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Statement by

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before the

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of the

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of the

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STATEMENT

Thank you for the opportunity to provide the views of the Board of Governors of the Federal Reserve System on H.R. 3180, the Government Check Cashing Act of 1989, and H.R. 3181, the Basic Banking Services Access Act of 1989.

H.R. 3180 would require depository institutions to cash government checks at cost for non-customers who are registered with the institution. A companion bill, H.R. 3181, would require depository institutions to offer "basic" transaction accounts. These accounts would be subject to minimal fees and balance requirements and would permit consumers to make up to 10 withdrawals per month. Both bills call upon the Federal Reserve Board to set the price of these services. Virtually identical bills have been introduced in the Senate.

The Board is familiar with the concerns that motivated the introduction of the House and Senate bills. Indeed, we share the belief that banking services should be widely available to all. To encourage financial institutions to offer such services, in 1986, along with other federal and state financial institution regulators, we adopted and publicized a **Joint Policy Statement on Basic Financial Services**. The basic banking policy statement recognizes the need of consumers for a safe and accessible place to keep money. It also emphasizes that consumers need a convenient way to obtain cash (including by cashing government checks) and to make payments to third parties. The basic banking policy statement encourages the continued development of basic transaction accounts and check cashing services by financial institutions. However, the policy statement also recognizes that addressing these concerns most effectively means tailoring services to differences in local needs and the characteristics of individual institutions. It reflects the belief that the development of truly useful services could be thwarted by the rigidities of legislation. Thus, in issuing the basic banking policy statement, the Board supported a voluntary rather than a mandatory approach. We thought that identifying a federal interest in the issue, but giving institutions the necessary flexibility to develop account products for the particular needs of their communities, would yield the best results. **We continue to support voluntary efforts as the most effective response.**

Comments on Check Cashing Bill

For several reasons, we are concerned about enactment of a requirement that depository institutions cash the government checks of non-customers. Initially, it is not clear that check cashing services are so widely unavailable that imposing burdensome federal requirements for mandatory check cashing is warranted. Over the last several years, various surveys have been conducted to assess the availability of check cashing services. Perhaps because of varying methodology, the results of the surveys differ on the extent to which people without accounts at a financial institution have access to check cashing services. Surveys by consumer groups found that few institutions offer the service while surveys sponsored by industry groups and by the General Accounting Office (GAO) found that generally many do.

The 1988 survey of the Consumer Federation of America for example, found that about 30% of the institutions they polled would cash government checks for non-customers. On the other hand, at least two surveys found check cashing services to be much more widely available. The GAO's recent report to Congress on government check cashing states that, as of 1985, 86% of banks and 55% of thrifts cash U.S. Treasury checks for non-customers. In addition, a 1988 survey of the American Bankers Association found that more than 90% of the institutions surveyed would cash government checks for non-customers. Taken together these surveys suggest that many institutions are already providing check cashing services. And we hope that over time even more institutions will offer such services, encouraged by the basic banking policy statement and also by the increased emphasis on institutions having a good Community Reinvestment Act (CRA) record. In this regard, our recent joint agency policy statement on CRA lists the cashing of government checks and the offering of basic banking accounts for low and moderate income people as a favorable factor in contributing to a positive CRA assessment.

Given the available information, the Board has doubts that enough of a problem has been demonstrated to justify sweeping legislation with specific requirements. Furthermore, enactment of check cashing requirements -- with all of the inevitable regulations -- may do little, in fact, to increase the number of people taking advantage of such services. For example, the state of Connecticut requires institutions to cash state-issued checks for recipients of public assistance. Yet, informal reports from bank representatives in that state indicate that there has not been a noticeable increase in the number of persons using financial institutions to cash these checks since passage of the law. We believe it would be useful to wait and see if these preliminary reports continue to hold true before launching a nationwide program that might not be effective.

In addition to our doubts about whether the need for check cashing legislation has been demonstrated, and whether it will be effective, the Board has several other concerns. As a general matter, we think the government should be very cautious about mandating the services that every financial institution must offer and, in particular, setting the fees that are permitted to be charged for such services. If the government determines that there is a need for low-cost cashing of government checks, it probably should first explore the possibility of making that service available itself. For example, using federal post offices to cash government checks might be considered since they offer financial services such as money orders and, like financial institutions, they are accessible nationwide in urban and rural areas. Another idea that should continue to be developed is electronic delivery of government benefits. Successful electronic benefits delivery systems are currently operating, including programs in New York

City and St. Paul, Minnesota. Further, a pilot program is expected to be launched this fall in Baltimore involving electronic delivery of Social Security Supplemental Security Income benefits. Electronic delivery systems offer numerous benefits for beneficiaries, government agencies and financial institutions. They include eliminating problems with delayed, lost, or stolen checks, providing quicker resolution of problems concerning payments, and lowering costs to all parties.

