April 2009

The SAFE-T Account

A Proposal to Deliver a Low Cost, High Value Transaction and Savings Account at Tax Time

Melissa Koide

Asset Building Program

New America Foundation

This paper was previously published in November 2007 as *The Assets and Transaction Account*. All mention of the Assets and Transaction Account (ATA) has been updated to reflect the change.

Executive Summary

Over the past two decades, policymakers, academics, and others have pursued an array of policies and strategies to help lower and middle income households build savings and assets and access reasonably-priced financial products at mainstream institutions. While some progress has been made, there have been few advances in delivering a high-value, affordable financial product at scale.

Over the last five years, however, technological developments, new entrants into the financial services market, and new insights into consumer demand have boosted the creation of innovative financial products. Prepaid products–essentially checkless checking accounts–represent an important development in the evolving financial services industry. These products can meet many of the transaction functions that checking and savings accounts offer, but without the limitations of credit checks and ChexSystems, which prevent millions from opening accounts. Moreover, they can offer many other features and functions that are valued among lower income consumers.

To build on the financial innovations offered by prepaid products, leverage the billions of dollars in annual tax refunds, and harness the bargaining power of the federal government, this paper proposes the delivery of a Savings and Financial Electronic Transaction Account–or SAFE-T Account–at tax time. Each year, tax refunds would be electronically deposited into individual SAFE-T Accounts for tax filers who do not direct deposit their refund into another account or who do not opt out of the SAFE-T Account. The refund would be bifurcated between a transaction and a savings account, with five percent automatically deposited into the savings account.

The SAFE-T Account would be issued, delivered, and serviced by financial institutions on behalf of the U.S. Department of Treasury. Money in the account would be accessible with a network branded card at ATMs, and could be used to make retail purchases, to make bill payments, and possibly to sent remittance payments and generate checks. The savings component would help to meet short-term savings goals. With federal legislation, the SAFE-T Account could serve as the "plumbing" for large-scale savings policy targeted at lower income families.

SAFE-T Accounts would leverage the billions of dollars in tax refunds that are not electronically deposited each year to incent financial institutions to offer the product at low to no cost. The federal government would save millions of dollars annually through the electronic delivery of refunds that are currently issued via paper checks. The availability of the SAFE-T Account also could encourage more households to file their taxes, resulting in more households "on-the-grid" and generating additional tax revenues at the state and local level.

Melissa Koide is Deputy Director of the Asset Building Program of the New America Foundation.

Each year, federal tax refunds offer a sizeable financial boon for most tax filers, but especially for lower income households, who receive tax refunds in the range of $2,000. These refunds are based in large part on the Earned Income Credit, a federal tax credit that rewards lower income taxpayers for work by providing a refundable credit for income earned.

Many households, particularly lower income households, plan to use their annual tax refund to meet pressing expenses and support longer-term savings goals. Research shows that tax filers often over withhold as a "voluntary forced savings" strategy. However, many of the financial products that are used to access tax refunds are costly. Fees for refund anticipation loans (RALs), a loan taken out in advance of a tax refund to expedite access to the refund, often consume significant portions of the refund itself. Low-cost alternatives to RALs are largely nonexistent.[1] Direct deposit of the tax refund would enable the tax filer to receive the refund in a matter of days, however it is not an option for the estimated 106 million individuals who lack or choose not to use a checking or savings account.[2]

Regardless of whether they have a bank account, lower income households spend considerable sums throughout the year to access and utilize their money, from cashing their paychecks, to purchasing money orders, to pay rent or other bills, to remitting money domestically or internationally. An estimated forty million lower income households pay high-cost, alternative financial service providers[3] to conduct routine financial transactions. In a period of one year, $10 billion in fees was collected by check cashers, payday lenders, and other alternative providers.[4]

In fact, over the past two decades, a two-tier financial services sector has emerged. Less-regulated, alternative providers target lower income consumers with high cost products and services that are not wealth building, while more regulated financial institutions, including banks and credit unions, target middle and upper-income consumers with a variety of wealth-building products. Though mainstream banks offer checking and savings accounts, the costs of overdrafts–$34 per check on average–are a heavier burden for lower income households, who have fewer resources with which to cover the costs.[5]

While access to affordable transaction products is important to financial stability, the ability to save and build assets is also necessary. Whether it is a home, an education, or a small nest egg, savings and assets provide an economic cushion to weather unexpected financial expenses and help smooth income flows when financial crises occur. Research shows that lower income families can and do save, particularly for short-term goals and for precautionary purposes.[6]

Savings and assets also provide psychological benefits for parents and children. In fact, the presence of assets appears to matter for more than the monetary value.[7] Yet, for millions, savings and assets are largely nonexistent. As of 2007, the median net worth of the bottom 25 percent of households was $1,200.[8] A study in 2000 showed that one-quarter to nearly one-half of all households were asset poor; they did not have sufficient net worth to subsist for three months at the poverty level.[9] While the federal government provides billions of dollars to subsidize asset ownership, particularly in the form of tax incentives like the mortgage interest deduction, very little benefits accrue to lower income families. Of the $384 billion that supports asset accumulation annually, 90 percent benefits households in the upper half of the income spectrum.

Filling a Gap in the Financial Services Market

This paper outlines a federal policy proposal to create a scaleable, credible, and safe financial product to enable millions of households to affordably transact, save and build wealth. Research by academics, behavioral economists, policy makers, and the financial services sector have brought to the fore seven important considerations that have helped to inform the design of the SAFE-T Account.

First, the financial product and infrastructure for delivering it should be simple and easy to use. The more complex the product, the more difficult it will be for the consumer to use it, and the greater the likelihood that it will not be tried and accepted. Complexity also adds to the cost to financial providers for developing, delivering, and servicing the product. And the more complex the product, the less inclined intermediary organizations, like volunteer tax preparation sites or community organizations, will be to encourage clients to use it.

