Center for American Progress

Financial Access in a Brave New Banking World

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Introduction and summary

Basic financial services can be expensive for working families that cannot easily afford them. In June 2013, a McDonald's employee in Pennsylvania named Natalie Gunshannon sued her local franchise over the fees on the prepaid debit card that the store used to pay its employees—a card on which employees were forced to receive their wages. These fees included $1.50 for each ATM withdrawal, $5 to withdraw cash at a bank, $1 to check the account balance at ATMs, and 75 cents to pay bills online.[1] In response to the lawsuit, the franchise owner agreed to give workers the options to get paid by a paper paycheck or by direct deposit to an account of their choice, rather than the payroll card.[2]

Since Natalie had a free account at a local credit union, she was better off without the card. But according to the Federal Deposit Insurance Corporation, or FDIC, 17 million American adults lack a bank account, and that number is growing.[3] An additional 51 million adults are considered "underbanked" by the FDIC, meaning that while they may have bank accounts, they also rely on some nonbank financial institutions such as check cashers and pawn shops.

These unbanked and underbanked consumers are the ones that banks are trying to reach with their prepaid "payroll" cards, recognizing that switching to direct deposit can save money for both the employer and the employee. Similarly, the federal government estimates saving $1 billion over the next 10 years by largely shifting from paper checks to electronic payments.[4] Getting by without a bank account can be expensive; in some states, check cashers may charge as much as 5 percent of someone's paycheck.[5] But despite the convenience, getting by with a bank account or prepaid card can also be increasingly expensive. Today, only about half as many banks offer free checking accounts as they did in 2009, and on average, monthly maintenance fees for accounts that are not free have more than doubled in the past few years.[6] Clearly the recession has had an impact, since lower interest rates in the overall economy limit the revenue that financial institutions are able to get from interest. But economic conditions only explain part of the change.

Technology has ushered in a brave new world of banking services. "Checking" accounts increasingly have fewer checks, or complement "checkless checking" accounts. In 2010, for the first time in 15 years, the number of bank branches in the United States declined.[7] Meanwhile, mobile banking technology has emerged as a substitute for some of the activities that would normally lead someone to a bank branch, such as depositing checks and transferring funds.[8] And prepaid debit cards that have many of the same benefits as a bank account—such as mobile tools, access to cash at ATMs, and the ability to make purchases online—increasingly look like bank accounts, even if they are not all regulated this way.[9] Regulators have also been paying attention to these issues, including the new Consumer Financial Protection Bureau, which has fielded thousands of consumer complaints.[10]

The European Commission introduced a proposal in May to require EU member states to offer basic banking accounts for all EU citizens.[11] While such a bold proposal would not likely succeed in the United States, it is important to recognize the need for affordable financial services and tools that can help create better options for the millions of Americans without bank accounts and the millions more who may not be satisfied with their existing banking options. There are a number of possibilities for expanding financial access in this brave new banking world, from better relationships with employers to city-led outreach programs to leveraging or expanding existing "public options" in banking, such as the prepaid debit cards that states and the federal government use to deliver benefits.

This report will walk through the newfound problems—and recognize the progress—of the current banking environment for low- and moderate-income consumers, and briefly discuss cities' efforts to address these concerns before suggesting potential recommendations to expand financial access.

Problems

Free checking's disappearing act

Free checking is increasingly disappearing as a product that banks offer. According to Bankrate.com's fall 2012 checking account survey, while three-quarters of banks offered free checking in 2009, only 39 percent did in 2012.[12] The average monthly maintenance fee increased to $5.48 in 2012, more than double its levels in 2009.[13] And some banks are now advertising double-digit monthly maintenance fees.

