Programs to "Bank the Unbanked" Must Guarantee Good Practices

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Bringing the "unbanked" into mainstream banking is good policy *only* if new account holders are not subject to financial practices that strip funds from these new accounts. Unfortunately, today's mainstream banking environment is fraught with danger for families who do not have a significant cushion of cash at their disposal.

Local, state and federal agencies; civic organizations; and financial institutions are partnering in bringing these families into the mainstream. These stakeholders should ensure that programs promoting mainstream banking do not unintentionally create a supply of customers who are vulnerable to abusive financial practices.

Banking the Unbanked

Thirty million U.S. families manage their money without the benefit of a checking account, or rely on alternative services for some of their banking needs. These "unbanked" or "underbanked" families often turn to expensive financial options like check cashing, higher-cost money orders, and rent-to-own credit.[1]

The FDIC reports that almost half of the unbanked have had a bank account in the past.

A movement to "bank the unbanked" has picked up steam across the country, aiming to address the unfairness of low-income people paying a great deal more for basic financial services than do most Americans.

These efforts are intended to save families money. They focus on overcoming challenges to opening a checking account,[2] and encourage consumers to turn to a bank or credit union instead of providers of high-cost alternatives.[3] But there are abusive features embedded in some checking accounts, and some of these escape the notice of outside observers.[4]

The Center for Responsible Lending, other advocates and academics, and federal banking regulators have documented rampant unfair checking account practices.[5] Practices such as high debit card overdraft fees and bank payday lending, have cost working families billions of dollars per year, ultimately driving some out of the banking system.[6]

Policymakers and regulators should recognize that harmful checking account practices contribute to the high number of unbanked consumers in the United States, and should strengthen protections addressing those practices. Advocates for mainstream banking should ensure that the financial products they support are safe and beneficial for new customers.

Defining the target demographic

In March of 2012, the Corporation for Enterprise Development (CFED) published a report that includes results from a survey of banks.[7] The banks are partners or potential partners of Bank On, a program that connects financial institutions with nonprofits and government entitites (mostly local), to encourage mainstream banking.

In the survey report, CFED summarizes the target market for banks: "Financial institutions that take Bank On participation seriously as a business opportunity to attract new individual customers all describe their target customer in the same way: steadily employed un- or underbanked consumers, and especially those who have the potential to receive their paycheck via direct deposit."[8]

This also describes the demographic that is most vulnerable to checking account abuse. That is, they have a steady if less-than-robust income, with automatic—thus reliable—deposit of their funds.

A low checking account balance and difficulty making ends meet make customers vulnerable to excessive overdraft fees. They are also vulnerable to the triple-digit interest payday loans a few of the big banks are now marketing.

A spider web of dangerous practices associated with checking accounts

Unfair overdraft fees and debt-trap bank payday loans are two big causes of financial harm for customers who are already struggling to make ends meet.

Overdraft Abuses

Overdraft "protection" practices have been extensively documented as dangerous to consumers, costing account holders billions of dollars each year.[9]

Some banks still allow small debit card purchases to go through when the account is in the negative, and then charge an overdraft fee averaging over $30 for each transaction while the account balance is negative. This commonly creates a scenario where customers can run up multiple fees per day, and pay hundreds of dollars per year.

Dozens of financial institutions have been sued for another practice that has driven up overdraft fees over the past few years. Many are settling claims that they have routinely changed the order in which transactions are posted to their customer's account so as to create more overdrafts and charge more fees.[10]

> **"What our customers kept telling me is 'just don't let me spend money that I don't have'...We wanted to help them avoid those unexpected overdraft fees."-** Bank of America representative, when announcing end to BofA's high-cost debit card overdrafts.

The Federal Reserve Board acknowledged the problems with overdraft practices when they ruled in 2010 financial institutions must seek their account holders' permission before enrolling them in a debit card overdraft program. But in response, many financial institutions persuaded customers to sign opt-in forms through high-pressure tactics or misleading advertising.[11] Once in, customers are still subject to unfair practices.