Second, the financial product should be reasonably priced and affordable. By definition, lower income households face greater economic constraints and are at greater risk for negative financial events than households with higher incomes. For a product to meet their financial needs while avoiding excessive income depletion, the product must be affordable. New product designs must build on insights into the lower income market segments and utilize business strategies to deliver products that can meet demand at a fair price, while maintaining profitability.

Third, the product should focus on accessibility and be based on consumers' true financial service needs. The alternative financial services sector is meeting the demand for certain financial services needed by lower income households. Eleven thousand alternative financial service providers cash 180 million checks worth over $55 billion each year.[10] Between 2003 and 2004, low and moderate income households purchased over 1 million money orders each month.[11] In 2006, $96 billion was remitted from households in the U.S. by money transfer firms.[12] Efforts to provide financial services to lower income households are likely to miss the mark if they fail to address these essential financial transaction needs.

In addition to the product offerings, consumer surveys repeatedly show that convenience and comfort level with the provider are driving factors in where they choose to conduct their financial business. Multiple studies have shown that unfamiliarity and a sense of intimidation impede many households from using mainstream financial institutions. Alternative financial service providers are designed and staffed to counter those perspectives. In addition, these providers are located in close proximity to their target customer base. Repeatedly, location is shown to be the primary driver for why customers use alternative providers, and convenient hours are a close second.[13]

Fourth, the design of the financial product should include automatic features, such as defaults, that ease the difficulty of making present financial decisions that provide future payoffs. Academic and industry research find that defaults and opt-out instead of opt-in features make significant differences in consumers' financial behavior, from paying bills on time, to participating in savings plans. For example, Nationwide Insurance found that participation in its 401(k) retirement plan among associates increased from 77 to 95 percent after implementing an auto enroll/auto increase plan.[14] In developing policies and products to facilitate savings, the inclusion of defaults could affect significant change in financial behavior.

Whether it is a home, an education, or a small nest egg, savings and assets provide an economic cushion to weather unexpected financial expenses and help smooth income flows when financial crises occur.

Fifth, the financial product should provide consumer protections, but with attention to consumers' preferences and sensitivity to compliance costs. In developing consumer protections and extending them to new products, consumers will be better served if policymakers consider consumer preferences in how the protections are provided and the compliance costs to providers for meeting the protections. For example, Federal banking regulators have made some important steps in this direction with the extension of Reg E to payroll cards in July 2007. Reg E implements the Electronic Fund Transfer Act, and it requires periodic account statements to be issued to accountholders, among other things. In extending the regulation to payroll cards, regulators stipulated that statements could be provided electronically or by phone, instead of the costly paper statement route, thus saving financial institutions money while ensuring accountholders receive important data on their accounts in a timely and useful fashion.

Sixth, the financial product should enable savings. Recent research shows that households in the lower-income spectrum prefer to save, particularly as a precaution against unexpected expenses. In a recent survey of the financial services needs of lower income households in the Detroit metro area, 32 percent of respondents were found to contribute to savings at least every month, with 11 percent contributing once or twice a year. Precautionary savings was cited as the major reason for savings: 78 percent reported saving to feel financial secure; 70 percent, to address emergency and medical expenses; and 51 percent, to help cover expenses from an unexpected job loss.[15]

Research also suggests that lower income households can and do save, particularly if a savings vehicle is available and accessible. In the Detroit survey, 80 percent of the savers had a bank account. In a survey conducted by the OCC in which 2.6 million individuals were represented, 78 percent of low- and moderate-income households with bank accounts held savings. Of those with savings, 94 percent held it in their account. In comparison, only 30 percent of those without bank accounts held savings.[16]

Migrant households in the lower income spectrum would prefer to save and many are doing so, but often without the benefit of accruing interest or the protections provided from saving in depository institutions. Among migrant[17] households in the U.S., at least one-third or more save, and almost 30 percent of migrants without bank accounts are saving. Individuals earning less than $10,000 save as much at $2,000 each year. And individuals earning between $15,000 and $30,000 save as much as $4,000 annually.[18]

And seventh, tax time presents a unique opportunity to facilitate savings, particularly for lower income households that receive sizeable refunds as a result of the earned income credit. Two tax time savings demonstrations have shown a demand for savings at tax time. The demonstrations, by Doorways to Dreams and the New York City Office of Financial Empowerment, suggest that tax refunds are perceived by tax filers as a financial "windfall", thus providing a fortuitous moment to put money away for future needs. While the findings are preliminary, the evidence suggests the larger the refund amount, the greater the likelihood the tax filer would save. In the New York City demonstration, those who choose to save had refunds roughly $400 higher than other EIC filers.[19]

SAFE-T: The Basic Structure

The SAFE-T Account proposal entails a wholesale shift in the delivery of federal tax refunds. As envisioned, SAFE-T Accounts would be the financial vehicle into which tax refunds would be delivered if the tax filer does not choose to directly deposit their refund into another account or to opt out of the SAFE-T Account to receive a paper check. Tax filers who receive a SAFE-T Account would have their refund bifurcated between a transaction and a savings account, with five percent automatically deposited into an interest bearing savings account. Individuals could choose to deposit more of their refund into the savings account via their tax return form.

Tax time presents a unique opportunity to facilitate savings, particularly for lower income households that receive sizeable refunds as a result of the earned income credit

For a sense of the potential SAFE-T Account volume, over the past three years, almost half of all tax filers did not use direct deposit. As of the end of September 2007, $70 billion, of total refund dollars, was not direct deposited in tax year 2006. In total, 41 percent of those who received a refund – approximately 42 million tax filers – did not direct deposit.[20] Moreover, $80 billion was refunded to households with adjusted gross incomes of $30,000 or less, according to 2005 IRS data.

