



ASSET BUILDING PROGRAM

April 2009

The Savings and Financial Electronic Transaction (SAFE-T) Account

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

By Melissa Koide¹

Introduction

Over the past two decades, policymakers, academics, and others have pursued an array of policies and strategies to help lower and middle income households¹ to build savings and assets and access reasonably-priced financial products at mainstream institutions. While some progress has been made, there have been few advances to 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, particularly the financial behavior of lower income consumers, have boosted the creation of innovative financial products. Prepaid products—accounts that are pre-funded and accessible using network branded cards—represent an important development in the evolving financial services industry. While similar to debit cards connected to a checking account, prepaid products are not explicitly linked to a typical demand-deposit account. As such, 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. Plus, they can offer remittance and money order 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 an interest bearing savings account.

The SAFE-T account, which would be issued, delivered, and serviced by financial institutions on behalf of the U.S. Department of Treasury, would be accessible with a network branded card and could be used for point of sale transactions, to access cash, to make web-based or telephone bill payments and retail purchases, and possibly to make

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remittances and secure money orders. The savings component would help to meet short-term expenses and savings goals. And with enactment of federal legislation, the SAFE-T account could serve as the “plumbing” for large-scale asset policy targeted at lower income families.

Utilizing the pooled account structure of the prepaid product, the SAFE-T account would leverage the billions of dollars in tax refunds that are not electronically deposited each year to generate sufficient volume to entice financial institutions to offer the product at low 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 in order to receive an SAFE-T account, resulting in more households “on-the-grid” and generating additional tax revenues at the state and local level.

The Need for a Low-Cost, High-Value Transaction and Savings Product

Each year, tax time offers 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 earned income.

Many households, particularly lower income households, plan to use their annual tax refund to meet pressing expenses and support longer-term savings goals, and 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, often consume significant portions of the refund itself. Low-cost alternatives to RALs are largely nonexistent. 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. And direct deposit, which could help to expedite the refund, is not an option for the estimated 10 million households who lack 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 in order 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 providers³ 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 are serving lower income households with checking 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 to help smooth income flows when financial crises occur. Savings and assets also provide psychological benefits for parents and children. In fact, the presence of assets appears to matter more than the monetary value.⁶ Yet, for millions, savings and assets are largely nonexistent. As of 2004, the median net worth of the bottom 25 percent of households was \$13,300, compared to \$328,500 for the top 75 percent of households. 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.⁷ And 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 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 six 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. Clearly, 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.⁸ Between 2003 and 2004, low and moderate income households purchased over 1 million money orders each month.⁹ And last year alone, \$96 billion was remitted from households in the U.S. by money transfer firms.¹⁰ 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.¹¹

Fourth, the design of the financial product should include mindless features, such as defaults, that ease the pain associated with making certain financial decisions now and that provide future payoffs. Academic and industry research repeatedly show that defaults and opt-out instead of opt-in features can 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.¹² In developing policies and products to facilitate savings, the inclusion of defaults could affect significant change in financial behavior.

Fifth, the financial product should provide consumer protections, including disclosures and FDIC or equivalent insurance, 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. 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. Consumers benefit from the extension of the protections, while the method of delivery is more affordable for the financial institutions.

And 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.¹³

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.¹⁴

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 migrant¹⁵ 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 as \$2,000 each year. And individuals earning between \$15,000 and \$30,000 save as much as \$4,000 annually.¹⁶

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.

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 for tax year 2006. In total, 41 percent of those who received a refund – approximately 42 million tax filers – did not direct deposit.¹⁷ For a sense of the refund payments to the target population of this proposal, \$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, commonly called stored-value cards, 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, on-line bill payment, and remittances. Many also offer savings capabilities, calling card functions, money orders, access to benefits such as food stamps and healthcare.¹⁸ Prepaid products provide the convenience of checking accounts with debit cards, but without the risks of overdrafts and barriers of ChexSystems and credit checks, which have prevented millions from acquiring accounts with mainstream institutions.¹⁹ Because they are not tied to an individual transaction account, monies from multiple account holders are pooled in one account at a depository institution. The funds are segregated by cardholder, either by the depository institution or a third party processor.

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 throughout the year will be critical to its ongoing use. Ideally, recipients of federal and state 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.²⁰ 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, however, in that it protects the consumer from the risk of overdraft charges and the guards the financial institution from excessive negative balances. Using the SAFE-T account, accountholders could access their money through an ATM and make purchases at grocery

stores, restaurants, and other POS terminals. Because the SAFE-T account would be branded with Visa, MasterCard or other network provider, the transactions could be conducted at almost 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.

