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ACCESS TO FINANCIAL SERVICES IN THE 21ST CENTURY: FIVE OPPORTUNITIES FOR THE BUSH ADMINISTRATION AND THE 107TH CONGRESS[†]

MICHAEL S. BARR*

INTRODUCTION

Noticeably absent from debate over President Bush's agenda is any discussion of a central question for equality of opportunity in the 21st century. Access to financial services is the "passport" to our modern economy, as former Treasury Secretary Lawrence H. Summers oft said, but despite the enormous progress that has been made over the last decade, too many families in the United States still are left out of the financial services mainstream. There are five key opportunities that the Bush Administration, working with Congress and the private sector, can seize in order to continue to democratize access to financial services: expand access to capital under the Community Reinvestment Act, invest in New Markets, combat predatory lending, bank the unbanked and build assets for the poor.¹

As Hernando de Soto has shown, access to capital and financial services is the key to economic growth both in advanced economies and in the developing world.² Today, the United States has one of the deepest, broadest and most efficient capital markets in the world. Access to capital helps to drive business formation and fuel economic growth, make housing affordable and let consumers purchase goods conveniently. Despite the

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1. I take up these and related issues more extensively in two works in progress funded by the Ford Foundation, *Democratizing Access to Capital* and *Banking the Poor*.

2. See generally HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* (2000).

depth and breadth of U.S. credit markets, low- and moderate-income communities, and minority borrowers, have not enjoyed full access to those markets. This lack of access to credit has helped to impede economic growth in these communities. Yet enormous progress has been made under the Community Reinvestment Act (CRA),³ which encourages mainstream banks and thrifts to provide credit to creditworthy borrowers throughout their service communities. Continued progress on CRA, new targeted public investments to spur private investment of business capital and greater attention to the problems of abusive or predatory lending in low-income neighborhoods can help to make our financial system work better for all Americans.

Similarly, access to basic financial services—owning a bank account, managing household finances and being able to save for the future—are critical to success in the modern American economy. Working families need access to bank accounts in order to conduct the transactions of daily life, but today, nearly ten million U.S. households lack this basic financial tool. Account ownership is also critical to saving funds for short-term emergencies, and for establishing credit history to access consumer, home mortgage and business credit. A bank account can help low-income families plan better financially and save for the future. Lack of a bank account can be quite costly to low-income families as they cash their checks and conduct transactions at alternative providers. Use of these costly alternatives impedes government initiatives to move families from welfare to work, and to reward work with the Earned Income Tax Credit. In addition, low-income families need better mechanisms to foster savings for important life events, including buying a home, sending their children to college or retirement. Yet few lower income workers have access to tax-preferred savings plans, such as Individual Retirement Accounts, that millions of middle- and upper-income families use today. New incentives are needed to transform the basic financial services landscape for the poor.

Thus, in the financial services context, there are five key objectives that the federal government should pursue to promote economic opportunity for lower-income families and communities:

- Expand access to capital and financial services through mainstream banks and thrifts, particularly by ensuring that CRA remains effective.
- Provide incentives and better information to encourage investment in central cities and rural areas, “New Mar-

3. 12 U.S.C. § 2901 (1994).

kets" that present untapped potential for economic growth.

- Combat abusive and predatory lending practices that threaten to undermine the enormous progress that has been made in democratizing access to capital.
- Bank the unbanked with innovative new private sector products and services, catalyzed by new incentives for financial services for the poor.
- Promote savings by the poor by catalyzing wide-scale establishment of Individual Development Accounts and other mechanisms that help low-income families to save.

I. EXPAND ACCESS TO CAPITAL UNDER THE COMMUNITY REINVESTMENT ACT

Enormous progress has been made over the last decade in expanding access to capital to low-income borrowers for home ownership and other activities, in part due to the CRA, a 1977 law that gained new effectiveness under the regulatory regime and market climate of the 1990s. While other factors in addition to CRA were important contributors to recent gains (see below), a Treasury Department study found that between 1993 and 1999, depository institutions covered by CRA and their affiliates made nearly \$800 billion in home mortgage, small business and community development loans to low- and moderate-income borrowers and communities.⁴ The number of home purchase mortgage loans made by CRA-covered institutions and their affiliates to these borrowers and areas increased by 94% between 1993 and 1999. Over this period, CRA-covered lender and affiliate loans increased the share of home purchase loans within their own portfolios going to these low- and moderate-income borrowers and areas from 31.5 to 35%, nearly all of the gain in share coming after the 1995 revisions strengthening CRA regulations.

Minority families also saw significant increases in access to home ownership capital during this period. Table 1 shows that home purchase lending to minorities increased at much greater rates between 1993 and 1999 than did lending to whites, and helped to fuel significant increases in minority homeownership rates. In 1999, conventional home purchase loans extended in neighborhoods that are predominantly minority were up 17% in 1999 over 1998, compared with 6% growth in other neighborhoods. The Treasury study found that minority share of CRA

4. ROBERT E. LITAN ET AL., U.S. DEP'T OF TREASURY, *THE COMMUNITY REINVESTMENT ACT AFTER FINANCIAL MODERNIZATION: A BASELINE REPORT* 66 (2000).

lending increased from 21 to 28% from 1993 to 1999, with most of the increase coming during peak fair lending enforcement years by the Justice Department, from 1993 to 1995.

TABLE 1. MINORITY HOMEOWNERSHIP AND HOME PURCHASE LENDING TO MINORITIES, 1993 & 1999

Race/ Ethnicity	Homeownership Rate – 1993	Homeownership Rate – 1999	Change in Homeownership Rate 1993–99	Increase in home purchase lending 1993–99
White	70.2%	73.0%	2.8%	33.5%
Black	42.0%	46.1%	4.1%	91.0%
Hispanic	39.4%	45.2%	5.8%	121.4%

Source: Census Bureau; R. Litan et al., *op. cit.*

The effectiveness of CRA is witnessed not only in growing access to capital for lower-income and minority borrowers, but also in the success that the financial services industry has had in serving these markets. Banks and thrifts have found new profitable business opportunities, including new customers, additional deposits, opportunities for cross-marketing and enhanced demand for capital that results from helping to build stronger communities. Under CRA, banks and thrifts have formed multi-bank Community Development Corporations (CDCs) and loan consortia to reduce risk and share information about low-income markets; they have invested in Community Development Financial Institutions (CDFIs) to develop specialized market knowledge, share risk, and explore new market opportunities; they have engaged in special marketing programs to targeted communities; they have experimented with more flexible underwriting and specialized servicing techniques to determine if a broader range of applications could be approved without undue risk; and they have funded credit counseling to improve the creditworthiness of potential borrowers.

