts or the fees charged them.

The ETA Accounts Do Not Comply with Congress's Mandate to Protect the Unbanked. When Congress passed EFT-99, it was clear in its mandate to Treasury that this statute be used as a means to bring unbanked federal recipients into the banking system. In the statute, all federal recipients are required to designate a financial institution to receive the electronic deposit of federal payments:

(g) Each recipient of Federal payments required to be made by electronic funds transfer shall -- (1) designate 1 or more financial institutions . . . to which such payments shall be made; . . .[16](#)

Treasury is then required to provide regulations to ensure access at a reasonable cost, with consumer protections. These regulations must apply to all accounts designated by recipients to receive federal payments electronically:

(i) Regulations under this subsection shall ensure that individuals required under subsection (g) to have an account at a financial institution . . .

(A) will have access to such an account at a reasonable cost; and

(B) are given the same consumer protections with respect to the account as other account holders at the same financial institution.[17](#) (Emphasis added.)

If all recipients are to be covered by the requirements of subsection (i), then Treasury has the obligation to establish basic requirements for all accounts at financial institutions into which federal payments will be deposited. This regulation would have to establish a standard for regulators of financial institutions to evaluate whether accounts which receive federal payments meet the requirements of the federal law. Treasury has not done so. Establishing the voluntary ETA without ensuring that all of the accounts provided to federal recipients are accessible and at reasonable cost fails to comply with this mandate. Too many otherwise unbanked federal recipients have been sucked into the underworld of check cashers and other payment service providers.

By allowing check cashers and other payment service providers to be a part of the process of electronically delivering federal payments to recipients, Treasury allows an additional cost to be assessed recipients who do not have bank accounts. The recipient then must pay two financial service providers (the check casher and the bank whose account the benefits are deposited), which will double -- or worse -- the costs of the

delivery system. There is no way that Treasury can meet the statutory mandate of "reasonable cost" and allow payment service providers to be a part of the delivery system. Once banks are prohibited from using payment service providers to market accounts to federal recipients the banks will find new ways of maintaining this source of profit. But the prices should be lower, because they would not have to share them with anyone else.

The legislative history shows that Congress intended to protect the unbanked by requiring access to bank accounts. The only rational reading of the law and the Congressional history requires Treasury to ensure the usage of banks throughout the process -- from initiating the account to withdrawal of the money.

Since this section will require participating beneficiaries to obtain a bank account, Congress expects the Secretary of the Treasury to work vigorously to accommodate the needs of the unbanked recipients through such means as . . . implement through the private sector consumer owned bank accounts where recipients access their funds by debit card or other means, rather than through traditional account features, such as checking. (Emphasis added.)[18](#)

There is a simple way to meet the statutory mandate to regulate for access, account, consumer protections and reasonable cost : prohibit payment service providers from being part of an arrangement with financial institutions for the electronic delivery of federal payments.

In summary, there are five significant reasons why Treasury must regulate these alternative service providers:

1) Recipients are captive customer for expensive "other" services. If recipients must go through the doors of the fringe bankers at least one time each month to access their federal benefits, it is very likely that they will fall prey to the expensive -- and unregulated -- other financial products of these fringe bankers, such as check cashing, payday loans, high cost home equity loans, even rent to own transactions. While recipients may always be able to opt for these services if they care to, they should not be required to go through the doors of these alternative providers every single month in order to obtain their federal entitlement. If fringe bankers are allowed to sign recipients up for the electronic receipt of federal payments, these recipients become captive customers. It becomes much more difficult for unsophisticated, often illiterate, recipients to exercise choice and do business with different, less oppressive, financial services providers.

2) Access to Federal payments becomes very expensive. The basic arrangements made to deliver the federal payments to recipients by fringe bankers are uniformly far more expensive than the cost for equivalent services directly through a bank. Also, the arrangements often provide no additional service or convenience to the recipient as compared to the continued direct receipt by the recipient of a paper check. Attached to this testimony is our comments to Treasury's ANPRM; this document provides extensive

details regarding the high costs of the arrangements between check cashers and banks for the delivery of federal payments.

3) Banks have no incentive to offer ETAs. So long as banks are permitted to make money from the delivery of federal payments through payment service providers, rather than by providing services directly, they will have no incentive either to provide the ETAs being pushed by Treasury, or even to design their own accounts for low income recipients to access their federal payments.¹⁹

4) Perpetuates financial apartheid. If Treasury permits non-regulated payment service providers to control access of federal benefit payments to those in low income communities, the financial apartheid that already exists in this nation will simply be extended. Already, middle and upper income Americans enjoy the safety and convenience of a highly regulated banking industry that provides competitive prices and is closely supervised to limit improper activities. Many poor people, on the other hand, are relegated to fringe bankers who are unregulated, unsupervised, and routinely charge exorbitant rates in the uncompetitive financial services market that exists in the low income community. Congress and Treasury originally envisioned EFT 99 as an opportunity to further the use of mainstream banking in low income communities. Allowing fringe bankers to serve as conduits not only fails to advance that admirable goal, it makes it more difficult to achieve.

5) Violates Treasury's Legal Mandate. The statute establishing EFT 99 clearly provides Treasury with the legal authority to regulate the arrangements for the electronic delivery of federal payments through financial institutions. Indeed, the plain reading of the statute indicates that Treasury must regulate -- one way or the other -- to protect "individuals required under subsection (g) to have an account at a financial institution . . ." Regulating to prohibit payment service providers is the cleanest and simplest method of accomplishing this statutory mandate. Such a regulation can be justified because of the lack of access to accounts, the lack of consumer protections, and the clearly unreasonable costs imposed upon recipients in the arrangements which are already in place.