Bank of America and Citibank cover debit card and ATM overdrafts only if their customers have signed up for more reasonably priced coverage, by linking their savings or line of credit to their checking account.[12] When Bank of America announced its decision to discontinue fee-based overdraft on debit card transactions in 2010, a bank representative said "What our customers kept telling me is 'just don't let me spend money that I don't have'...We wanted to help them avoid those unexpected overdraft fees."[13]

In response to reports of unfair practices, the Consumer Financial Protection Bureau (CFPB) has announced it is investigating overdraft practices. In February 2012, the agency asked for input on the product from financial institutions, advocates and consumers.[14]

Bank Payday Lending

Four of the nation's largest banks—Wells Fargo, US Bank, Regions and Fifth Third—are currently making triple-digit interest payday loans to their customers, creating the same high-cost debt trap as non-bank payday lenders. This drains borrowers' bank accounts, and it makes them more vulnerable to overdraft fees.

The banks call their payday loans different names, including Direct Deposit Advance, Checking Account Advance, Access Now, and Ready Advance. But they are structured just like storefront payday loans, and they may be even more dangerous since they are shrouded by the perceived legitimacy of the banks.

Bank Payday Loans

The banks: **Wells Fargo, US Bank, Regions, Fifth Third**

The cost: **365% APR**

The cycle: **16 loans** per customer average annually

The duration: **175 days of the year** (FDIC recommends no more than 90 days in this type of short-term loan)

Although the banks insist the loans are not intended for long-term use,[15] the data show that their payday loan customers regularly find themselves in a long-term cycle of debt at annual interest rates averaging 365 percent. In one year, the average bank payday borrower is in debt for 175 days, with 16 repeats of these high-cost loans.[16]

The CFPB is investigating payday lending, and includes these bank payday loans as part of their concern.[17] And the FDIC recently responded to a letter signed by 250 advocates and organizations asking for action on bank payday lending. FDIC acting chairman Martin Gruenberg expressed concern that banks that are engaging in this practice undermining consumer protections in many states, and undermining federal protections for military personnel. Gruenberg said their investigation would take high priority.[18]

Payday lending harms borrowers

A Harvard Business School study found that payday borrowers are more likely to have their bank accounts closed, and that those closures are due to multiple overdrafts.

Originally limited to the realm of street corner and strip mall storefronts, payday loans are designed to stimulate repeat use that systematically strips fees from the customer at very high cost.[19] Payday lending is associated with higher rates of credit card delinquency and more unpaid medical bills. One study found that payday borrowers are twice as likely to end up in bankruptcy, compared to similarly-situated borrowers.[20]

Promoters of payday lending sometimes claim that taking a payday loan is a better option than overdrawing a checking account. But the reality is that payday loans and overdrafts are not substitutes for one another; instead they frequently exacerbate each other. Payday loans drain fees from borrowers. A CRL report found that 44 percent end up defaulting over a two-year period, so when the payday lender deposits their check, they are assessed bounced check fees.[21]

A report from Harvard Business School found that payday lending actually puts a family's bank accounts at risk. The study found that payday borrowers are more likely to have their bank accounts closed, and that those closures are due in fact to multiple overdrafts.[22]

Financial partners in "banking the unbanked" must commit to safe and fair practices

Although many financial institutions are committed to the financial well-being of their customers, too many banks and credit unions have become dependent on boosting fees in evermore creative ways. Unfortunately, those families who are without a cushion of liquid assets and living from paycheck-to-paycheck are the most vulnerable to unfair practices. Many Americans who are currently unbanked or under-banked have already experienced harmful checking account practices, and have rationally chosen to avoid banks altogether and take their chances with cash and alternative financial services.[23]

In its evaluation of Bank On programs, CFED recommends a model based on consistent national guidelines for products that are "useful, safe and appealing." Among those guidelines, CFED include "clear, simple and transparent pricing" and avoidance of fee-based overdraft."[24]

CRL supports those recommendations for Bank On and similar programs. We also specifically urge advocates for expanded access to mainstream banking to avoid partnership with financial institutions that engage in unfair overdraft practices or bank payday lending.