Many larger institutions have developed specialized units within their organizations that focus on the needs of low- and moderate-income communities. There is growing evidence that a virtuous lending cycle has begun in many communities: once lenders know that others will be making loans to a community, liquidity risk is diminished, information is gathered and disseminated more quickly and positive information externalities can result. Increased lending by banks and thrifts to low-income communities has generally not led to the unprofitable or excessively risky activity predicted by critics.⁵

5. See generally BD. OF GOVERNORS, FEDERAL RESERVE SYSTEM, THE PERFORMANCE AND PROFITABILITY OF CRA-RELATED LENDING (2000) [hereinafter BD. OF

Of course, the rapid growth in lending to low- and moderate-income and minority borrowers and areas cannot be solely attributed to CRA. In fact, as noted by Treasury, a series of other factors undoubtedly helped to drive these gains. First and foremost, strong economic growth in the 1990s increased incomes and lowered unemployment rates for minorities and residents in many of the largest central cities. Second, mortgage interest rates were at low real levels during much of this period. Third, financial and technological innovation helped to drive down the costs of assessing creditworthiness, offering mortgage products, effectuating transactions and funding loans through securitization. Fourth, major consolidation in the financial services sector not only heightened the potential consequences of poor performance under CRA on regulatory approval of merger applications, but also enhanced competition for the delivery of credit products in lower-income markets. Fifth, CRA, fair lending, disclosure, and the government sponsored enterprise affordable housing goals all had an intensified effect during this period.⁶ Importantly, though, statistical analysis conducted for the Treasury report indicates that even after taking these factors into account, CRA itself had a positive effect on home purchase lending to lower-income borrowers and communities over the last several years.

Given the importance of CRA in spurring the revitalization of communities over the last decade, the Bush Administration should work to maintain the Act's effectiveness. The banking regulators are conducting a review of the 1995 CRA regulations. That review may result in proposals for revised CRA regulations in 2002. Regulators will need to wrestle with a series of thorny questions. Let me highlight only four here:

- In an era in which banks collect deposits, raise funds, and make loans not only across states, but also across national borders and over the Internet, what should "community" mean for purposes of a bank's "assessment area" in its CRA examination? The current framework, which focuses on physical locations where banks take deposits, rests on outdated notions of how banks do business. A more flexible approach is needed that lets banks better define their low- and moderate-income target mar-

GOVERNORS]. Loan performance during the economic downturn of 2001 will be important to evaluate going forward.

6. Although only touched on here, greater attention will need to be focused on the potential roles of the Government Sponsored Enterprises in expanding access to capital and combating abusive lending practices.

kets for providing services while strengthening protections against gerrymandering.

- While enormous progress has been made in home mortgage lending, increased commoditization of home mortgages—brought about in part by increasingly uniform credit scoring, technological innovation and changes in the secondary mortgage market—raises questions about the current regulation's focus on "bean counting" of mortgage loans, as well as the treatment of purchased loans and mortgage-backed securities. The regulation needs to preserve the gains that have been made in expanding home mortgage lending at an unprecedented pace and scale, while moving towards a more qualitative assessment of innovation in serving more difficult markets, and while better taking into account the funding roles of banks and thrifts.
- The "service" test of the CRA⁷ has been largely ignored in both theory and practice,⁸ yet low-income consumers face serious barriers to access retail financial services, as evidenced, in part, by the growth in payday lending, check cashers and other alternative providers. Basic bank accounts, for example, are important gateways for credit and other financial products.⁹ Regulators need to focus on the extent to which banks and thrifts are attracting low-income customers with innovative retail products and services that meet the needs of these populations.
- How should small banks be treated under the revised regulations? Although small banks successfully argued

7. The CRA service test, part of the large bank CRA examination, evaluates the availability and effectiveness of an institution's retail banking services. This generally includes an evaluation of the distribution of the institution's branches among neighborhoods of different income levels; an institution's record of opening and closing branches; alternative systems such as ATMs and loan production offices in low-income neighborhoods; and special community development services such as credit counseling or low-cost bank account programs. See LITAN ET AL., *supra* note 4, at 136–37.

8. See MICHAEL A. STEGMAN, ET AL., CREATING A SCORECARD FOR THE CRA SERVICE TEST: STRENGTHENING BASIC BANKING SERVICES UNDER THE COMMUNITY REINVESTMENT ACT (The Kenan Institute, University of North Carolina-Chapel Hill, Working Paper, June 2001) (documenting that only 15 CRA examinations out of nearly 2,000 conducted over the last five years have resulted in a rating of "needs to improve" on the service test, and that no bank has ever earned a "substantial noncompliance" rating on service activities).

9. See, e.g., Jeanne M. Hogarth & Kevin A. O'Donnell, *Banking Relationships of Lower-Income Families and the Governmental Trend Toward Electronic Payment*, 85 FED. RES. BULL. 463 (1999).

that they should be subject only to a simplified lending test under the 1995 regulation, with increased competition for commoditized mortgage loans, many smaller institutions now see their comparative advantage in retail services, more specialized lending and in some cases investment. This argues for developing reasonably straightforward analyses that small banks could bring forward to demonstrate how they meet the needs of their communities in those ways.

II. INVEST IN NEW MARKETS

In its final day of its last session of 2000, Congress enacted the bi-partisan Community Renewal Tax Relief Act, providing over \$25 billion in tax incentives for economic growth and affordable housing in low- and moderate-income communities across the country. The Act includes Renewal Communities championed by Reps. Watt and Talent, expansion of Empowerment Zones, a New Markets Tax Credit for \$15 billion in new equity invested in community revitalization and expansions of the Low Income Housing Tax Credit, Private Activity Bonds and brownfields tax incentive. These initiatives rely on private-sector driven, local strategies for growth, and recognize that private financial markets need to prime the pump for local business development. The new Administration should support these market-based approaches, which hold out the potential for engaging the private sector in significant ways to stimulate community revitalization.

A. *Implement the New Markets Initiative*

The New Markets Tax Credit (NMTC) holds special promise for communities in the coming years. Private investment funds will compete for allocations from the Treasury Department authorizing them to issue up to \$15 billion of equity as to which investors may claim tax credits worth over 30% of their investment, in present value terms. By leaving investment decisions in the hands of locally-based market participants, the NMTC is structured to be quite flexible. Investment funds will compete for tax credit allocations, raise private funds and then use these funds to invest in or provide loans to local businesses located in lower-income communities. The private sector has shown enormous interest in this new initiative, from commercial banks and investment funds to community development corporations. The NMTC will become an important part of economic growth strategies in communities across the country, as these privately-man-

aged funds help to grow businesses in low-income communities. In December 2001, Treasury issued guidance on the NMTC.¹⁰ The regulations are, by and large, flexible, prudent, and workable. Treasury needs now to launch competitions to allocate tax credits. The Bush Administration and Congress should take four additional steps in the coming months to ensure that the New Markets Initiative maximizes the competitiveness of businesses in these communities:

1. Strengthen the CDFI Fund's Capacity to Provide New Markets Technical Assistance

The NMTC is to be administered by the Treasury Department's Community Development Financial Institutions (CDFI) Fund, which has a strong track record in providing grants, loans, equity investments and technical assistance to specialized, locally-based, private-sector institutions focused on the revitalization of economically distressed communities. The CDFI Fund will need to provide technical assistance to investment funds that in turn provide capital to businesses in low-income communities. Community development venture finance is a new and growing field, relatively lacking in market participants who are experienced both in working in low-income communities and in business finance. Technical assistance could help mainstream investment funds form partnerships with local organizations to get up to speed on the particular barriers to business growth in low-income communities. Likewise, many community development organizations are in need of technical expertise to expand their focus beyond affordable housing and community revitalization to business lending and investing. The Bush Administration has reduced funding for CDFI in 2002 and 2003. Congress should restore funding to the CDFI Fund, allowing it to grow a vibrant community development venture finance market.