SAFE-T Accounts would be built on the same platform as a prepaid product in order to utilize the efficiencies and functionality of the established system. Prepaid products, which effectively work like checkless checking accounts, are pre-funded accounts that are accessible via a card and capable of a range of financial transactions, including point-of-sale purchases, ATM withdrawals, bill payment capabilities, and daily balance alerts. They can also include savings capabilities, credit lines, money orders, and remittance capabilities. Some are designed to deliver unemployment insurance and other state benefits.[21] The prepaid nature of the product protects consumers from the risks of overdrafts and barriers of ChexSystems and credit checks, which have prevented millions from acquiring accounts with mainstream institutions.[22]

Tax refunds would be an important initial deposit into the SAFE-T Accounts, given the relatively large lump sum payment. However, the ability to deposit wages and salary and other sources of funds throughout the year will be critical to ongoing use. Ideally, recipients of non garnishment-exempt government benefits and entitlements could also elect to have those funds deposited to the SAFE-T Account. States are some of the largest users of the prepaid product infrastructure, delivering millions of dollars in benefits such as TANF, food stamps, and other payments to households.[23] And many states offer their own Earned Income Credit and could leverage the SAFE-T Account as a vehicle to deliver those funds as well.

The SAFE-T Account: The Account and Its Transaction and Savings Capabilities

SAFE-T Accounts would provide the same functionality of a traditional checking account, with the exception of check writing privileges. This is an important aspect of the product because it protects the consumer from the risk of overdraft charges and guards the financial institution from excessive negative balances. Accountholders could make deposits into their accounts through a variety of venues, from direct deposit of wages and other monies, to ATM terminals, and retail stores that can load monies into the account. Monies in the SAFE-T Account would be accessible through ATMs and point-of-sale purchases made in stores and online. Because the SAFE-T Account would be branded with Visa, MasterCard or other network provider, the transactions could be conducted at any location where the brand is accepted. This product would be especially useful for tax filers who are transient, work on a limited or seasonal basis, or work for multiple employers, as each employer could direct deposit wages into the account.

Comparison of the SAFE-T Account to Traditional Checking and Savings Accounts

Functions/Protections/ Features	SAFE-T	Checking Account	Savings Account
FUNCTIONS			
Funds Access			
Cash withdrawal ATM	X	X	X
Point-of-sale transactions*	X	X	
Bill payments	X	X	
Web-based purchases	X	X	
Remittances	X		
Money orders	X		
Electronic check writing		X	
Deposit			
Direct	X	X	X
Payroll	X	X	X
Checks and Cash	X	X	X
Non garnish-exempt benefits	X	X	X
FEDERAL PROTECTIONS			
Reg E	X	X	X
FDIC insurance	X	X	X
Reg DD (disclosures)	X	X	X
FEATURES			
Overdraft avoidance	X		X
Safety: Safer than cash	X	X	X
Building savings	X		X
Federal match for savings goals**	X		
Budgeting			
Daily balance alerts***	X	X	X
Online account review	X	X	X

*PIN or signature
**Applies to certain savings goals, if law enacted
***Via Text Message

Source: New America Foundation

The chart to the left illustrates the benefits of a SAFE-T Account in comparison to a traditional checking or savings account.

The savings component of the SAFE-T Account would allow users to save and earn interest on those funds. For a sense of the potential interest in a saving component to the SAFE-T Account, consider the *All Access Savings Program* offered by the prepaid firm, NetSpend. It is a prepaid product with a savings pocket that pays five percent interest. To date, approximately $100 million has been put into savings.[24]

The inclusion of a savings component with SAFE-T Accounts builds on learnings from behavioral economics and field research, showing that consumers often employ strategies to limit their access to their monies to facilitate savings. Building on those insights, the savings component of the SAFE-T Account would be designed to be slightly harder to access than the transaction account. For instance, there could be a limit on the number of withdrawals from savings each month.

Bill payment capabilities, whether electronic payments or money order issuances, will be important SAFE-T Account functions. Lower income households use money orders to pay bills, rent, and other expenses, even when they have a bank account and can write a check. The Detroit survey found that 65 percent of the households in the survey who had bank accounts nevertheless used money orders as their payment instruments. Of respondents without bank accounts, 77 percent used money orders to pay bills and make other payments.[25]

Finally, remittances are another highly-valued financial service, particularly among migrants, who comprise 1 in 9 residents in the U.S., or 35 million people.[26] Almost $100 billion flows annually from the United States to other countries via remittance payments.[27] Although adding remittance capabilities is likely to increase the complexity of opening the accounts on the tax form because of Customer Identification Program requirements (this issue is described, below), to the extent that those issues could be addressed, remittance capabilities would meet an important financial service need among potential users.

Rationale for the Federal Government, Financial Institutions, and Employers

Federal Government

In addition to the policy objective to provide a low cost, valuable financial product to lower income households, successful uptake of SAFE-T Accounts would save the federal government millions of dollars each year. It costs the government approximately 89 cents to process and generate one check, compared with 9 cents to electronically deposit the payment. In 2006, it cost the federal government approximately $37.8 million to issue refunds via a paper check to the 42 million tax filers with refunds who did not use direct deposit. $34 million would have been saved had those refunds been issued via direct deposit.

In addition to receiving tax refunds, SAFE-T Accounts would provide a vehicle into which other federal and state payments could be made. Including individual income tax refunds, the Treasury Department disburses almost one billion non-Defense, non-Postal payments to 100 million payees, totaling more than $1.5 trillion each year.[28] If those payments were disbursed electronically and delivered via SAFE-T Accounts, the cost savings could be enormous.

The provision of a SAFE-T Account, with its cost savings benefits, could persuade households, which do not currently file income taxes, to do so. The result could mean more revenues for federal, state, and local governments.