Selected FDIC Recommendations for "SAFE" Accounts

- **No NSF or overdraft fees**

For loans small loans (would include direct deposit advance, or bank payday loans):

- **Minimum 90-day term**
- **Maximum 36% APR**
- **Underwriting and a savings component**

A good standard these programs could set for their financial partners is outlined in the FDIC's Model SAFE Accounts pilot program.[25] Among its recommendations for low fees and other consumer-friendly features, the FDIC includes a recommendation for no NSF or overdraft fees. It also points to the FDIC's guidelines for small dollar loans for small loans, which would include the direct deposit advances that banks have structured as payday loans.[26] Those guidelines set the term at a minimum of 90 days and the APR at a maximum 36 percent, with low or no fees, underwriting, and a mandatory savings component.

Through programs aiming to "bank the unbanked," financial institutions are given access to a market of potential new customers. These financial partners benefit from the referrals and the public service marketing of community organizations that bring underserved communities into mainstream banking. As such, they must be held to high standards of practice that eliminate any possibility of financial abuse.

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1 "FDIC National Survey of Unbanked and Underbanked Households," Federal Deposit Insurance Corporation, 2009. Available at http://www.fdic.gov/householdsurvey/full_report.pdf.

2 For example, former bank account holders who have had trouble maintaining a positive checking account balance and have been reported to ChexSystems often cannot open an account until a negative report disappears, usually five years after it is filed. Bank On programs (mentioned on page 2) typically ask financial partners to open accounts for customers if the ChexSystem report is dated, or if the customer agrees to financial counseling. Bank On also typically encourages financial partners to open accounts using alternatives to social security numbers as identification if the customer does not have one. "Partnerships You Can Bank On: Sustainable Financial Institution Engagement in Bank On Programs," Genevieve Melford and Michelle Nguyen, Corporation for Enterprise Development (CFED), March 2012. Available at http://cfed.org/knowledge_center/publications/partnerships_you_can_bank_on_sustainable_financial_institution_engagement_in_bank_on_programs/.

3 The high cost of payday lending is often cited as a benefit of bringing unbanked families into mainstream banking. Although it is a high-cost debt trap, it is one alternative financial product that is unrelated to the issue of unbanked or underbanked consumers: an active checking account is required to get a payday loan, so payday borrowers are already in the mainstream banking system.

4 Some Bank On programs attempt to negotiate with their financial partners for forgiveness of one set of overdraft/NSF fees as a feature of their accounts for new customers. This is an inadequate standard of protection because today's abusive overdraft practices can cost consumers hundreds or thousands of dollars per year in the form of multiple fees. See section on "Overdraft Abuses," page 2.

5 "Overdraft Explosion: Bank Fees for Overdrafts Increase 35% in Two Years," Leslie Parrish, Center for Responsible Lending, October 6, 2009. Available at http://www.responsiblelending.org/overdraft-loans/research-analysis/crl-overdraft-explosion.pdf. Also, "Big Bank Payday Loans: High-interest Loans Through Checking Accounts Keep Customers in Long-Term Debt," Rebecca Borné, Joshua Frank, Peter Smith and Ellen Schloemer, Center for Responsible Lending, July 2011. Available at http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf. Also, Michael S. Barr, University of Michigan Law School, Financial Services, Savings and Borrowing Among Low- and Moderate-Income Households: Evidence from the Detroit Area Household Financial Services Survey (March 30, 2008). See also Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures, Harvard Business School (June 6, 2008). Also, in its opt-in rule, the Federal Reserve Board acknowledged that the fees charged for debit card overdrafts can "substantially exceed" the cost of the overdraft itself. The change to Regulation E became effective on July 1, 2010 for new customers opening accounts, and August 15, 2010 for existing account holders. 74 Federal Register 59033-59056

6 See note 1, FDIC.

7 "Partnerships You Can Bank On: Sustainable Financial Institution Engagement in Bank On Programs," Genevieve Melford and Michelle Nguyen, Corporation for Enterprise Development (CFED), March 2012. Available at http://cfed.org/knowledge_center/publications/partnerships_you_can_bank_on_sustainable_financial_institution_engagement_in_bank_on_programs/.