2. Experiment with New Markets Venture Capital Firms

SBA's New Markets Venture Capital (NMVC) program, is designed to provide critical technical assistance and loan guarantees to smaller venture funds focused on developing entrepreneurs in low-income neighborhoods. These entrepreneurs often lack access not only to equity capital, but also to the technical assistance that they need to succeed. SBA should be given time to fund and evaluate the effectiveness of NMVC companies.

10. 66 Fed. Reg. 66307 (Dec. 26, 2001).

3. Promote Private Sector Linkages through BusinessLINC

BusinessLINC, a private-sector led initiative led by the Business Roundtable, links Fortune 500 and other large companies with smaller firms. These linkages provide smaller firms with new market and joint venturing opportunities, business advice and technical assistance that are often critical for small businesses to succeed. These are not government-run technical assistance programs, but private-sector led, market-tested initiatives to bring the wealth of experience of larger corporations to smaller firms, particularly those in central cities or remote rural areas, where such firms are often cut off from mainstream business networks. At a small budget investment of less than \$10 million per year in seed funding, Congress could help to realize BusinessLINC's potential for enhancing the competitiveness of minority-owned, rural and inner-city businesses.

4. Enhance Market Information on Economically Distressed Communities

The Administration should further the potential for private sector growth in urban and rural communities by improving its role as a collector and disseminator of statistical information. Unlike statistical information about suburban jurisdictions or other areas with high concentration of businesses or wealth, information available to potential businesses or investors in many central cities and rural areas is woefully inadequate for business locational decisions or market analysis, and the information is viewed as too costly to obtain for any given business. The federal government, on an interagency basis, should improve its collection and dissemination of useful market data on central cities and rural areas and make it widely available to local governments and businesses. As a first step, Congress should fully fund the implementation of the American Community Survey, which will provide businesses and investors with more timely information about these markets than is available through the decennial census.

III. COMBAT ABUSIVE AND PREDATORY LENDING

For the vast majority of home owners, U.S. mortgage markets now work exceedingly well. Yet the enormous progress in expanding access to capital to low-income and minority communities has unfortunately been accompanied by an increase in abusive or predatory lending practices, particularly in the home mortgage market. Although varied in form, predatory lending typically entails brokers or lenders engaging in fraudulent or

deceptive sales practices or encouraging borrowers—often less educated, older, and concentrated in poor communities—to take on mortgage debt on unreasonable terms that can strip the equity in their homes and threaten their financial well-being.

When low-income families needed access to credit in the past, many may not have been able to find it due to their limited or poor credit history. With the rise of the subprime lending market, however, it has become relatively easier for these borrowers to access credit. The volume of subprime mortgage originations has increased nearly five times in the last five years. The Survey of Consumer Finances reveals that in 1998, nearly one in five households with income between \$10,000 and \$20,000 reported debt payments totaling more than 40% of its income. Increasingly, lower-income families secure this debt with home equity. The median value of home-secured debt for these families increased by 15% from 1995 to 1998, and contributed to an overall decrease in their net worth.¹¹ Having the ability to tap into home equity to pay for important expenses is crucial. Nonetheless, this trend is of concern, not only because it represents an increase in debt burden for struggling families, but also because it means that these families are putting their homes—their key financial asset—at risk in the event of default.

As a means for expanding access to credit, the development of the subprime mortgage market is quite positive. However, because the astounding growth in subprime lending has occurred largely outside the purview of federal regulation, the potential for abuses has grown in tandem with the new opportunities for credit. The number of market participants—considering both brokers and lenders—is huge, but the resources and legal authorities to monitor their activities are limited. A number of state and federal suits have been brought against predatory mortgage lenders, but evidence suggests that the problem may be growing faster than existing legal remedies can address. In particular, policing broker conduct with existing tools is difficult, disclosure requirements have proven inadequate and some

11. See Christine Dugas, *Homeowners Lose Equity in Spite of Economic Boom*, USA TODAY, Nov. 17, 2000, at 1B (citing Consumer Federation of America study for Freddie Mac). Average home equity fell 2% between 1989 and 1999, despite median home price growth of 49%. Hispanic home equity dropped 20%, while home equity increased 12% for Blacks, and 6% for lower income families. Some of the decrease in net worth among lower-income families may be due to greater availability of home mortgage products with higher loan-to-value ratios, which enable many families with down payment constraints to own their own homes.

lawful loan arrangements may be entirely unsuitable to low-income borrowers.

Treasury-HUD hearings and other evidence suggest, moreover, that many low-income communities still have difficulty accessing credit at banks, thrifts and credit unions. Without competition from mainstream lenders, low-income consumers in some neighborhoods may have little choice but to turn to alternative lenders offering higher priced products. Evidence that a sizeable percentage of subprime borrowers could qualify for prime credit suggests that banks and thrifts may be missing an opportunity to compete for a creditworthy portion of this customer base seeking home equity and home improvement credit.¹²

Unfortunately, credit market failures for lower-income consumers are not confined to the mortgage market. Problems have arisen with respect to short-term consumer lending, including payday lending, car title loans, appliance title loans, rent-to-own, pawnbroking and tax refund anticipation loans. The size of the market is considerable: Financial Service Centers of America (FiSCA), the check cashing industry's trade group, estimates that payday loan volume in 2000 topped \$1.2 billion, representing 45–60 million transactions. There are an estimated 12,000 companies in operation today providing payday loans.¹³ The products these companies offer may fill important credit needs for low-income consumers, but they come at a high cost,¹⁴ and consumers are often unaware of the full cost of the product or available alternatives. In addition, most payday borrowers refinance or "roll over" their loans multiple times in a year, effectively converting short-term borrowing to cover family budget shortfalls

12. See *Testimony on Predatory Lending Before the House Comm. on Banking and Financial Services*, 107th Cong. (2000); U.S. DEPT. OF TREASURY AND U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, *CURBING PREDATORY HOME MORTGAGE LENDING* 105 (2000).