This does not mean that everyone is paying monthly fees to have a bank account. Banks will generally waive monthly fees if customers maintain a minimum balance each month. But the average minimum balance required to avoid a fee soared to $723 in 2012, up 23 percent from the previous year.[14] This may be a high hurdle to jump, as 27 percent of Americans report having no emergency savings at all.[15] And a 2010 nationwide survey found that 45 percent of bank customers had minimum balances of less than $500 per month and average balances of less than $1,000 per month, making them highly susceptible to fees.[16]

Accounts with direct deposits may also find monthly fees waived, which is good news for the approximately 72 percent of workers who use direct deposit to automatically have their regular pay or government benefits placed into their account.[17] But not everyone uses or has access to direct deposit. While more than four-fifths of customers with incomes of more than $75,000 use direct deposit, only 66 percent of those earning between $40,000 and $75,000 and 52 percent of those earning between $20,000 and $40,000 use it.[18] In particular, small businesses in America issue 2.7 billion payroll checks annually, or one out of every eight nongovernment checks.[19] While the vast majority of businesses with more than $5 million in annual revenue offer direct deposit, less than half of businesses with less than $1 million in annual revenue offer it. It is possible that at least one in six workers does not have direct deposit as an option.[20]

In these cases, workers without access to direct deposit are doubly penalized. If they choose to have a bank account, they may well have to pay a double-digit monthly maintenance fee. If they do not, they will have to pay for cash-based financial services, starting with check-cashing fees that in some states can take 3 percent to 5 percent of a paycheck right off the top. Check-cashing fees may range from 1 percent to 5 percent of one's paycheck, and costs more than doubled from 1987 to 2006.[21] A low-income worker who is paid $700 every two weeks, faces a 2 percent check-cashing fee, and needs to buy two money orders each month would pay more than $30 per month just for financial services.

High-cost payroll cards are a poor alternative

Natalie Gunshannon was one of millions of Americans issued a prepaid card for her pay, which is also common for unemployed workers in 41 states and federal benefit recipients who choose not to enroll in direct deposit.[22] While these cards can be beneficial—serving as the functional equivalent of a checking account, allowing consumers to make purchases, use ATMs, pay bills, and participate in direct deposit[23]—some have very high fees, and consumers deserve the choice of a cheaper banking option through their own bank or credit union. Like Natalie, they do not always get this choice; for example, unemployed Californians must receive benefits on the card even if they already have a bank account.[24] The Consumer Financial Protection Bureau recently reminded employers that they are not permitted to require direct deposit to a specific financial institution, including to a prepaid payroll card.[25]

Payroll cards, unlike cards sold to the general public, are subject to Regulation E protections that require deposit insurance and have more consumer protections than other cards.[26] For example, they cannot be overdrawn. There are, however, few limitations on fees. Cards may charge fees for customer services such as using an ATM to inquire about the account balance, or speaking to a customer-service representative over the phone. Even unemployment-benefits cards issued by states may charge for these services; 22 states charge for some balance inquiries at ATMs, and 6 states charge for all balance inquiries, even at in-network ATMs.[27] These fees effectively reduce pay or benefits, and make some prepaid cards a much less reasonable option for consumers.

Shrinking bank branches

In 2010, the number of bank branches in the United States fell for the first time in 15 years.[28] According to data compiled by Bloomberg, an estimated 93 percent of the nearly 2,000 branches that have been closed since the end of 2008 fell in ZIP codes with household incomes below the U.S. median.[29] For working families, this may result in longer distances to bank branches or longer waits for banking services. Branches themselves are changing as well, with an increased focus on fewer tellers and more automated services. In some cases, customers will be encouraged to use kiosks at teller windows—or, alternately, ATMs combined with video tellers—to deliver services more efficiently.[30] If banking becomes less convenient as a result, high-cost alternative financial services may appear more attractive to these workers.

Exclusions based on bad banking history

A negative banking history can persistently keep many people out of the financial mainstream. Among unbanked households that previously had a bank account, 10 percent said the main reason they no longer had an account was because the bank closed it, while 6 percent said they were not able to open an account because of ID, credit, or banking-history problems.[31] Indeed, 65 percent of banks surveyed by the FDIC reported that a negative screening hit for a prior account closure or mismanagement was the most common reason for denying a checking-account application, with insufficient identification as the second most common reason at 18 percent.[32] Yet most banks now accept nontraditional identification such as non-U.S. passports.[33]

Most banks report involuntary closures to agencies such as ChexSystems or Early Warning that help ensure that new account openings will not create fraud risk. While these databases are necessary, these firms' systems—unlike traditional credit-reporting agencies—are not as transparent or well regulated. *The New York Times* estimates that more than 1 million low-income Americans are outside the financial mainstream as a result of negative hits in these systems.[34] Unlike credit scores and reports, which have been widely promoted in recent years, consumers may not know about these databases, how to monitor them, or how to resolve inaccuracies. Only about one in five banks offers a second-chance account for these customers, according to the FDIC.[35]