8 See note 7, page 10.

[9] "Overdraft Explosion: Bank Fees for Overdrafts Increase 35% in Two Years," Leslie Parrish, Center for Responsible Lending, October 6, 2009. Available at http://www.responsiblelending.org/overdraft-loans/research-analysis/crl-overdraft-explosion.pdf.

[10] See CRL round-up of media stories, "Shuffling Transactions to Boost Overdraft Fees Draws Ire of Bank Customers and Judges." Available at http://storify.com/CRLONLINE/overdraft-fees-boosted-as-banks-and-credit-unions.

[11] "Banks Collect Overdraft Opt-Ins Through Misleading Marketing," Center for Responsible Lending, April 2011. Available at http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/CRL-OD-Survey-Brief-final-2-4-25-11.pdf

[12] See http://www.responsiblelending.org/overdraft-loans/tools-resources/some-banks-are-denying-debit.html

[13] "Bank of America to End Debit Overdraft Fees," Andrew Martin, The New York Times, March 9, 2010. Available at http://www.nytimes.com/2010/03/10/your-money/credit-and-debit-cards/10overdraft.html?_r=2

[14] See "Comment period on overdrafts extended to June 29," Gary Stein, CFPB blog post, April 25, 2012. Available at http://www.consumerfinance.gov/blog/comment-period-on-overdrafts-extended-to-june-29/.

[15] See for example, "The Checking Account Advance is designed to fulfill a short-term funds need and not for use as a continuous source of funds for basic financial maintenance…" U.S. Bank Checking Account Advance Agreement, accessed on-line at http://www.usbank.com/checking/caa/agreement.html on March 21, 2012.

[16] "Big Bank Payday Loans: High-interest Loans Through Checking Accounts Keep Customers in Long-Term Debt," Rebecca Borné, Joshua Frank, Peter Smith and Ellen Schloemer, Center for Responsible Lending, July 2011. Available at http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.

[17] "Share your input on payday lending for the official record," Zixta Q. Martinez, CFPB blog post, March 23, 2012. Available at http://www.consumerfinance.gov/blog/share-your-input-on-payday-lending-for-the-official-record/.

[18] See full text of letter here: http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/fdic-invests-bank-payday-lending.html

[19] "Payday Loans, Inc.: Short on Credit, Long on Debt," Leslie Parrish and Uriah King, Center for Responsible Lending, March 21, 2011. Available at http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf.

[20] Using a database on payday borrowers of a large Texas-based payday lender, researchers find those approved for a payday loan were 88 percent more likely to file for Chapter 13 bankruptcy within two years than the rest of the Texas population. They were also 14 percent more likely to file for Chapter 13 bankruptcy than their peers who had applied—and then been denied—a payday loan. See Paige Marta Skiba & Jeremy Tobacman, Do Payday Loans Cause Bankruptcy?, Vanderbilt University Law School and University of Pennsylvania, (September 8, 2008), available at http://bpp.wharton.upenn.edu/tobacman/papers/rd.pdf.

[21] See note 19, "Payday Loans, Inc."

[22] An increase in payday lending locations in a particular county is associated with an 11 percent increase in involuntary bank account closures (generally due to the account being excessively overdrawn), even after accounting for county per capita income, poverty rate, educational attainment, and a host of other variables. For more information, see Dennis Campbell, Asis Martinez Jerez, & Peter Tufano, Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures, Harvard Business School, (December 3, 2008).

[23] See note 1, FDIC.

[24] See note 7, CFED.

[25] FDIC Model SAFE Accounts Template. Available at http://www.fdic.gov/consumers/template/template.pdf.

[26] "Small Dollar Loan Pilot Program, FDIC, Available at http://www.fdic.gov/smalldollarloans/.