13. Jerry Robinson, *Payday Advance—The Final Innings: Standardizing the Approach*, at <http://www.stephens.com>.

14. STATE PUBLIC INTEREST RESEARCH GROUP, *SHOW ME THE MONEY! A SURVEY OF PAYDAY LENDERS AND REVIEW OF PAYDAY LENDER LOBBYING IN STATE LEGISLATURES* (Feb. 2000). The state PIRGs' and CFA's February 2000 survey found an average APR of 474%—the equivalent of a \$36 fee on a two-week, \$200 advance. The most common APR was 390% (\$30 on \$200 for two weeks). The report explores payday lending in twenty-five states that span the spectrum of payday lending regulatory regimes: states with low usury ceilings (nineteen states); states without usury ceilings where the practice is permitted and licensed (eight states); and states where usury ceilings exist but payday lending is granted a safe harbor (twenty-three states and Washington D.C.). In five of the ten surveyed states with usury ceilings, the state PIRGs/CFA found that payday loans were nonetheless being made.

into longer-term, high-cost debt.¹⁵ The overwhelming majority of short-term consumer lenders are licensed at the state level, but subject to no examination and little regulation. In the past four years alone, nineteen states have adopted new laws or regulations clearing the way for payday lenders to operate in the state.¹⁶

Given the high number of lightly or un-regulated players and inadequate competition from mainstream lenders, the potential for abuse is ripe. Yet over-regulation of the subprime market could result in cutting off access to credit for low-income borrowers, the very individuals such laws are designed to protect. Recognizing this balance, a Treasury-HUD report issued last year proposed a four-part approach to curbing predatory home mortgage lending, including recommendations to: improve consumer literacy and disclosure; prohibit harmful sales practices; restrict abusive terms and conditions; and improve market structure. This framework could be equally beneficial in the short-term consumer lending context, although it would need to be adapted to those markets.

The new Administration has the opportunity to work with federal regulators and the states to get the balance right by continuing to democratize access to capital and protecting against abuses. While much can be done at the state level to improve regulation, supervision, and enforcement,¹⁷ a series of changes in federal law and regulation could help to make the credit markets for lower-income borrowers and neighborhoods work more like the prime market and help to drive out abusive and predatory lending practices. I want to highlight five key approaches here:

15. WOODSTOCK INST., REINVESTMENT ALERT #14: UNREGULATED PAYDAY LENDING PULLS VULNERABLE CONSUMERS INTO SPIRALING DEBT 3-6 (2000). The Indiana Department of Financial Institutions found that ninety-one percent of consumers rolled over their loans, with consumers taking an average of thirteen loans over a single year, ten of which were rollovers. A survey from the Illinois Department of Financial Institutions indicates that more than half of borrowers had more than ten loans over an average 18-month period, and twenty-one percent had twenty or more loans—nearly a year's worth of payday loans (borrowed or rolled over on a biweekly basis). *See also* Gregory Elliehausen & Edward C. Lawrence, PAYDAY ADVANCE CREDIT IN AMERICA: AN ANALYSIS OF CUSTOMER DEMAND (Apr. 2001) (indicating that a third of payday lending customers obtained more than fourteen loans in one year).

16. *See* Robinson, *supra* note 13, at 10.

17. Michael S. Barr, Remarks to the National Association of Attorneys General Predatory Lending Summit, Portland, Maine (Nov. 15, 2000) (transcript available at <http://www.ustreas.gov/press/releases/ps1025.htm>).

A. *Strengthen and Implement New Regulations on High-Cost Mortgage Lending*

First, the Federal Reserve Board, in December, 2001, issued a rule addressing the harmful sales practices and abusive terms often associated with high-cost mortgages using its existing authority under the Home Ownership and Equity Protection Act (HOEPA).¹⁸ The Board's rule would take significant steps towards limiting abusive practices. Congress could bolster the Board's action in a number of ways, including: banning the financing at or before closing of single premium credit insurance, products often "packed" into subprime loans; requiring lenders to report the full credit histories of borrowers to the credit bureaus; requiring lenders to offer the borrower a choice of a loan without a prepayment penalty; and including "yield spread premiums" in the points and fees trigger for HOEPA.¹⁹ The Board's requirement that creditors document and verify a borrower's ability to repay will help to deter asset-based lending, although stronger requirements analogous to securities disclosure and suitability standards have been suggested.²⁰ It should also be noted that the Board's rule changes made in December, 2001, under the Home Mortgage Disclosure Act (HMDA),²¹ complement its efforts on predatory lending in important ways, by requiring disclosure of certain rate spreads and of whether a loan exceeds HOEPA triggers; the rule could have been strengthened by including all rate spreads, points and fees, as well as other loan characteristics, in the reports.²²

B. *Hold Lenders Liable for Mortgage Broker Abuses*

Second, legislation is needed to hold lenders liable for failure to supervise brokers engaging in abusive practices. Often the

18. 66 Fed. Reg. 65,604 (Dec. 20, 2001).

19. See U.S. Department of the Treasury Comment on Regulation Z (Truth in Lending Act; Home Ownership and Equity Protection Act), Proposed Rulemaking Docket No. R-1090. Yield spread premiums permit lenders to pass on the cost of a mortgage broker fee to the borrower in the form of a higher interest rate rather than in the form of a cash payment at closing.

20. See U.S. Department of the Treasury and U.S. Department of Housing and Urban Development, *supra* note 11 (suggesting documentation of ability to repay be signed by broker and acknowledged as received by borrower three days prior to closing); see also Kathleen C. Engel & Patricia A. McCoy, *The Law and Economics of Remedies for Predatory Lending* (draft 3/7/01 presented to FRB Conference on Changing Financial Markets & Community Development Apr. 5, 2001) (calling for suitability standard).

21. 67 Fed. Reg. 7,221 (Feb. 15, 2002).

22. See U.S. Department of the Treasury Comment on Regulation C (Home Mortgage Disclosure Act) Proposed Rulemaking Docket No. R-1001.

source of abusive practices in the subprime mortgage market, brokers are simply too numerous, and too thinly capitalized, to be constrained by realistic threats of enforcement. There are far fewer lenders than brokers; federally insured depository institution lenders are subject to comprehensive examination and their mortgage lender affiliates may also be subject to risk-based examination; and state regulated lenders are, at least in theory, subject to state supervision, although states often lack adequate enforcement and supervisory resources. Holding lenders liable for failure to engage in effective oversight over brokers with whom they do business is critical. This legislation should be accompanied by increased funding for enforcement. The FTC has the authority to investigate and bring suit against lenders for unfair and deceptive practices associated with home mortgage lending. Its resources for pursuing such suits, however, are quite limited, and could easily be doubled in size next year. Federal policymakers should also consider whether certain additional disclosure and due diligence requirements on the secondary market—both GSEs and securities firms—with respect to high-cost loans could enhance discipline in the primary market.²³