Financial Institutions

The scale of the SAFE-T Account proposal should generate sufficient volume–in dollars and in accounts–for financial institutions to approach this population as a true market opportunity. As much as $35.1 billion could be available for deposits if only half of non-direct depositors used SAFE-T Accounts, based on the average 2006 refund among of non-direct depositors, ($1,653). If wages and salary were also direct deposited to the SAFE-T Account, the size of deposits would increase substantially, as would the revenue generated through the interchange fees assessed to merchants on transactions using the network branded card.

The average interchange rate is approximately two percent per transaction. A study by the Center for Financial Services Innovation, which consisted of 500 randomly selected prepaid users, found that POS terminals were the most common way in which the funds were accessed, at 71 percent of all access methods. Thus, every time the prepaid card was used at a POS terminal with a signature purchase (as opposed to a PIN purchase), approximately two percent of the transaction amount was paid to the institution that issued the card.

Finally, the SAFE-T Account offers financial institutions[29] a low risk product that can be used to better understand lower income consumers.[30] The institution could view the SAFE-T Account holder's transaction activity, savings balance, and readiness for additional financial products.

Employers

Success of the SAFE-T Account as an ongoing transaction and savings tool will hinge in part on direct deposit of wages and salary. Fortunately, the SAFE-T Account presents advantages to the employer, from the cost savings of delivery of wage payments electronically.

The SAFE-T Account would be especially useful for employers with a high percentage of employees without bank accounts and who cannot use direct deposit to receive wage payments. Employees would benefit from immediate access to their pay, protection against theft, and the expanded financial access resulting from a financial product with broad recognition and acceptance. To gauge the potential interest by employers in SAFE-T Accounts, it is helpful to look at the growth that has occurred in the payroll card sector. Payroll cards are prepaid products that employers use to deliver wage payments. Payroll card volume escalated from approximately $6 billion in 2005 to $143 billion in 2007.

While employers and financial institutions are very interested in moving employees to payroll cards as a strategy to facilitate direct deposit, employees have complained that the products are not structured to meet their needs in terms of functionality, but instead are designed largely as a vehicle for the employer to deliver payments electronically. The SAFE-T Account could address both perspectives.

Design and Roll-out of the SAFE-T Account

To implement SAFE-T Accounts, the Treasury Department would need to undertake a number of steps to generate and deliver the product to tax filers, including designing the baseline SAFE-T Account features; coordinating with regulators to ensure consumer protections are clear; contracting with financial institutions; establishing protocols to collect, verify, and communicate tax filer data to financial institutions; establishing a public-private advisory committee; and embarking on an education campaign to inform tax filers about the SAFE-T Account and encourage its use.

Building on the precedent set by the Treasury Department in contracting with financial institutions in the *Direct Express* program, which delivers Social Security and other federal benefits on a debit card, the Treasury Department would follow a similar process with one or more financial institutions to issue the SAFE-T Accounts.

To inform the design and implementation of SAFE-T, Treasury should pilot the proposal to:

- Identify segments of the tax filer population, who are most likely to use the SAFE-T Accounts and assess the likely uptake of a nationwide program
- Determine the most appealing features of the SAFE-T Accounts
- Inform government efforts to increase electronic delivery of federal payments
- Identify effective strategies to facilitate direct deposit of wages, salary, and government benefit payments into the SAFE-T Accounts
- Identify effective education and outreach strategies to increase the uptake and facilitate the ongoing use of the SAFE-T Accounts
- Assess the potential of utilizing tax filer data as presented on the tax returns to inform the Customer Identification Program requirements under the Bank Secrecy and PATRIOT Acts

Insights from the pilot would help Treasury approximate the number and type of financial institutions that should participate in order to achieve nationwide coverage, low to no cost to the consumer, and sustained financial institution interest and engagement.

Once the pilot is completed, Treasury would release a request for proposals to secure one or more contracts with financial institutions to issue, deliver, and service the SAFE-T Account for a set period of time. In choosing the institutions, emphasis would be placed on the institution and its partners' product development capabilities, including the functionality that could be provided; the pricing proposal; infrastructure to handle the volume, enrollment, and distribution capabilities; and consumer service and marketing capabilities.

Depository institutions would be the likely entities eligible for the SAFE-T Account contracts. However, that would not preclude a depository institution from contracting with one or more nonbank parties to provide and service the SAFE-T Accounts. In fact, such partnerships should be given serious consideration given the nonbank financial services provider's deeper understanding of the financial services preferences of lower income households. In addition, these types of partnerships could be especially important for providing certain functions, such as remittances, particularly given the complexity of systems needed to satisfy federal compliance requirements. A partnership between a financial institution and one or more licensed money transmitter firms, which have the internal controls in place to comply with state and federal compliance requirements as well as the brand recognition among consumers using remittances, could be vital to the product's uptake and usage. In other instances, the depository institution may contract with processing firms and distributors to conduct functions like payment transactions, customer service, and product distribution.

Regulatory Considerations

A number of federal regulatory issues would need to be addressed, including Reg E, and the Bank Secrecy and PATRIOT Acts. The latter two require financial institutions that offer individual accounts to demonstrate that they know their customers through the Customer Identification Program (CIP) requirements. Banks must establish a plan to verify the identification of accountholders, including the collection and storage of data on those account holders. The law allows institutions to rely on third parties or employers to verify the identification of customers, but ultimate responsibility and liability rests with the institution. CIP applies to all demand deposit accounts; therefore, any product linked to a specific demand deposit, such as a debit card used to deliver government benefits, must comply with CIP requirements.

By issuing the SAFE-T Account at tax time and utilizing the personal data generated through the tax filing process, the critical elements of the CIP could be satisfied. The tax filer's name, address, social security number or individual tax filer identification number are captured on the tax return and could be authenticated by the IRS or another bureau of the Treasury Department. Treasury also could require additional data that was provided on the filer's prior return to further authenticate the tax filer's identity. For instance, information about accounts or a previous address that were only in the tax filer's name could help to satisfy the CIP requirements.