Progress

Consumers have new protections and a new regulator

Dealing with overdrafts is a crucial component of regulation. Overdraft fees are rising, with the median overdraft fee charged by banks at $35 per occurrence in 2011.[36] About one in four accounts is overdrawn at some point during the year, according to the Consumer Financial Protection Bureau, launched in 2011, and the average customer who overdrew his or her account would pay $225 in overdraft or insufficient funds fees over the course of one year.[37]

The Federal Reserve took a solid first step to address overdrafts in 2010, when banks' overdraft coverage switched from "opt-out"—where banks would allow payments to go through that would overdraw an account and charge fees for the privilege unless consumers declined this coverage in advance—to "opt-in," where banks would only let these payments go through and charge the related fees if consumers agreed to participate in overdraft programs.[38] Yet the Consumer Financial Protection Bureau released a report earlier this year on overdraft fees that estimated that 61 percent of banks' fee revenue on consumer accounts comes from overdrafts.[39]

One of the Consumer Financial Protection Bureau's main benefits has been the development of a large complaint database to address disputes with financial-services companies. The Consumer Financial Protection Bureau began taking complaints about bank accounts in March 2012, and in the first 15 months, it processed 25,700 complaints. Eighty percent of the complaints were routed back to financial institutions, and in the vast majority of cases—97 percent—banks responded, with consumers receiving monetary relief from banks in about one in four of the cases.[40]

Banks have developed new product alternatives to checking accounts

New banking products involve fewer checks, recognizing that checking itself is on the decline. Beginning in 2003, more electronic payments were made in the United States than check payments.[41] Banks have expanded checkless-checking accounts along the lines of the FDIC's Model Safe Accounts, a card-based account that cannot be overdrawn.[42] Given that steep overdraft fees and banking-history problems prevent consumers from opening and managing bank accounts, this is an important development.

On the whole, banks' prepaid offerings have been getting better, too. In 2010, the Kardashian sisters withdrew support for a prepaid card named for them after a public outcry over fees associated with the Kardashian Kard, which included double-digit upfront fees and monthly fees as high as $7.95.[43] Last fall, American Express and Walmart launched the Bluebird card, a card with no monthly fee.[44] And the Chase Liquid card has a monthly fee of $4.95 but offers free deposits and withdrawals at all Chase branches and ATMs.[45] As prepaid cards become more affordable and have greater features, they are better able to serve as checking-account substitutes—provided that regulations converge as well.

Mobile technology offers alternatives to bank branches

According to the FDIC, 88 percent of the largest banks now offer mobile banking as a tool to make services more convenient.[46] The majority of cell-phone users in the United States now have smartphones, according to a 2012 Nielsen survey.[47] This can provide significant advantages for consumers to access financial services on their phones. One particularly transformative technology is remote deposit capture, in which consumers can take photos of both sides of a check using a mobile-phone camera and transmit these photos using a smartphone app to deposit a check anytime and anywhere a cell-phone signal exists.[48] Under these circumstances, branch hours are no longer a limiting factor. Prepaid provider NetSpend, which operates largely online and on mobile phones, reports that 40 percent of account loads, or deposits, take place outside of traditional banking hours.[49]

This can be a major opportunity to reach the underserved. In seven states and the District of Columbia, cell phones are more prevalent than bank accounts.[50] And the Federal Reserve estimates that 59 percent of unbanked consumers have access to mobile phones, of which half are smartphones.[51]

While smartphones offer the most functionality, any cell phone can receive text alerts—enabling consumers to know, for example, when their account balances are low and when they run the risk of overdrawing their accounts. But unlike in some developing countries, mobile-banking tools in the United States still rely on underlying banking products such as checking accounts and prepaid cards whose fees and features may vary.