C. Bolster Consumer Financial Education

Third, steps can be taken more broadly to improve consumer literacy and market structure that will help to ensure a more fair and efficient credit market for consumers. While the benefits of improving consumer financial literacy are innumerable, two stand out with respect to predatory lending. First, helping individuals to better understand credit, and encouraging them to prepare for financial contingencies through saving, can reduce their demand for credit altogether. Second, financially literate consumers who do need credit will be more likely to consider all of their credit options, and more likely to avoid high-cost, high-pressure products, such as costly home mortgage refinances, payday or auto title loans. In particular, financial education should focus on educating consumers on how to shop for mortgage and other loan products. The Bush Administration

23. Fannie Mae and Freddie Mac have announced certain voluntary steps to combat predatory lending; see Press Release, *Fannie Mae Chairman Announces New Loan Guidelines to Combat Predatory Lending Practices* (Apr. 11, 2000) at <http://www.fanniemae.com/news/pressreleases/0710.html>; see also Press Release, *Newspapers Report Legislative Progress on Anti-Predatory Lending Legislation* (March 15, 2001) at <http://www.freddiemac.com/news/analysis/predindex.html>. Similar steps could be taken by other market participants who hold more significant shares of the subprime market.

should help lower-income Americans to better understand how to access and manage credit effectively.

D. *Enhance Competition for Lower-Income Consumers Among Prime Lenders*

Fourth, mainstream depository institutions can, and should, play an important role in improving the credit market for lower-income consumers. Evidence to date suggests that the low-income market can be a profitable one for banks,²⁴ and recent census data confirm that minority and new immigrant communities will need to be a growing share of any bank customer base. Banks can get ahead of the curve by moving more quickly and creatively to serve central city markets where these growth populations disproportionately live and work. Bank regulators can help stem the explosive growth of high-cost short-term lending services by focusing attention and providing additional guidance on the CRA services test for large banks, a part of the CRA examination that is largely ignored in practice. Moreover, serving the credit needs of lower-income borrowers and communities, as intended under the CRA, also means providing these consumers with access to the mortgage products for which they qualify. However, evidence suggests that lower-income borrowers may be ending up in a bank's subprime unit, or subprime affiliate, when in fact they could qualify for a mortgage on better terms. Banks and thrifts should have in place procedures to "upstream" these borrowers with good credit histories into their prime mortgage units. The federal banking regulators should consider how banks and thrifts might be given CRA consideration for "promoting" borrowers from the subprime to the prime market.

E. *Increase Scrutiny of Payday Lending Transactions Involving Federally Regulated Banks*

Laws and regulations governing short-term lending activity are largely at the state level. The federal government, however, should devote attention to the growing activities of depository financial institutions in this market. A handful of national banks are exporting high interest rates to payday lending outlets in states with usury laws, thus circumventing those states' implicit restrictions on payday lending. These new partnerships between banks and alternative financial service providers increase the need for effective supervision by the federal banking regula-

24. See, e.g., BD. OF GOVERNORS, *supra* note 5, at 69–70.

tors.²⁵ Regulators should ensure that banks are not merely “renting” their names to payday lenders to evade state usury laws, but in fact are ensuring proper underwriting and disclosure, as well as appropriate consumer protections. To the extent that federally-regulated financial institutions are involved, regulators should play particular attention to the problem of repeated refinancings. In addition, as noted above, greater attention to the CRA services test could help shed light on bank practices in this area.

V. BANK THE UNBANKED

In addition to improving the structure of the credit market for lower-income consumers, the Administration should foster a financial services marketplace for families who currently lack the most basic of all financial products—a bank account. The Federal Reserve reports that in 1998, approximately 22% of families earning under \$25,000 had no bank account.²⁶ These families were approximately four times as likely to be “unbanked” as other families. Being unbanked was not just associated with having a low income—nonwhite and Hispanic families, about one in four of whom has no bank account, were five times as likely to be unbanked as white, non-Hispanic families.

Altogether, the size of the unbanked population in the United States is approximately ten million families. For some of these families, being unbanked may be the most rational choice, regardless of the options available in the marketplace. They may wish to keep their finances private, or they may be undocumented aliens who lack the requisite identification to open an interest-bearing account. Others may simply not want an account. A significant amount of evidence suggests, however, that the problem for most unbanked families is lack of supply. Numerous studies have confirmed that the unbanked would become “banked” if they found an account product that worked for them:

25. The OCC has recently taken important steps in this regard. *See, e.g.*, OCC Bulletin, Third-Party Relationships (OCC 2001-47, Nov. 1, 2001) (advising national banks on risk management); OCC consent order in the matter of Eagle National Bank, Upper Derby, PA (OCC 2001-104, Dec. 18, 2001) (ordering bank to cease making payday loans).

26. Checking account, savings account, money market deposit account or brokerage call/cash account. Arthur B. Kennickell et al., *Recent changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances*, FED. RES. BULL. (2000). The same report found that 9.5% of all U.S. families (all income categories) did not have a bank account. This was down from about 13% of all families in 1995.

- Treasury-commissioned research by Dove Associates found that unbanked African-American federal check recipients were approximately twice as likely as unbanked white recipients to enroll in a product similar to the Electronic Transfer Account.²⁷
- Many unbanked individuals already use banks to cash their checks. In a 1997 study of lower-income households that did not have deposit accounts, John Caskey found that about half of respondents usually cashed their check at a bank, savings and loan or credit union.²⁸ Fully 70% of unbanked households acknowledged that they had owned a checking or savings account in the past.²⁹
- Institutions that have offered products tailored to the needs of the unbanked have met with success. Banco Popular of Puerto Rico, for example, introduced *Acceso 24* in 1995, a non-interest bearing electronic account with ATM card, no minimum monthly balance, free direct deposit, unlimited ATM access and a very low monthly fee. The bank has enrolled tens of thousands of Puerto Rico customers in the product.³⁰ In one year, Bank One's Alternative Banking Program, operating in only six Chicago neighborhoods, opened 1,000 checking accounts and over 500 savings accounts for unbanked families. The retention rate is over 80%. All of the ABP account holders would have been ineligible for tradi-

27. Dove Assoc., Inc., *ETA Conjoint Research: Final Report and Market Model Unbanked Federal Check Recipients* (1999) (unpublished report), at <http://www.fms.gov/eta/conjoint.html>. The Electronic Transfer Account (ETA) is a low-cost, electronically-based account designed by the Department of Treasury and available to federal benefit recipients at 600 banks and 17,400 branches nationwide.

28. JOHN P. CASKEY, INCOME AMERICANS, HIGHER COST FINANCIAL SERVICES 22 (1997). Treasury studies of unbanked federal recipient demographics arrived at similar findings.