Another important regulatory consideration is FDIC insurance coverage. FDIC or equivalent insurance is important both in terms of providing such protection and because federal protections have been shown to be important to lower income consumers. A FDIC legal opinion, issued in November 2008, extended coverage to prepaid card accounts, as long as the depository institution (or third-party on behalf of the institution) collects and maintains records specifying which funds are attributable to which prepaid cardholder. The issuing banks for the SAFE-T Accounts would be required comply with the FDIC's legal opinion to ensure the monies are FDIC insured.

By issuing the SAFE-T Account at tax time and utilizing the personal data generated through the tax filing process, the critical elements of the CIP could be satisfied.

Reg E provides protections to consumers who use electronic fund transfers and requires banks to provide periodic statements to consumers on certain accounts as well as protections regarding lost or stolen cards. Although the Federal Reserve Board extended Reg E to payroll card accounts, it did not propose that the regulation would apply to all prepaid products. Clarifying how this regulation would be extended to the SAFE-T Account would be needed.

SAFE-T Oversight and Education

In order to design the SAFE-T Account and to ensure the product continues to evolve to meet the financial services needs of lower income households, Treasury could establish an advisory committee composed of representatives from the public sector, academia, and the financial services industry. The committee would advise the Treasury Department on the SAFE-T Account's design, review contract proposals, and stay abreast of the evolving financial services industry and the financial needs of lower income households in order to provide guidance on future iterations of the SAFE-T Account. For example, one could imagine mobile banking or smart card technology becoming a more prominent method for conducting financial transactions. The advisory committee would be responsible for following these developments to ensure they are factored into the consideration of future SAFE-T Account designs.

An extensive marketing and education effort should take place in advance of the release of the SAFE-T Account in order to build awareness and to ensure that the product is understood, credible, and widely accepted. This education campaign would include basic information about the SAFE-T Account: what it is and how it would work; how it can be used as an alternative to more costly financial services; the savings function and its accessibility; how it can be used as a cash management tool;[31] and how it can be the start of a long-term relationship with a financial institution. The campaign would also have an outreach arm that focuses on educating employers and their employees about the benefits of SAFE-T Accounts.

Community organizations would play an important role in educating consumers about the SAFE-T Account and providing basic financial education. These organizations already play an important role in educating and helping lower income individuals file their taxes and access the EITC and other credits. Part of the roll out would include utilizing these organizations to publicize the SAFE-T Account. Large, national organizations, such as the National Council of La Raza, with existing experience in helping to educate its members about financial services, could serve as a key educator and conduct outreach efforts prior to and during the disbursement of the SAFE-T Account. La Raza, alone, counts on a network of over 300 affiliates.

How the SAFE-T Account Could Work

At least one year prior to the tax year in which the SAFE-T Account is made available, the contracts will have been awarded, the product and infrastructure for supporting it will be in place, and a substantial education and awareness campaign will have started.

SAFE-T Accounts could be implemented in several different ways. The New America Foundation is researching the legal and practical implications of the implementation options. The basic premise for how SAFE-T Accounts would work is as follows.

Individual income tax forms will specify that if tax filers do not choose to deposit their refund into an existing account, it will be automatically deposited into a SAFE-T Account, unless they opt out to receive a paper check. The forms will identify which institution will hold the account (which is likely to be predetermined by geographic coverage, when the SAFE-T Account will arrive, how the funds can be accessed, what functions are available and any associated costs. The materials will also explain that five percent of their refund will be placed into an interest-bearing savings account, with the option to deposit additional funds into savings. It will also explain how the product can be used as an ongoing low cost transaction and savings product.

An extensive marketing and education effort should take place in advance of the release of the SAFE-T Account in order to build awareness and to ensure that the product is understood, credible, and widely accepted.

Once the IRS receives the tax return indicating that the tax filer will receive a SAFE-T Account, it (or a third party on its behalf) would verify the tax filer's data, confirm the refund amount minus any outstanding debts or obligations, relay the tax filer's data to the financial institution, and electronically transmits the refund amount, specifying how much to place in the transaction account and how much to place in savings.

The financial institution, upon receiving the information from the IRS, would individualize the SAFE-T Account card and mail it to the tax filer, along with the phone number to complete the accountholder verification and activation process, further details regarding the SAFE-T Account functions, a customer service number, and instructions and forms for direct deposit of wages. Activation of the SAFE-T Account should, literally, take minutes, as is the case with activation of other prepaid products, particularly since the customer identification and authentication would have largely already occurred through the tax filing process.

Once activated, the individual could use their SAFE-T Account card to access their refunds and make additional deposits into the account. In subsequent tax seasons, the refunds will be automatically deposited into the same SAFE-T Account, substantially decreasing the time it takes to access the refunds.