Locally grown financial products

Cities' efforts to reach the unbanked

While more than half of unbanked populations live in rural areas, there are millions of unbanked or underbanked Americans living in major metropolitan areas. According to the FDIC, there are 2.1 million unbanked or underbanked in the New York metropolitan area; 1.2 million in Los Angeles; and 855,000 in Chicago.[52] In its own analysis, the New York City Department of Consumer Affairs estimated that there might be close to 1 million unbanked New York City residents alone.[53]

Recognizing the effect that this has on city residents—effectively diverting a portion of their incomes to alternative financial services in the presence of potentially lower-cost options—some city governments have taken a particular interest in reaching underserved residents and communities. In 2006, San Francisco launched Bank On, a marketing and outreach initiative designed to encourage the use of bank accounts and direct deposit. Local banks and credit unions advertised affordable checking-account products and agreed to offer second-chance accounts for those with banking-history problems. In the first five years, more than 70,000 people opened accounts.[54] This model was replicated next in Seattle, before reaching Evansville, Indiana, and then Los Angeles. As of 2011, it has been fully implemented in 32 cities, four states, and four regions. For several years, a nationwide Bank On demonstration was in the Obama administration's proposed budget, but was never approved by Congress and was not in the fiscal year 2014 budget proposal.[55]

In addition to marketing bank accounts to individuals, San Francisco launched the CurrenC SF initiative in 2012 to encourage businesses within the city to adopt direct deposit and payroll cards to reduce costs, provide greater privacy and convenience to employees, and reduce paper waste. As part of this initiative, participating businesses were encouraged to offer direct deposit to a bank account, but the city also identified best practices in payroll cards for consumers who did not want, or could not open, an account. These practices include no overdraft fees, no monthly or annual fees, and at least one free bank withdrawal and one in-network ATM withdrawal each pay period.[56] Additionally, payroll-card recipients in CurrenC SF also have one free phone call to a live customer-service agent each month. These guidelines fall within the voluntary Compass Principles proposed by the nonprofit Center for Financial Services Innovation.[57]

Not all local initiatives to reach the unbanked and underbanked have been as successful. Oakland, California, is one of several cities that offers a municipal identification card enabling anyone, including undocumented residents, to receive city services. The card doubles as a prepaid debit card in an attempt to provide better banking services, but has a $2.99 monthly fee plus fees for services such as customer-service calls and ATM withdrawals.[58] Similarly, earlier this year, the Chicago Transit Authority announced the Ventra card, a new farecard for public transit that optionally doubles as a MasterCard debit card. Under the initial proposal, Chicagoans would have had to pay $1.50 for each ATM withdrawal; $2 for every customer-service call with a live operator; and $6 to cancel the card and receive a refund—while the Chicago Transit Authority was guaranteed at least $500,000 in revenue from debit-card fees.[59] Card features were redesigned in response to public pressure and the guaranteed revenue provision went away, but some fees persist, including a $4.95 fee to add cash to the debit card at retailers.[60] In both cases, card features and fees especially matter when receiving an implicit public endorsement.

But locally grown financial products are important. Local governments have the power to coordinate with financial institutions on a neighborhood basis, and to build trust with residents. They also have power to build financial inclusion both as payment recipients—such as parking tickets and licensing fees—and payers directly to citizens. And local governments have the potential to provide residents with one-on-one support to better manage their finances, such as New York City's Financial Empowerment Centers—a citywide network of free financial counseling delivered through neighborhood-based organizations.[61] Yet when cities do engage in expanding financial access, they need to ensure that the products they are supporting are safe, affordable, and attractive to the consumers who need them the most.

Recommendations and conclusion

Prepaid cards should have the same consumer protections as bank accounts. Given the rapid growth in the prepaid sector over the past few years, these cards have grown in popularity for government agencies, employers, and the general public. But practices and regulations vary from one card to another. Moreover, some protections—such as provisions for resolving unauthorized charges—are offered voluntarily by issuers, so there is nothing preventing a card issuer from changing them in the future. If prepaid cards have the same features as bank accounts—from the ability to get cash and make purchases to using direct deposit and depositing checks using a mobile-phone camera—they should have common regulations to make them a viable alternative rather than a second-class financial product.