29. *Id.* at 20. Other research, however, suggests that where unbanked individuals conduct their financial business may depend on where they are located. The 1999 Metro Chicago Information Center annual survey of Chicago households indicated that 71.8% of surveyed unbanked households regularly cashed their checks at a currency exchange (colloquial term for check casher), while only 15% regularly used a bank. This difference may reflect regional differences, or differences between inner city and other unbanked individuals. Sherrie L.W. Rhine et al., *The Role of Alternative Financial Services Providers in Serving LMI Neighborhoods* (March 2001), at tbl. 6 (paper prepared for Federal Reserve System Conference "Changing Financial Markets and Community Development Conference, Federal Reserve System" on April 5-6, 2001).

30. Banco Popular de Puerto Rico's response to U.S. Department of Treasury Request for Information on First Account (December 11, 2000).

tional Bank One accounts, mostly because they lacked credit history.³¹

If demand for accounts among the unbanked is indeed considerable, why do they remain unbanked? Evidence suggests that the options available to these families are limited. Most accounts are ill-designed to meet the needs of the unbanked, and many families are unfairly denied the opportunity to own accounts due to past problems with the system:

- Regular checking accounts may not make economic sense for many lower-income families. A 1999 U.S. Public Interest Group study on bank account fees found that consumers who could not meet account balance minimums for a regular checking account at a bank paid an average of \$217 annually (\$18/month).³² Notably, a recent Treasury study showed that a full-time worker earning the federal minimum wage would pay, on average, the same amount to cash his paychecks at a check cashing outlet.³³ Most banks also levy high charges for bounced checks—these fees average between \$20 and \$25 per bounced check. Households with low incomes are at greater risk of paying these fees both because they maintain low balances and because they may have less experience in managing household finances.
- Lower-income communities have fewer access points to the financial services mainstream. A September 1997 study by the Federal Reserve Board of Governors found that low-income central city neighborhoods have fewer bank offices than higher-income neighborhoods and those outside the central city.³⁴ In addition to lacking

31. *Reinvestment Alert #15: Community-Bank Partnerships Creating Opportunities for the Unbanked*, REINVESTMENT ALERT (Woodstock Institute), June 2000, at 6.

32. U.S. PUBLIC INTEREST GROUP, *BIG BANKS, BIGGER FEES: PIRG's 1999 BANK SURVEY* (1999). According to the study, the average minimum balance required to avoid fees for checking accounts at large banks was \$616. Even for "no-frills" accounts, which provide limited check-writing with no minimum balance, consumers paid an average of \$148 annually to maintain an account. Only 26% of large banks surveyed offered a low-cost all-electronic account (average monthly fee \$3.77), and only 17.5% offered free checking (typically with direct deposit).

33. DOVE CONSULTING, U.S. DEP'T OF THE TREASURY, *SURVEY OF NON-BANK FINANCIAL INSTITUTIONS* 57 (2000), available at <http://www.ustreas.gov/press/release/docs/nbfirpt.pdf> (Study found that in the markets surveyed the cost to cash a payroll check averaged two percent of the face value).

34. Robert B. Avery et al., *Changes in the Distribution of Banking Offices*, 83 FED. RES. BULL. 707, 721 tbl.9 (1997). Using 1995 Federal Reserve and OTS data, the study looked at the concentration of bank offices in low-income resi-

access to “brick-and-mortar” banks, these communities have fewer opportunities to access the banking system electronically through ATMs. Using data from the national Mastercard/Cirrus ATM network³⁵ and 1990 Census data, Treasury found that in New York and Los Angeles, there are nearly twice as many ATMs per resident in middle-income zip codes as there are in low-income zip codes.³⁶

- An often overlooked barrier to banking the unbanked is the significant portion of the unbanked who have had prior problems with the banking system. Nearly seven million individuals, for example, are currently recorded as having had their accounts closed because of prior problems with their accounts—whether fraud or inadvertent error—in ChexSystem, a database used by most banks to decide whether an applicant should be allowed to open an account. These records are generally kept in the ChexSystem for five years after first entry. Banks rightly concerned with the need to protect against fraud have generally refused to open accounts for individuals in the ChexSystem. However, the system provides little detail on the reasons that an individual’s account may have been closed, and banks generally treat the appearance of an applicant’s name in the database as cause for refusing to open an account for that person, regardless of the type of account product under consideration.

Helping to bank the unbanked could help the economy to achieve new efficiencies, and help low-income families to cut costs and begin saving for the future:

dential central city zip codes. In central city zip codes where median income was less than 50% of area median income, and where at least 33% of housing was owner-occupied, there were 1.2 bank offices per 10,000 residents (representing 2.7 million residents in 1995). By comparison, higher-income suburban zip codes—where median income was 120% or greater than area median income—had 3.42 bank offices per 10,000 residents in 1995 (these zip codes represented 2.6 million residents). *Id.* at 720 tbl. 8.

35. Mastercard/Cirrus is the second largest EFT network in the United States (after Visa/PLUS). A 1999 survey of ATM deployers by Dove Consulting found that 64% of those surveyed were members of the Mastercard/Cirrus network. This analysis does not include merchant point-of-sale (POS) locations. See DOVE CONSULTING, *supra* note 33.

36. Los Angeles included residential zip codes in Los Angeles county. New York included zip codes in New York, Queens, Kings, Bronx, Richmond, Rockland, Putnam and Westchester counties. Middle-income zip codes were those with \$25,000 to \$50,000 median household income in 1990; low-income zip codes had less than \$25,000 median household income in 1990. Internal US Treasury research, 2000.

- Banking the unbanked can increase the efficiency of the economy. For example, it costs just two cents for the Federal Government to pay an employee by electronic transfer whereas it costs forty-two cents to process a paycheck. This is the reason why over the past five years, Treasury has worked to increase the number of individuals who receive their benefits by Direct Deposit, and to make the low-cost Electronic Transfer Account (ETA) available to these individuals at banks, thrifts and credit unions.³⁷ Private sector employers face similar costs and can achieve savings by moving their employees into Direct Deposit relationships. Financial institutions can also gain by banking the unbanked. Surveys of the unbanked indicate that about half of households without bank accounts regularly cash their checks at banks, thrifts or credit unions, and often at no fee. By moving customers who already are in the bank lobby into an account relationship, banks can reduce costs and generate revenue.
- Low income families face relatively high costs from being unbanked.³⁸ In 2000, Treasury surveyed check cashers in Atlanta, Boston, San Antonio and San Diego. The survey results indicate that the average fee to cash a \$500 payroll check in these markets ranges from \$8 to \$14, so that a worker earning \$12,000 a year would pay approximately \$250 annually to cash payroll checks at these establishments.³⁹ If that worker had a child and filed for the federal Earned Income Tax Credit, the survey data indicate that it would cost him or her over \$40 to cash the \$2,200 refund check associated with that level of earnings.