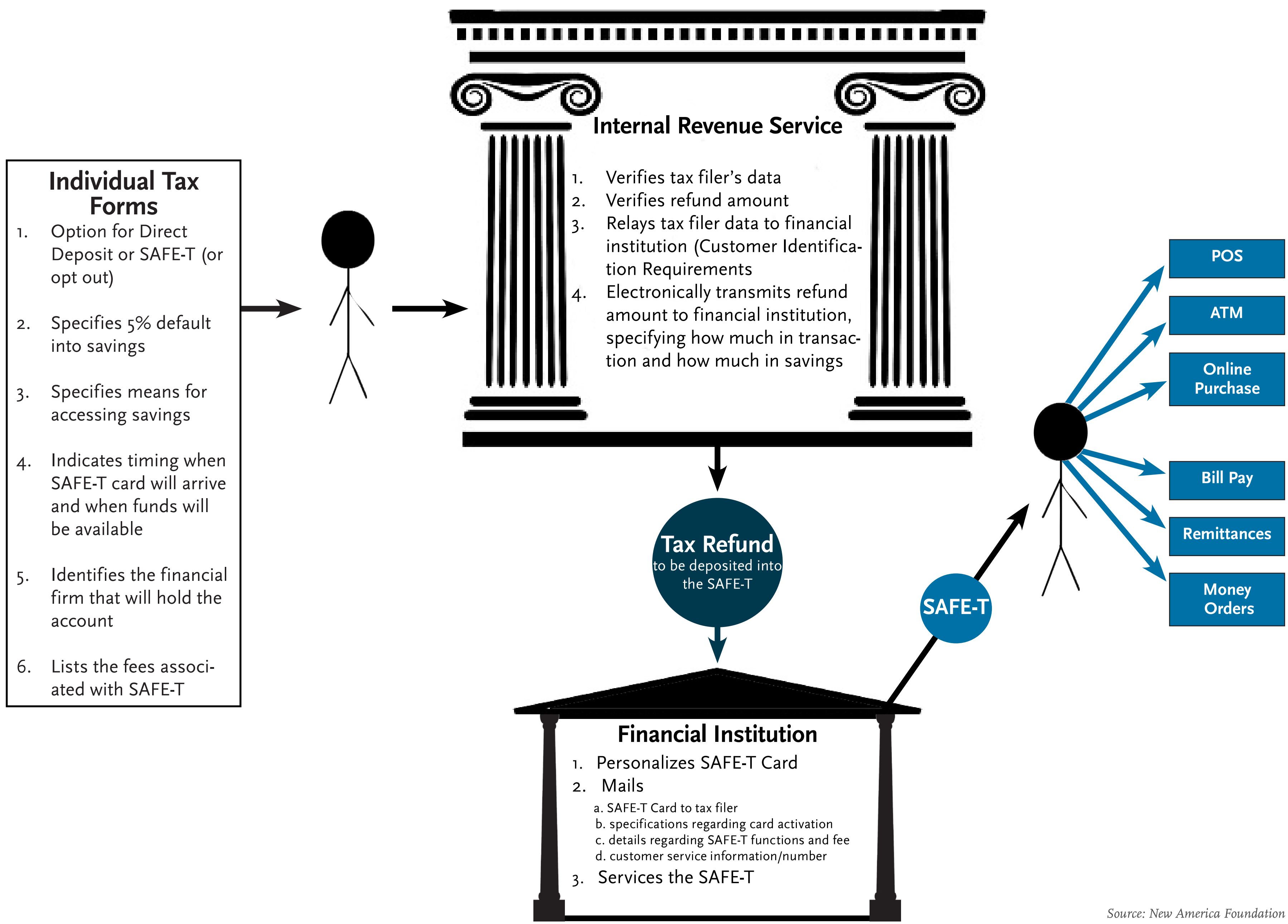
A diagram illustrating the process flow follows on the next page.

Conclusion

Building on the unique infrastructure of the prepaid product, a federal policy to deliver the SAFE-T Account at tax time could enable millions of lower income households to easily meet their daily financial transaction needs at low cost, while enabling savings to meet emergency expenses and longer term savings goals.

A precedent exists for delivering government benefits and entitlements on a prepaid product, whether it is for food stamps, wages and salary to the military and their families, or Social Security entitlements. For both the government and the beneficiaries, the transition to electronic delivery of benefits has meant millions of dollars in savings, efficiencies, and improved safety and convenience. This proposal builds on that precedent to establish a scaleable, credible, and safe financial product. It utilizes the scale of the potential market, the bargaining power of federal government, and new technology in the financial services sector. The SAFE-T Account may offer a scaleable strategy to reach millions of lower income households with a financial tool that can help them to save, build assets, and conduct routine financial transactions, in a safe, affordable, and convenient way. ■

SAFE-T Account Opening Process



Source: New America Foundation

Appendix

Origins of the Savings and Financial Electronic Transaction Account: The Prepaid Product

Thirty years ago, credit cards were the only financial product one would have thought of when asked to identify a plastic card to conduct financial transactions. Even today, most people envision a credit or debit card when asked to name a card they would use as a financial transaction instrument. Nevertheless, prepaid products are making significant inroads into the financial services space, with over $181 billion in transactions in 2006.[32]

Prepaid products, also known as stored-value cards, are plastic cards with magnetic strips that access information about funds that have been pre-paid or pre-loaded into an account and that are available to the cardholder through a variety of financial transaction methods. Many of the prepaid products are branded with Visa, MasterCard, or Discover and can be used anywhere the brands is accepted. Prepaid products are issued by financial institutions and non-bank financial service providers.

While there are a variety of prepaid products on the market with different purposes and different structures, three of the prepaid types are particularly relevant to the SAFE-T Account proposal. They are the payroll card product; the re-loadable, general spending product; and government benefits cards. The following provides an overview of each to illustrate their relevance to the SAFE-T Account proposal.

General-Spending Prepaid Products

Over the last five to ten years, the general-spending prepaid product has emerged among both banks and other providers. By allowing users to preload money into an account that is accessible via a card, users gain an array of financial transaction options. In industry parlance, these "platforms" include: point-of-sale purchases, ATM withdrawals, savings capabilities, on-line bill payment capabilities, remittance capability, calling card functions, money orders, access to benefits such as food stamps and health care, and small loan products.

These general-spending products operate on an open-loop system, which allows them to be used for a variety of purposes.[33] They typically operate on ATM and credit card networks, with either PIN- or signature-based transactions,[34] which enables them to be used at virtually all of the same locations as debit and credit cards.

General purpose prepaid products can be divided between those that are reloadable and those that are not. Reloadable means that additional funds can be added to the product from sources such as employers, or through venues such as the internet and kiosks located at convenience stores, check cashing facilities, and other outlets.