Conclusion

As advocates of low income people, and of consumers generally, we agree that electronic transfers can be a more efficient and safer method of receiving payments than the paper check based system. However, the additional advantages of the electronic system quickly evaporate if recipients have higher costs, unanticipated risks, and greater potential losses, as will clearly occur unless Treasury prohibits financial institutions from contracting with payment service providers for the delivery of federal payments.

¹ The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and

organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen examples of predatory practices against low-income people in almost every state in the union. It is from this vantage point - many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities - that we supply these comments. We have led the effort to ensure that electronic transactions subject to both federal and state laws provide an appropriate level of consumer protections. We publish and annually supplement twelve practice treatises which describe the law currently applicable to all types of consumer transactions.

2 The Consumer Federation of America is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

3 Consumers Union is the publisher of Consumer Reports.

4 The U.S. Public Interest Research Group is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

5 As part of its obligations to implement EFT 99, Treasury has engaged in an extensive education program, enlisting the expertise and contacts of the low income and community organizations throughout the nation. Thousands of pamphlets, guides, fact sheets and brochures on financial literacy, translated into multiple languages have been distributed in an impressive effort to provide important financial information to the unbanked. Many believe that Treasury's educational program should be a model for similar efforts by Treasury and other federal agencies to combat these problems in the future.

6 31 C.F.R. Chapter II, RIN 15055--AA74.

7 Our comments on the ANPRM, along with the summary of the lengthy appendices to those comments, are attached to this testimony as Appendix. The factual information asserted in this testimony is based on the information previously provided Treasury in these comments.

8 EFT 99 was mandated by § 31001(x) of the Debt Collection Improvements Act of 1996.

9 See, e.g. Treasury's Rule 31 C.F.R. § 208 in the discussion regarding § 208.5: "It is estimated that approximately 10 million individuals who receive Federal payments do not have an account at a bank, savings association, savings bank, or credit union, and, therefore, cannot receive payment by Direct Deposit."

10 Conversation with Cathy Donchatz of Treasury's FMS department, June 13, 2001.

11 A study by the New York Office of the Public Advocate found that a check cashing customer with an annual income of \$17,000 will pay almost \$250 a year at a check cashing business for services that would cost \$60 at a bank. According to a recent study of fringe banking in Milwaukee: "Customers pay far more for services provided by a check cashing business than they pay for the same services at a conventional bank. Fees for cashing payroll checks nationwide generally range between one percent and three percent of the face value of the check. For personal checks the range was generally between 1.7 percent and 20 percent, averaging around 8 percent. In some instances, however, fees and interest rates have been reported as high as 2000 percent. Squires & O'Connor, "Fringe Banking in Milwaukee: The Rise of Check Cashing Businesses and the Emergence of a Two-Tiered Banking System," 34 Urban Affairs Rev. 126 (1998). The Federal Reserve Bank of Kansas City reported that a family with a \$24,000 annual income using a check cashing business will spend almost \$400 in fees for services that would cost under \$110 at a bank."

12 Payday loans are generally provided by check cashers who agree to cash a post-dated personal check with the understanding that it will not be deposited until the customer's next payday. See, e.g. Pressey, Debra, "Payday Loan Industry Proliferating," The News-Gazette, November 11, 1998. (A couple on disability due to mental illness owed seven payday loans to four lenders at the same time for a total of \$1,440, more than their combined monthly income. One loan cost 1,825% APR.)

13 This information was supplied in April, 1999.

14 Under Pennsylvania law the maximum interest permitted for small loans is 23.57% a year. Under the PNC example, assume that the bank allowed one half of the monthly deposit to be made available in the second half of the month, and that the only charge for this would be the additional \$10 for the "gold card." Thus a \$10 fee would be charged for a \$250 extension of credit for 14 days (a relatively low priced loan compared to most payday loans). The APR on this extension of credit equals 250%.

15 Reg E is promulgated by the Federal Reserve to implement the consumer protections of the Electronic Fund Transfer Act, 15 U.S.C. §1693 et seq.

16 31 U.S.C § 3332(g).

17 31 U.S.C. § 3332(i).

18 142 Cong. Rec. H48721.

19 In our 1999 comments to Treasury's ANPRM we detailed the arrangements of a number of national banks engaged in these arrangements, although in many cases we were unable to tie the check casher and retail store arrangements to each bank sponsor. The banks involved include Delaware Bank, which has an ATM program that recipients sign up for at check cashers. There is a \$19.95 set up fee, \$9.95 monthly fee and .95 charge from this bank for all ATM withdrawals. This bank also offers what they call

"overdraft" protection for all federal recipients, including Social Security and SSI recipients. For any overdraft incurred during the month, a flat fee of \$19.95 is charged for that month, in addition to all other charges. These arrangements are made available through check cashers in New York, Pennsylvania, Delaware and other northeastern states. Other banks involved in these activities include Corus Bank, Chicago, Illinois, which was formed by check cashers for check cashers; Pacific State Bank which uses Quick Access, available through check cashers and rent to own stores, and charges a fee of \$3 per transaction; Republic and Trust Bank runs a program called Benefits Express which makes funds available through check cashers, liquor stores, and rent to own stores, and has a bank fee of \$2.95 per withdrawal with no apparent limit on the payment service providers' fees; River City Bank has a program called Dollars Direct providing electronic deposits through check cashers, pawnbrokers and tax preparers. The bank charges the customer a fee of \$2.95 per check. Citibank has a program with the National Association of Check Cashers of America which uses an ATM card program which also allows POS purchases. PNC Bank has a program through check cashers and pawnbrokers with a sliding scale of fees in Philadelphia.