A more specific concern that we have with the legislation is demonstrated by the process for determining the fees that may be charged for cashing government checks. The bill requires the Board to study the "actual costs" of financial institutions and to set the fees permitted to be charged for these services to recover these costs. It would be extremely difficult and expensive for the Board to obtain uniform data from institutions on their actual costs for providing the check cashing services envisioned by the bill. Furthermore, the cost to an institution for cashing government checks will inevitably vary from institution to institution based on size and locality. Inasmuch as cashing a check for a non-customer is an interest-free loan by an institution, there also are certain hidden costs to an institution which may be different from its costs for cashing a customer's check.

Thus, any fees set by the Board would almost certainly be an average of those costs and, as such, could never reflect the actual differences among institutions. With a single federally established fee, some institutions would fail to recover their costs while other institutions would be over-compensated. Finally, it appears inequitable for financial institutions to be required to cash government checks at cost while other entities, such as check cashers, could continue to offer such services at a profit.

The Board is also concerned that financial institutions could increasingly fall victim to fraud if the check cashing legislation is enacted. Given that checks can easily be stolen and identification cards are readily forged, the risks of fraud may be significant.

The bill recognizes the fraud risk but limits regulatory relief to large scale fraud on a "classification of checks" as determined by the Board. This fraud provision may be small comfort to institutions since it would likely take a long time for the Board to learn of any general patterns of fraud. By then, significant losses might already have been suffered. Individual cases of fraud will be very difficult to protect against, since the bill requires that an institution cash any government check upon presentation of certain limited registration information.

We are aware that at present the overall level of fraud involving U.S. government checks is low. However, the level may be high in certain areas where Social Security or other benefits checks are stolen directly from recipients or from mail carriers. Furthermore, the fraud losses of an individual institution may be significant even though the overall level of fraud is low. We also believe there is a good chance that the overall level of fraud with government checks could increase following enactment of the legislation. For example, a large-scale fraudulent check-cashing ring has operated for over four years in several eastern states and is responsible for up to $15 million in losses. This check cashing ring had highly sophisticated methods, including a "how-to" manual to train its members to pass bad personal checks. It is not far-fetched to think that such techniques might be applied to government check cashing if all institutions are required to accept checks. The bill would prevent individual institutions from protecting themselves from fraud on a case-by-case basis by establishing procedures that are more protective than those included in the bill.

As mentioned earlier, other innovative arrangements are being investigated that would eliminate many of the problems with delivering government benefits by paper checks. The Board strongly supports the facilitation of electronic alternatives for the delivery of government payments. These "electronic benefits transfer" (EBT) arrangements probably are a better long-term solution to the problems that motivate the check cashing legislation.

We have reason to be encouraged about the prospects of the EBT alternative. Over the course of the past year, a number of meetings have been held among representatives of government agencies, financial institutions and consumer groups to develop a "blueprint" for a model electronic benefits service program. This document is expected to be published by December. In addition, several programs are now operating and others are about to be initiated. The GAO has concluded that electronic delivery provides significant advantages over a paper-based system of delivery of government benefits, and the Board wholeheartedly agrees. Consequently, we are pleased with the increased momentum in EBT activity. It is possible, of course, that these systems may not prove as efficient or useful as we hope. But, in our view, it seems wise to concentrate on encouraging these far-sighted efforts as a solution, rather than prematurely imposing permanent and unavoidably burdensome new requirements on financial institutions which may not solve the problem.

Comments on Basic Banking Bill

Turning to the basic banking bill, the Board questions the need for mandatory basic banking for many of the same reasons it questions the need for mandatory government check cashing. Initially, it is not clear that the price of banking services is the primary reason why many people do not currently have accounts. Since 1977, we have sponsored four surveys that provided data from which we could determine the number of families without depository accounts. Our research suggests that the overall percentage of families without deposit accounts has remained fairly constant at around 10% in the period 1977-1986.

(A Census Bureau estimate cited by the GAO in its report is higher at 18%.) Our research indicates that roughly 30% of the families whose income falls in the lowest quintile do not hold accounts. Although the percentages for this latter group have fluctuated, the numbers were more or less the same in 1986 as in 1977. Thus, while many low-income families do not have accounts --and we think it is unfortunate that people who may want accounts are outside the nation's financial system -- the fact that the percentage has remained relatively constant suggests that recent increases in fees and minimum balance requirements have not caused a significant decline in account holding. Rather than the cost of opening or maintaining an account, there are probably more fundamental reasons for much of the lack of account ownership. For example, given the convenience of check cashing alternatives and the difficulties in managing an account with limited resources, some low-income people may not choose to open an account. It may be that some people simply prefer not to deal with banks, especially if they are unfamiliar with them or distrust them.

