Remarks by
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Winston Churchill used to say of democracy that it was the worst form of government ever devised -- except for all the others. Churchill's comment can also be applied to banking. Although little loved, banks are nonetheless the best instruments yet invented for the promotion of thrift, wealth, and general prosperity. That's why we focus so much on what banks can do to help improve the lot of Americans who remain outside the financial mainstream. And that's what I want to focus on this afternoon.

Bankers have never had a monopoly on the provision of financial services in this country. They have always shared that market with a host of other providers -- many of them unregulated -- and that's never been truer than it is today. A walk through virtually any town or city in America gives a sense of how diverse the financial marketplace is, and how many different kinds of financial providers operate and compete in our communities. All of them have a role to play in meeting a wide variety of financial needs. Choice, after all, is an essential element of our economy, and to suggest that banks can be, or should try to be, all things to all people would be unrealistic.

Yet not all financial providers are created equal. As the risk of sounding parochial, let me suggest that banks add unique value to the services they deliver. Though there may be no end of places to cash a check, get a loan, or pay a bill, the millions of Americans who -- for whatever reason -- don't obtain those services through a bank lose something important in the process.

What they lose are the tangible and intangible benefits that a relationship with a mainstream financial institution can provide. That may include the incentives and institutional support necessary for individuals to build assets, transaction services at prices below those of unregulated fringe providers, and financial services that fringe providers can't offer at all, such as safe repositories for funds, and cheap and efficient payment services. For a small business loan, a loan for education or job training, or an affordable mortgage, only a bank or other mainstream institution will usually do.

There are also the benefits of building a formal credit history and a long-term financial relationship with a bank. The importance of those intangible benefits cannot be exaggerated for anyone who wants to climb the ladder of success in this country today.

If all this is so, why then do some 10 million American families still not have an account with an insured depository institution? It's possible, of course, that the benefits I've just described are not well understood by those who don't presently enjoy them. Thus, the work that you, and a host of government, community, and consumer organizations around the country do to enhance basic understanding of financial issues is a crucial aspect of tackling this problem. Educating people about making wise choices and avoiding the pitfalls that dot the road to financial security will always be an important facet of any strategy to address the problem of the unbanked.

Another explanation is the physical shortage of banking outlets in communities that are home to the unbanked -- a situation that could be related to the consolidation that has taken place in the banking industry. A recent government study found, not surprisingly, that low-income central city neighborhoods have fewer bank offices than higher-income neighborhoods and those outside the central city. Affluent neighborhoods, where the median income was 120 percent or greater than the area median income, had three times as bank offices per 10,000 residents as neighborhoods where the median income was 50 percent of area median income. In New York City, at last count, only 2.5 percent of all bank branches were located in low-income areas that housed more than six percent of the city's total households. In those areas, unregulated check-cashing establishments outnumbered bank branches by as much as two to one.

When we look for explanations from banks that have a low profile in low- and moderate-income neighborhoods, what they tell us is usually valid -- but not necessarily sufficient. Some have tried to make a go of it, only to find that they were unable to make a profit. Some have pulled out of certain communities -- or chosen not to enter them in the first place -- due to security concerns. And others have decided that service to the unbanked was inconsistent with the upscale image they were seeking to cultivate.

It's obvious, I think, that in order to serve the community effectively, an institution should have a physical presence there. But the lack of physical access to banks cannot be the entire answer to the problem of the unbanked. Many of those who remain outside the banking system are there by choice. Neighborhood residents will walk right past the local bank branch -- which is usually pretty hard to miss -- to get to the check-cashing outlet next door. Obviously, even where banks do operate, they're not always meeting the needs of the local community.

The best way to find out what those needs are is to ask, and when we do, we usually hear the same thing. People who lack banking relationships tell us that they are uncomfortable in banks and, especially in communities in which English is not the dominant language, that it's sometimes difficult to communicate with bank personnel. Some express concerns about confidentiality. But more than anything else, they tell us that conventional banking services simply cost too much for small customers. And the evidence suggests they're right.

According to a 1999 study by the U.S. Public Interest Research Group, the average minimum balance required to avoid fees for checking accounts at large banks was $616. Consumers who were unable to meet that minimum balance requirement paid an average of $217 a year, or $18 a month, to maintain a checking account. That's about the same price that a full-time worker earning the federal minimum wage would pay to cash his or her paychecks at a typical check-cashing outlet. Even for "no frills" accounts, which provide limited check-writing with no minimum balance, consumers paid an average of $148 a year. Most banks also levy high charges for bounced checks -- as much as $20 to $25 each. Indeed, I once heard a representative of one of our major money center banks boast about how bounced check fees were an important profit center for his institution -- which, if true, is shocking and, in any event, not a very smart thing to say publicly. Households with low incomes may be at greater risk of paying these fees, both because they maintain low balances and because they may have less experience in managing household finance.

Given these realities, it's no wonder that so many low- and moderate-income Americans choose not to conduct financial transactions at a bank. But it's a decision that carries serious long-term consequences -- for the unbanked, for the economy, and for banks themselves, which lose customers whose business could well be profitable over time. The challenge, then, is to find a way to build relationships between the unbanked and the mainstream financial institutions that make economic sense for both, over the short- and long-terms.

We have a prototype for such a relationship in the Electronic Transfer Account, or ETA, which was developed under my direction when I served as Under Secretary of the Treasury for Domestic Finance. It would be superfluous for me to describe in detail the features of the ETA to an organization that has been as intimately involved as NCRC has been in its development and promotion. The opportunity should not pass to congratulate you on the important role NCRC continues to play in this effort.