The major difference between general-purpose prepaid products and debit cards is that the prepaid product is not typically linked to a demand deposit account. Instead, the product is issued by a financial institution or other provider, with funds from multiple card-holders pooled in one account at a financial institution. The funds can be segregated by card holder, based on notational or ledger accounting, either by the issuer or a third-party vendor. In other prepaid account structures, the funds are held in a pooled account with explicit sub-accounts for individual cardholders. While pooled accounts are the most common structure for prepaid products, sometimes the funds are held in distinct accounts, usually demand deposit accounts, for each cardholder.

Different entities may conduct the various roles of issuing, delivering, processing, and servicing the prepaid product. The issuer, which could be a bank or not, issues and often services the product, including risk management and payment settlement responsibilities. Third-party processing firms, like Metavante Corporation, conduct payment transaction processing, including real-time payment authorizations and managing the customer service center, although depending upon the issuer and/or the bank's capabilities, they may provide some or all of these services. First Data Corp. is the largest distributor of prepaid products. The network that the prepaid product is branded with provides the connection between the retailer and the processor for authorization of the transactions.

Prepaid providers also see the potential of these products to reach the unbanked at large, because these products enable the user to perform a number of critical financial functions without a checking or savings account. Some issuers market prepaid products as check-less checking accounts, because of the many functions they can deliver. In a recent *American Banker* article, the vice president for prepaid cards at Visa noted this population was a "significant focus" for VISA and "one of the biggest opportunities in prepaid," with 80 million would-be customers with a combined annual income of $1 trillion.

Payroll Cards

Payroll cards are another form of prepaid product. They are used by employers to deliver wages or salary via ACH processing to employees in a non-check form. Employers, often working through third-party administrators, provide these products to cut costs and provide employees with access to their wages and salary safely and conveniently through ATM terminals and point of sale venues. Payroll cards are considered especially useful for employers who have a high percentage of employees who are unbanked and unable to use direct deposit to receive their payments.

Employers report that the use of the payroll product saves both themselves and their employees time and money. Employees aren't leaving work to cash their checks; ACH instead of paper checks reduces check processing, printing, and handling fees; and check replacement costs for lost or stolen checks are significantly reduced. Employers also benefit from increased employee productivity and the goodwill that is generated by offering their employees an additional benefit.

Employees appreciate 24-hour access to funds via ATM terminals; the ease in making money transfers; and the safety associated with not having to carry cash. Payroll cards also save them time by eliminating the need to go to work on an off day to pick up their check–the payroll product can provide real-time access through the ACH process. Employees, especially those without bank accounts, can avoid high cost fees of cashing their checks at alternative financial service providers. A study by the Office of the Comptroller of the Currency (OCC) found a payroll card can be a less-expensive alternative to a checking account, as well as being lower-cost than check cashing facilities. OCC estimated the annual costs to employees for a payroll card was $72.00, compared to a basic bank account at $79.40, and check cashing fees at $246.48.[35]

Government Benefit and Entitlement Cards

State and federal governments are among the largest users of the pre-paid infrastructure, delivering millions of dollars in entitlement payments and benefits such as TANF, food stamps, military benefits (to the enlisted and their families), and disaster relief funds each year. State and federal governments were one of the first to use the pre-payment platform to deliver benefits and entitlements on a card, and they are increasingly adopting the product to streamline financial transactions, improve program accountability, provide more security, increase consumer convenience and reduce paperwork and administrative costs, according to a study by the Electronic Benefits Council. The study of state government agencies found baseline costs from issuing government checks were as high as $35.00 per check.

The federal government is also using the prepaid infrastructure to deliver entitlements. The U.S. Treasury Department is providing Social Security and Supplemental Security Income on a debit card to check recipients who elect to receive the *Direct Express* product.

Direct Express is reloadable with federal benefits and contain FDIC insurance and Regulation E consumer protections for card-holders. The card, issued by Comerica, is branded with MasterCard and allows PIN- and signature-based transactions at both point-of-sale and ATM locations. Treasury developed and rolled out a cardholder education plan explaining how to use the product in a cost-effective manner, including maximizing fee-free access options such as point-of-sale instead of ATM withdrawal, minimizing overdrafts and losses due to unauthorized use or fraud, and maximizing effective and efficient use of customer service options.

The nationwide rollout followed a one year demonstration of the program, which was tested and found to be a cost-effective payment strategy. The goal of *Direct Express* is to reduce the dependency on federal check payments; reduce the cost to government; provide operational efficiencies; and reduce paperwork; while also providing safety and efficiency for the beneficiaries.[36] ■

Notes

1 While some community-based strategies have been effective in guiding consumers away from these products, the efforts to date have been marginal relative to the number of households using RALs.

2 The CFSI Underbanked Consumer Study Fact Sheet. June 2008. http://www.cfsiinnovation.com/research-paper-detail.php?article_id=330366

3 "Alternative financial services providers" and "alternative providers" are the terms used throughout this paper to refer to non-depository financial services firms.

4 "Underbanked Financial Services Market Exceeds $10 Billion." *Payment News*. Phoenix ESP Payments Research Group, Salisbury, MD. www.paymentsnews.com/2006/05/underbanked_fin.html

5 Eric Halperin and Peter Smith, Out of Balance, Consumers pay $17.5 billion per year in fees for abusive overdraft loans. Center for Responsible Lending. July 2007.