The survey on account holding that we conducted does not contain information about the availability of basic banking accounts among financial institutions. We have not conducted such a specific survey. A survey of the availability of basic banking accounts would be costly and time consuming for the Board to undertake. It would take a minimum of 9 to 12 months to design and conduct a survey of this type and to analyze the data. In any event, with the account variety among institutions and the variations in the needs of people depending on where they live, survey information on basic banking likely will not present a clear picture.

There have, in fact, been a number of surveys by other groups aimed at assessing the availability of low-cost banking accounts. As may be expected, the survey findings vary greatly, in part because of different definitions of "basic banking accounts," and thus do not conclusively answer the question of how widely basic banking services are available. As with the surveys on check cashing, surveys by consumer organizations found that relatively few institutions offer basic banking accounts -- the GAO suggested this as well except in the case of accounts for senior citizens -- while surveys sponsored by industry representatives concluded that many do. Depending on which national survey is considered, the percentage of institutions offering basic banking accounts range from a low of about 15% to a high of about 74%. Assuming that the actual number is somewhere between those extremes, many financial institutions appear to be providing this service.

Several states have also undertaken studies to determine how accessible low cost banking services are for their citizens. In a survey of virtually all financial institutions in New York State, the Banking Department found that low-cost banking services are widely available. It also concluded that the vast majority of low- and moderate-income people have ready access to such accounts. Although the New York State study found that not all institutions offered basic accounts, it found that at least some institutions in each rural and metropolitan area offered them. The Pennsylvania Department of Banking reported in a 1988 study that almost 54% of the institutions they surveyed offered a type of basic account. The Pennsylvania report recommended that similar studies be conducted periodically in the state "to measure trends within the banking industry." The State of Virginia currently is conducting a study of account availability in that state, involving surveys of both consumers and financial institutions and a series of public hearings around the state.

Given the data, in our view the jury still is out on the extent to which there is a basic banking "problem," and on when, if ever, legislation is needed to fix it. At a minimum, clearer evidence that a problem exists is probably needed before considering taking legislative action. While none of the surveys found that every institution offered basic accounts, the need for access to these accounts can be met as long as some institutions in each community offer them. And that is what the surveys generally found to be the case.

As with the check cashing bill, the Board is concerned about the many difficulties in setting fees for transaction accounts, particularly when we must determine the "net processing costs" for financial institutions based on "actual time studies." It would be very expensive to obtain uniform data from institutions since various components affect their individual costs and there is no uniform cost accounting system used by all institutions. As with check cashing, a single federally established fee would be inequitable because it would not reflect the actual differences in costs among individual institutions.

The basic banking policy statement that I mentioned demonstrates the federal government's encouragement of financial institutions to provide basic services. But it has the benefit of leaving the development and implementation of such programs to the creativity of individual institutions. The basic banking bill would result in the standardization of basic banking services. In our view, a better approach is for individual institutions to address the varying and changing needs of low-income and elderly individuals. A number of different account products have evolved as a result of voluntary efforts by financial institutions. Some, for example, involve savings accounts with money orders used for third-party payments. Others, based on a "pay-as-you-go" idea, have fees for each check, rather than a monthly maintenance fee as contemplated by the bill. Either of these accounts could be preferable to the bill's basic banking account for the person who writes fewer than 10 checks each month. Thus the bill risks thwarting the voluntary development of alternative products such as these which may more directly meet the needs of some low-income consumers. Indeed, an institution might have little incentive to offer additional, and potentially cheaper, basic banking services once a standard service is required by law.

Conclusion

We share the concern that people who may want access to financial services are outside the nation's financial system and we recognize the need for institutions to make a greater effort to reach out to all segments of the public. We adopted our basic banking policy statement in response to these concerns and we think that voluntary efforts have gone a long way toward dealing with them. Our general impression, looking at banking applications, is that many banks offer some type of low-cost account and we expect to see more and more in the future in light of our policy statement on CRA.

In our experience, well-intentioned legislation and regulations, particularly as they pyramid one on top of the other, involve a cumulative burden which is sometimes not fully appreciated -- especially as it affects the numerous small financial institutions. All of us should be concerned about the expense and burden of new rules when a need for legislation has not been clearly demonstrated. In our view, the surveys on check cashing and basic banking do not give a strong enough message that such widespread problems exist that it is now time to enact new laws.

The Board continues to believe that voluntary efforts by financial institutions and further development of electronic benefits transfer will meet many of the goals of the bills -- probably more effectively -- without the burden and cost that rules and regulations inevitably impose.