37. As part of the Treasury strategy to bank unbanked federal benefit recipients, Treasury shares a portion of its processing savings with financial institutions that provide the ETA to recipients. For each ETA a participating financial institution opens, it receives \$12.60 from Treasury to offset account opening costs. See e.g., John P. Caskey, *Reaching Out to the Unbanked* (April 2001), at <http://www.chicagofed.org/cedric/2001/session1paper3.pdf> (Paper prepared for Federal Reserve Conference "Changing Financial Market & Community Development" on April 5-6, 2001).

38. In a survey of unbanked households in New York and Los Angeles, it was found that 43% of unbanked households regularly used a check cashing outlet for financial services. Constance R. Dunham, *The Role of Banks and Non-Banks in Serving Low and Moderate-Income Communities*, (March 2001), at <http://www.chicagofed.org/cedric/2001/session1paper1.pdf> (Paper prepared for Federal Reserve System Conference "Changing Financial Markets & Community Development" on April 5-6, 2001).

39. See DOVE CONSULTING, *supra* note 33, at 36.

- Despite the low incomes of the unbanked, helping them to access bank accounts may help them to begin saving and gain access to credit and other financial products. Hogarth and O'Donnell found that owning a bank account was highly correlated with ownership of other financial products, including mortgage loans, automobile loans and certificates of deposit—more so than household net worth, income or education level.⁴⁰ Dunham found that regardless of income, individuals with bank accounts were more likely to save on a continual basis than were unbanked individuals.⁴¹ This finding is consistent with research in the IDA field, discussed below, that emphasizes the importance of institutionalized mechanisms such as bank accounts or retirement accounts in promoting savings. Thus, access to a bank account can be an important entry point for participation in the financial services system and progression to a wide range of other services over time.

A. *Private Sector Innovation*

To help bank the unbanked, private sector innovation and outreach will be critical. Caskey advances a model in which mainstream depository institutions operate stand-alone outlets in lower-income communities that offer deposit products, such as low-cost transaction accounts, and fee-based services, such as check cashing and money orders. These outlets would look like check cashers, but would offer lower prices to unbanked consumers, as well as the opportunity for them to transition to a deposit relationship.⁴² More than just opening a new branch, depository institutions entering this market would need to ensure that these outlets are sensitive to the needs of the clientele they seek to serve. Treasury research found that NBFIs hire employees that speak their customers' languages, that they are open for about seventy hours per week including Saturdays and that they are typ-

40. Hogarth & O'Donnell, *supra* note 9, at 463.

41. Dunham, *supra* note 36, at 20.

42. See Caskey, *supra* note 35, at 6–12. He estimates that such an outlet could earn approximately \$100,000 a year from fee-based services alone. *Id.* at 14. Treasury research on check cashers in four U.S. markets found that annual pre-tax income for the larger outlets that banks could be expected to support averaged over \$65,000. DOVE CONSULTING, *supra* note 33, at 10. Since outlets operated by depository institutions could save money on interest costs of funds—one of the largest costs incurred by check cashers—Caskey's estimate seems reasonable.

ically located within half a block of a public transportation route.⁴³

In reaching out to the unbanked population, the private sector should take the lead in removing the barrier to banking that ChexSystem creates for many lower-income families. First, the system itself could do a better job of working with financial institutions to classify prior problems more carefully as between fraud and overdrafts (or other problems).⁴⁴ Second, banks could experiment with providing accounts to individuals in the system contingent on completion of appropriate financial literacy classes or counseling.⁴⁵ Third, banks can offer electronically-based products with little or no risk of overdraft that effectively lower the risk profile of the consumer.

Employers of low-income workers also have a critically important role to play. By encouraging their employees to sign up for direct deposit, employers can not only reduce their own payroll costs, but also help bring their workers into the financial services mainstream. Employers can provide on-site financial education and information on available accounts. They can also educate their lower-income workers about the Advanced Earned Income Tax Credit; through reduced withholding, the credit can be directly deposited along with payroll into their workers' accounts.

Creative private sector solutions can continue to diminish the number of unbanked and increase competition in the provision of financial services for the poor. But in order to foster innovation in the private sector, there are a few key steps the Administration can take. As discussed above, the CRA service test needs to be more clearly defined. Bank regulators can work with financial institutions to develop safe ways to accommodate individuals in the ChexSystem as well as "know your customer" rules. Most importantly, a governmental incentive may be necessary in the short term to assure that low-cost accounts can be offered to the poor on a reasonably profitable basis.

43. See DOVE CONSULTING, *supra* note 33.

44. ChexSystem is beginning to explore this problem with Milwaukee's Alliance Credit Union as part of the credit union's "Get Checking" program. See Alliance Credit Union, *Get Checking*, at <http://www.acuwi.org/getchecking.htm> (last visited Aug. 26, 2001).

45. The Greenlining Institute is working with the Federal Reserve Board of San Francisco on such an approach, with several major banks considering how they might apply more flexible standards. The "Get Checking" program at Milwaukee's Legacy Bank and Bank One's Alternative Banking Program are other examples of such approaches. As noted, however, accounts without checking features may be the most appropriate products for unbanked individuals who are "re-entering" the banking mainstream.

B. *Connect Families to the Financial Services Mainstream*

In laying the groundwork to bring the unbanked into the financial services mainstream, the Administration should implement Treasury's pilot initiative, known as "First Accounts."⁴⁶ This initiative is designed to support research and development by financial institutions into meeting the needs of low-income customers; provide incentives to financial institutions for offering electronically-based accounts designed to meet low-income consumer needs and for expanding distribution of these accounts through ATMs, internet kiosks, POS, or otherwise; and expand the availability of financial education. Additionally, Congress should expand this initiative in 2002, permitting pilots to operate in multiple markets with rigorous evaluation to guide the private sector towards the most innovative, useful and cost-effective solutions to helping lower-income families overcome barriers to banking.

Once the pilot projects have been evaluated, the Administration should work with Congress to bring the program to scale by providing \$1 billion in tax credits for financial institutions to offset the costs of providing new low-cost electronic banking accounts to up to ten million low- and moderate-income "unbanked" families. Ownership of a bank account is the passport to the modern economy, and low-income households in central cities too often have to rely on expensive alternatives that reduce their take home pay and ability to save. Banks can develop innovative electronic products that nearly eliminate the risk of overdraft and dramatically reduce the cost of offering accounts. By offering these products through new storefront branches in lower-income areas, or through ATMs, POS or the Internet, banks could realize new profits and enhance competition for the provision of financial services in underserved neighborhoods across the country.