6 Federal Reserve Board of Governors. (2009). *Survey of Consumer Finances*. Washington, DC. Retrieved April 22, 2009, from http://www.federalreserve.gov/PUBS/oss?oss2/2007/bulletin.tables.int.xls

7 J. Bynner and W. Paxton, The Asset Effect. Institute for Public Policy Research. 2001.

8 Federal Reserve Board of Governors. (2009). *Survey of Consumer Finances*. Washington, DC. Retrieved April 22, 2009, from http://www.federalreserve.gov/PUBS/oss?oss2/2007/bulletin.tables.int.xls

9 Robert Haveman, Edward Wolff, and Jerome Levy, *Who are the Asset Poor?* April 2001.

10 Financial Services Centers of America Inc. http://www.fisca.org/about.htm. Accessed October 25, 2007.

11 Ellen Seidman, Moez Hababou, and Jennifer Kramer, *Getting to Know Underbanked Consumers, A Financial Services Analysis*. The Center for Financial Services Innovation. September 2005. This survey represented almost 1 million households in 63 low- and moderate-income tracts in Washington, D.C., Chicago, and Los Angeles.

12 Manuel Orozco, "Remittances and Financial Access: Understanding the Market Base of MSBS." Presentation to the FDIC Advisory Committee on Economic Inclusion, Money Services Businesses – Access to the Banking System. October 24, 2007.

13 Financial Service Centers of America, Inc., "Economic Inclusion: Meeting the Financial Needs of Low- and Moderate-Income Consumers through Financial Service Centers." Presented at the FDIC Advisory Committee on Economic Inclusion, Money Services Businesses – Access to the Banking System. October 24, 2007.

14 Mark Swanson, "Nationwide Savings Plan Automatic Enrollment Getting Back on Track." Nationwide Benefits Planning. Data presented at the Consumer Federal of America, America Saves meeting, Fall 2007.

15 Michael Barr, *Financial Services for Low- and Moderate-Income Households*. Detroit Area Household Financial Services Study, Survey Research Center, University of Michigan. 2006. Presented at the National Poverty Center: Access Assets and Poverty Conference, October 2007.

16 Constance Dunham, The *Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities*, in J.L. Blanton, Sherrie Rhine, and A. Williams, eds., *Changing Financial Markets and Community Development: A Federal Reserve System Research Conference*. 2001. Federal Reserve Bank of Richmond.

17 A migrant is defined as any foreign born person, authorized or unauthorized, legal or illegal, documented or undocumented, who is living temporarily or permanently in the U.S.

18 Manuel Orozco, October 2007.

19 New York City Department of Consumer Affairs Office of Financial Empowerment, "Innovation in Asset Building: the $aveNYC Account *A Learning Brief*." April 2009.

20 IRS data: http://www.irs.gov/pub/irs-soi/06ifss12.xls. Accessed November 19, 2007.

21 For a full description of prepaid products, including general spending, payroll and government cards, see the Appendix.

22 Of the millions of consumers who have had their bank accounts closed, it is largely as a result of account overdrafts. (A very small percentage have been closed due to abusive and fraudulent activity.) Most financial institutions use ChexSystems, a private database containing information about consumers who have mishandled their accounts, and many institutions will not extend an account to a consumer who is in the ChexSystems database, regardless of the transgression.

23 For more information about government benefits provided on in a prepaid product, see the Appendix.

24 NetSpend. "FiSCA and NetSpend Celebrate 'America Saves Week' With $100 Million Savings Milestone." Press Release, February 27, 2009. https://www.netspend.com/info/pr2009-02-27.shtml

25 Michael Barr, 2006.

26 Okonkwo Osili, Una and Paulson, Anna, *Immigrants' Access to Financial Services and Asset Accumulation*, September 2007. Presented at the National Poverty Center: Access Assets and Poverty Conference, October 2007.

27 Manuel Orozco, October 2007.

28 Ronda Kent, U. S. Treasury Department Financial Management Service. Presentation at the 2007 Prepaid Card Expo. In addition to federal income tax refunds, the full list of federal benefits and entitlements payments made by the federal government includes: security benefits, veterans' benefits, civil salary and retirement payments, and vendor and grant payments.

29 Financial institutions are already engaged in the prepaid market in a variety of ways. Some have sought to capitalize on existing consumer bases and corporate clients; others have invested to build systems internally to process the prepaid products, including transaction processing platforms; others are providing the mezzanine financing to support nonbank providers; while others are marketing the prepaid cards.

30 Financial institutions such as Bank of America are focusing on the lower income consumer market as an area for growth, and the SAFE-T Account could be the driver that engages financial institutions in a scaleable way. John Gruce, senior vice president and prepaid card manager for Bank of America, said, "The underserved population presents a significant opportunity for the consumer retail channel. ... As payroll card portfolios grow and other ways in which to capture new customers begin to be tapped out, banks may look to prepaid cardholders as potential buyers of other products."

31 Prepaid industry experts report consumers employ the prepaid product as a budgeting management tool to segregate funds for distinct functions and to help meet budgeting goals.

32 H. Michael Jalili, "Review 2006: New Rules and Opportunities in Prepaid," *American Banker*, December 28, 2006.

33 Open-loop, as opposed to closed-loop, implies the product is not limited to a certain merchant, store, or product. One of the more well known closed-loop products is the Starbucks card.

34 PIN-based products can be used at ATMs, PIN-based POS terminals or both (they operate using electronic fund transfer networks). Signature-based cards can be used at POS terminals with signature-based capabilities, in addition to ATMs and PIN-based POS terminals. They operate using the platform of the "brand", whether it's Visa, MasterCard, Amex, Discover, or other. The potential for overdrawing is less likely under the PIN-based system.

35 OCC Analysis on Payroll Cards, June 2005. The estimates are based on two paychecks of $400 each month and three payments that would require money orders or checks each month.

36 Ronda Kent, 2007.

MAIN OFFICE
1899 L St., NW
Suite 400
Washington, DC 20036
Phone 202 986 2700
Fax 202 986 3696

CALIFORNIA OFFICE
921 11th Street
Suite 901
Sacramento, CA 95814
Phone 916 448 5189
Fax 916 448 3724

NEW AMERICA FOUNDATION

WWW.NEWAMERICA.NET