All financial products should clearly disclose and explain fees. Unclear or buried account terms are often a significant barrier to owning and maintaining a bank account. During the recession, more bank accounts were closed in 2009 and 2010 due to unexpected or unexplained fees than due to economic factors.[62] Consumers would be better served by products with transparent fee structures that are disclosed using standard forms that allow consumers to easily compare options. According to the Pew Charitable Trusts, the median bank account disclosure form is 69 pages.[63] Several models for improved disclosures exist. One is the standardized Model Disclosure Box for Checking Accounts proposed by Pew.[64] Another is the standardized disclosure box for prepaid cards proposed by the Center for Financial Services Innovation.[65] These are not entirely new developments. Congress first established standardized disclosures for credit cards—often known as the "Schumer Box" after then-Rep. Charles Schumer (D-NY)—by enacting the Fair Credit and Charge Card Disclosure Act of 1988.[66]

Employers can and should facilitate access to affordable bank accounts. While employees must retain the choice of how they are paid—and if by direct deposit, through which financial institution—employers have the opportunity to play an important, but overlooked, role in connecting employees to free or discounted banking services by partnering with a bank or credit union. Financial institutions generally offer accounts to employees in conjunction with direct deposit, enabling both employers and employees to take advantage of the benefits of electronic payroll.

States and cities should promote safe, affordable bank account and prepaid products. States have shifted toward prepaid cards for unemployment benefits and tax refunds with mixed results. Many cities have participated in Bank On initiatives to encourage new bank account openings and some have experimented with prepaid cards of their own, but these cards have been criticized for excessive fees. At a minimum, state and local governments should ensure that they are providing sound products with reasonable fees, and that their practices both when issuing products and receiving payments do not disproportionately increase costs on the unbanked. Cities should also go further to market and encourage reasonable financial products, as San Francisco has done with Bank On and CurrenC SF, and build financial-counseling mechanisms as New York City has done.

Basic accounts should be made available to vulnerable populations, possibly leveraging existing public options. Basic, low-cost banking services should be available to the populations least likely to afford them, such as the elderly. Efforts to mandate affordable bank accounts at the state level have only gained traction in a handful of states. For example, New York state requires basic banking accounts with a monthly fee of no greater than $3, and more than 100 banks in Massachusetts have voluntarily agreed to offer such accounts.[67] Notably, in some cases, specialized accounts may not actually be cheaper; some senior checking accounts, for example, are more expensive than other basic options.[68] The federal government already offers a low-cost prepaid card option—the Direct Express card—to those receiving federal benefits such as Social Security or veterans' benefits who do not want direct deposit. This card, provided under contract through a competitive bidding process, has no initial or monthly fees and offers many free services, including one free cash withdrawal at ATMs each month, free withdrawals from bank tellers, free balance inquiries at ATMs, and free customer-service calls.[69] Extending this card to other low-income Americans for purposes other than distributing federal benefits would be one option.

This is not the only way the federal government has historically expanded access to basic financial services. Indeed, from 1911 to 1967, the Postal Service operated a system of basic low-balance savings accounts with funds largely deposited in local banks.[70] Similar systems still exist in other countries. Savings bonds, too, have historically been a government function, while they have largely migrated from paper to electronic forms that may be less accessible to consumers.[71] There is a long precedent for a federal role in making basic banking services available to fill financial inclusion gaps.

Over the past few years, the banking tools available to Americans have changed considerably, with new developments in prepaid and mobile technology and a new regulator, the Consumer Financial Protection Bureau, on the beat. In a changing banking world, however, working families have sometimes been left out of the benefits—or forced to deal with higher costs. Leveraging cities and employers, providing consistent regulations, improving transparency, and building out public options can all help create a stronger financial system that works for all Americans.

About the authors

Joe Valenti is the Director of Asset Building at the Center for American Progress. His work focuses on improving the ability of low- and moderate-income consumers to participate in the financial sector and to make the most of their resources. Prior to joining the Center, he was a Hamilton Fellow at the U.S. Treasury Department, serving as a research analyst working with the Community Development Financial Institutions and New Markets Tax Credit programs. He previously served as a senior analyst at the New York City Office of Financial Empowerment, the first local government initiative geared toward educating, empowering, and protecting low-income consumers, and as an associate at the Aspen Institute's Initiative on Financial Security. He also interned for the U.S. Senate Committee on Banking, Housing, and Urban Affairs under Chairman Christopher J. Dodd (D-CT).

Deirdre Heiss was a summer intern with the Economic Policy team at the Center for American Progress. She is a master of public administration candidate at the Wagner Graduate School of Public Service at New York University, where she received a fellowship in 2012 to support her work in the risk and control department of a microfinance enterprise based in Lima, Peru. Deirdre received her bachelor's degree in psychology from Washington University in St. Louis.

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