VI. BUILD ASSETS FOR LOW-INCOME FAMILIES

Participation in the financial services mainstream is most meaningful when individuals and families can leverage their banking relationships to improve their economic life over time. Savings products can provide lower-income consumers with that leverage. Michael Sherraden and Sondra Beverly at the Center for Social Development identify four determinants of saving: (1) institutionalized saving mechanisms, such as 401(k)s and IRAs;

46. Treasury issued a request for proposals in December, 2001, and is expected to make awards in May, 2002.

(2) financial information and education, such as that provided in retirement education seminars; (3) saving incentives, such as matching employer contributions; and (4) facilitation mechanisms, such as payroll deduction. They suggest that access to these mechanisms increases the amount that individuals save, and that these mechanisms are not available to most low-income U.S. households.⁴⁷ In fact, the tax system—where the bulk of savings benefits are provided in the United States—largely subsidizes wealth creation among higher-income households. Two-thirds of pension tax expenditures go to families in the top 20% of the distribution. For families at the bottom of the income distribution “who pay no federal income tax, 401(k) and IRA tax incentives are worth nothing.”⁴⁸

The “American Dream Demonstration,” a privately-funded nationwide demonstration of Individual Development Accounts (IDAs), has shown that given similar incentives, low-income people can save.⁴⁹ Over the first two years of the program, over 2,300 low-income participants enrolled in an IDA. Nearly 90% of participants lived in households with incomes below 200% of the poverty line (about \$27,000 for a family of three), and about half lived below the poverty line. Most were female, unmarried, minority and urban dwellers. Their savings outcomes are notable: even at low-income levels, participants were saving an average of \$25 per month. Very low-income households saved at higher rates than other households, and overall participants saved 2.2% of income. Notably, average monthly deposits did not appear to be affected by the levels of assets a household owns, indicating that IDA savings are new and not transfers of existing savings.

Additional evidence supports the conclusion that savings account features have appeal for the unbanked. For low-income savers, a savings mechanism may be more important than incentives to boost the rate of return. In a Treasury survey of unbanked federal check recipients, respondents were aware that an ETA savings feature would only pay a nominal rate of interest (explicitly stated as “\$2 annually on a \$100 deposit”), but this

47. Sondra G. Beverly & Michael Sherraden, *Institutional Determinants of Saving: Implications for Low-Income Households and Public Policy*, 28 J. OF SOCIO-ECON. 457 (1999).

48. Lawrence H. Summers, Remarks at the Choose to Save Forum (April 4, 2000) (transcript available at <http://www.treas.gov/press/releases/ps524.htm>).

49. MARK SCHREINER ET AL., CTR. FOR SOC. DEV. AT WASHINGTON UNIVERSITY IN ST. LOUIS, SAVINGS AND ASSET ACCUMULATION IN INDIVIDUAL DEVELOPMENT ACCOUNTS (2001).

feature accounted for 25% of the typical respondent's decision on whether to enroll in the ETA.⁵⁰ In the Bank One Alternative Banking Program, more than one-third of the accounts opened in the program are savings accounts, and the average balances in both the checking and savings accounts established under the program are relatively high—\$600 for checking accounts and \$1,300 for savings accounts.⁵¹ Researchers have also found that low-income taxpayers over-withhold on their income taxes more frequently than higher income taxpayers; some economists suggest that these taxpayers use withholding as an automatic savings mechanism. This may suggest that demand for savings among some of the working poor is high even with an implicit zero or negative interest rate.⁵²

A. *Enact New Incentives for Saving*

The Administration should enact new incentives to help low- and moderate-income families enter the financial services mainstream, save for the future and build wealth. Given the fact that for many low- and moderate-income families, the primary financial asset is their own home, the Administration has taken an important step in this regard with its proposal for a homeowner-ship tax credit. If enacted, the credit could help to spur the construction or rehabilitation of homes for low-income persons.

Individual Development Account programs have demonstrated that low-income individuals can save. These pilot programs, however, have been undertaken at relatively low scale, and are too reliant on non-profit administration and foundation support to develop wide scale usage at reasonable levels of efficiency. Individual Development Accounts need to be made to work more like integral parts of the financial services system, and be offered by mainstream financial institutions. IDAs may always require additional elements of financial education or counseling provided by non-profit organizations, but the core tasks of marketing, offering and managing accounts are the proper functions of financial institutions. The key issue, therefore, is how to encourage more financial institutions to offer these accounts, which will often have relatively low deposits and may have significant additional overhead costs.

50. BACHELDER, *supra* note 23.

51. WOODSTOCK INSTITUTE, *supra* note 29. As noted previously, none of the families that hold these accounts could have qualified for a conventional Bank One account due to their blemished or limited credit history.

52. Jannett Highfill et al., *Tax Overwithholding as a Response to Uncertainty*, 26 PUB. FINANCE REV. 376 (1998).

A promising approach is to provide financial institutions with a tax credit for offering IDAs. The Administration should enact the Savings for Working Families Act of 2001, introduced by Senators Santorum (R-PA) and Lieberman (D-CT) and Representatives Pitts (R-PA) and Stenholm (D-TX).⁵³ The Act creates an Individual Development Account (IDA) Tax Credit. Under the Act, IDAs could become the poor person's IRA, helping them to save for retirement, home ownership, entrepreneurship and education. The Act, at a cost of \$12.5 billion over 10 years, would provide a 100% tax credit to financial institutions for providing matching funds to IDA account holders of up to \$500 per year, together with tax credits to offset the costs of opening and administering accounts. By transforming IDAs from a non-profit centered, relatively small scale initiative into a depository-institution-focused, profit-driven enterprise, the Act would help to transform saving and financial services for low- and moderate-income families.

Expanding access to financial services is at the core of any wealth-building strategy for low-income Americans. A wealth-building strategy could have important implications not only for reducing poverty, but also for reducing racial disparities on a host of economic and social issues.⁵⁴ By focusing on building opportunities for the poor to accumulate assets, federal policy can help to empower low-income Americans to manage household finances and weather out financial emergencies, to plan financially and save for the future and to leverage their assets to access additional capital for homeownership, education and business. Thus, strategies for increasing access to bank accounts and savings vehicles are mutually reinforcing of a strategy for increasing access to capital.

CONCLUSION

U.S. financial services markets work extraordinarily well for most families. For low-income Americans, however, much more can be done to continue to democratize access to capital and financial services. In particular, federal policy should focus on five key areas: attention should be paid to ensuring that any new regulations under the Community Reinvestment Act take account of changing market circumstances. New incentives are needed for business investment in low income communities.

53. In its 2003 budget proposal, the Administration has proposed a pilot IDA tax credit for up to 900,000 accounts at a cost of \$1.7 billion.

54. DALTON CONLEY, *BEING BLACK, LIVING IN THE RED: RACE, WEALTH AND SOCIAL POLICY IN AMERICA* (1999).

Abusive lending practices need to be pushed out of these markets. Low-income families need better access to the banking system. And working families need new avenues to save. Access to capital and financial services is the lifeblood of economic growth for low-income communities and a key to economic success for low-income families. Thus, reform of financial services for the poor should be at the center of any anti-poverty policy. By catalyzing private sector innovation in these five key areas, federal policy can help to transform financial services for the poor, promoting greater economic opportunity for low-income families and communities in the 21st century.