But in the context of our discussion today, it's important not to forget that that ETA concept evolved from a business decision by Congress, embodied in the Debt Collection Improvement Act of 1996, to reduce the cost of delivering Federal payments by requiring that they be delivered electronically. Projections were that, when fully implemented, the conversion from paper to electronic funds transfer would save the government upwards of $100 million per year -- 28 cents for every paper check that would no longer have to be printed, issued, and mailed -- and replaced when the first one went astray.

Of course, it was widely understood that these savings were not going to materialize unless those required to receive payments electronically had the means to do so, and we estimated that nearly 20 percent of all Federal benefits recipients did not have accounts at a financial institution. The Debt Collection Improvement Act mandated that the Secretary of the Treasury assure that anyone required under the Act to receive a payment directly have access to an account at a bank for that purpose at a reasonable cost. It was in response to this mandate that we developed the ETA -- a model for a utilitarian, all-electronic account, which, for a fee of no more than $3 a month, allows recipients of many kinds of Federal payments, including salaries and retirement benefits, to access their funds automatically through electronic funds transfer. The ETA was purposely designed as a "bare bones" model, in order not to preempt the development of more elaborate accounts by banking institutions.

With the help of NCRC and more than 1400 local community-based organizations, consumer groups, and faith-based groups who are participating in the nationwide ETA campaign, we're making tremendous progress in getting the word out to potential account holders. And financial institutions, which receive $12.60 for every ETA they open, are rapidly signing up to offer it. Right now the ETA is available at more than 600 financial institutions with thousands of branches nationwide.

What's particularly encouraging is that many of these institutions are aggressively marketing the ETA as part of their basic retail banking strategy. Some banks are waiving or reducing the monthly service charge, making low-cost money orders available as an additional benefit to account holders, and allowing ATM withdrawals in excess of the four they are required to allow under Treasury rules. Some banks are offering cash bonuses to the account holder when the first government payment is received. Some are holding promotional events with local government officials. Others encourage tellers to talk about ETA with customers trying to cash a Federal check, and offer tellers a bonus for every ETA customer they sign up

Any program so new is inevitably a work in progress, and we certainly have a long way to go before we can declare the program a success. How shall we measure that success? Not so much, I believe, in the number of ETAs that are opened, though that's important. I think, rather, that the ETA's greatest value is as a stepping stone -- for customers who use them to get a foothold into the financial mainstream <u>and</u> for financial institutions who use the ETA as a model to bring the benefits of a banking relationship within reach of others. I see the ETA as a prototype for a technology-intensive, low cost account capable of generating profits -- or at least paying its own way -- for the banks that offer them and attracting millions of Americans who do not currently receive Federal payments into the banking system. That's what I meant by the importance of building relationships between the unbanked and mainstream financial institutions that make economic sense for both.

Technology, I believe, is crucial to the solution. The savings generated by a shift from paper-based systems, like traditional checking accounts, to electronic delivery should make it possible for banks to offer low- and moderate-income customers basic banking services at prices both can afford. That was the logic behind the ETA, but it doesn't require government involvement to make it work. The importance of technology has significant implications for legislators and community groups that have typically focused on traditional paper-based delivery in promoting so-called "basic banking" legislation as a solution to the problem of the unbanked.

The ETA, and similar types of electronic accounts, also have important implications for the spread of unregulated fringe providers. Check-cashers and payday lenders offering high-priced services flourish where there are no lower-cost alternatives. But with the cost savings possible through electronic delivery, surely banks could offer these services at lower prices.

Indeed, we see more and more banks drawing inspiration from the ETA but going well beyond it, developing their own low-cost electronic accounts that link direct deposit of payroll with a menu of services that can be accessed through ATMs, debit cards, and even personal computers. Banks are targeting local employers to publicize the advantages of direct deposit -- advantages that, according to one research study, can add up to more than $1.25 for each payroll check that doesn't have to be issued. Savings like that help explain why more than 50 percent of private sector employers participate in direct deposit today -- a fivefold increase in little more than ten years. Still, that takes us only half way to what our goal should be -- a goal that other countries with advanced economies are far closer to achieving.

Expanding participation among employees, of course, is crucial, and banks are making significant headway in this area, too. Bankers may visit work sites to distribute informational materials and answer questions about direct deposit and the accounts that are based on them.

They're structuring these accounts in ways that make them increasingly appealing. In at least one case, employees receive a debit card that, in addition to its customary functions, can be used to transfer funds to individuals in other countries at lower cost than a traditional wire transfer. Other types of accounts offer electronic payment features, enabling employees to pay recurring bills. And I know of a bank that offers customers short-term loans of up to 50 percent of their regular incoming direct deposit directly from an ATM. I can think of no better or more constructive response to the payday lenders and others like them who prey on our communities. It's one more way that mainstream financial institutions can help low- and moderate-income Americans get off the treadmill of debt and onto the road of greater financial security.

I believe that technology offers great potential for bringing the unbanked into the financial mainstream, with all of its benefits. It also offers new possibilities for financial institutions to develop deeper and more profitable customer relationships. In order for these possibilities to be achieved, banks, employers, and community organizations must work collaboratively and creatively to understand the needs of the individuals they serve. We in government have an important role to play as well, but it's the work you do in our communities, day in and day, that will make the most enduring difference in the lives of our citizens.