The following chart illustrates the benefits of a SAFE-T account in comparison to a traditional checking or savings 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 withdraw ATM	X	X	X
Funds Access: Point-of-sale transactions (PIN or Signature)	X	X	
Funds Access: Web-based bill payments	X	X	
Funds Access: Web-based purchases	X	X	
Funds Access: Remittances	X		
Funds Access: Money Orders	X		
Funds Access: Check writing		X	
Deposit: Direct	X	X	X
Deposit: Payroll	X	X	X
Federal Protections			
Reg E (Account Statements and card loss protection)	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 Certain Savings Goals, if law enacted	X		

The savings component of the SAFE-T account would allow users to save and earn interest on those funds. The inclusion of a savings component with SAFE-T accounts builds on learnings from behavioral economics and field research, which show that consumers often employ strategies to limit their access to their monies to facilitate savings. Research also shows that consumers engage in mental accounting when planning for the use of their money, even when the funds are in effect fungible. 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. For a sense of the potential interest in a saving component to the SAFE-T account, consider the *All Access Savings Program* offered by NetSpend and FISCA. It is a relatively new prepaid product containing a savings pocket that earns five percent interest. To date, approximately \$44 million has been put into savings.²¹

Other transaction capabilities that SAFE-T account holders ideally would have include the ability to make remittance payments, domestically and internationally, and to purchase money orders. Based on the large demand for money orders as a means for paying bills such as rent, money orders would be an important function to provide as part of this product. Repeatedly, research shows that lower income households use money orders to pay bills, rent, and other expenses, even if they have a bank account. The Detroit survey found that 65 percent of the households in the survey who had bank accounts nevertheless purchased money orders. Of respondents who did not have a bank account, seventy-seven percent used money orders to pay bills and make other payments.²²

Remittances are another highly-valued financial service, particularly among migrants, who comprise 1 in 9 residents in the U.S., equal to about 35 million people.²³ Last year, \$96 billion flowed from the United States to other countries via remittance payments. \$62 billion of that was remitted to Latin America. That amount is projected to increase to \$70 billion this year.²⁴

Interest and Rationale for Relevant Parties

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. For tax year 2006, it cost the federal government an estimated \$37.8 million to issue refunds via a paper check to the 42 million tax filers with refunds who did not use direct deposit. In comparison, had those refunds been issued via direct deposit, it would have cost the government approximately \$3.8 million.

SAFE-T accounts would also provide an electronic vehicle into which other federal (and potentially state) payments could be made. Including individual income tax refunds, the Treasury Department disburses almost 1 billion non-Defense, non-Postal payments to 100 million payees, totaling more than \$1.5 trillion each year.²⁵ If those payments were disbursed electronically and delivered via SAFE-T accounts, the cost savings could be enormous.

As mentioned in the introduction, the provision of a SAFE-T account with its cost savings benefits, could persuade households, who have an obligation to file income taxes but are not

doing so, to do so. The result could mean more revenues for federal, state, and local governments. And finally, the IRS and the Treasury Department could benefit from the positive publicity associated with providing a useful and effective financial tool that benefits tax filers while saving the federal government and taxpayers millions each year.

Financial Institutions

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.

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.”

Press coverage suggests the prepaid market is ripe for a large-scale impetus to stimulate large-scale demand, generate greater efficiencies, and increase competition, all of which will help to drive down costs. The scale of the SAFE-T account proposal should generate enough 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 currently 2 percent per transaction. For a sense of the interchange potential, 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 2 percent of the transaction amount was paid to the institution that issued the card.

Finally, the SAFE-T account offers financial institutions a low risk product that can be used to better understand lower income consumers. 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 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 to the

general positive effects that accrue to employers for providing benefits to employees: lower absenteeism and improved retention; increased recruitment potential; and improved workplace productivity.

The SAFE-T account could be especially useful for employers that have a high percentage of employees who lack a bank account and are unable to use direct deposit to receive their wage payments. Employees would benefit from immediate access to their pay, the increase in the safety of their monies, and the expanded financial access resulting from a financial product with broad recognition and acceptance. To get a sense of 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 another form of prepaid products that employers, along with employer assistance programs and payroll firms, use to deliver wage payments. This year, \$143 billion is anticipated in payroll card transactions. Two years ago, the volume was \$6 billion.

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 by serving as a product into which direct deposits can be made while also meeting a variety of employees' financial transaction and savings needs.

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 minimum SAFE-T account feature requirements; coordinating with the regulators to extend consumer protections and address federal regulations; 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 depository institutions to serve as issuers for its *Direct Express* program, which delivers Social Security and other federal benefits on a debit card, the Treasury Department could issue the SAFE-T account by contracting with one or more depository institutions. Prior to releasing a request for proposals, Treasury would likely undertake preliminary research to determine the minimum account requirements, including the functions, cost estimates, and geographic coverage requirements. As part of that research, Treasury would approximate how many depositories could participate, with the goals of complete nationwide coverage, low cost, and sustained financial institution interest and engagement. Once the early research is completed, Treasury would release the request for proposals with the goal of securing one or more contracts with depository institutions to issue, deliver, and service the SAFE-T account for a set period of time. In choosing the institutions, ideally, 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 entities eligible for the SAFE-T account contracts, in part to ensure that SAFE-T accounts are FDIC (or equivalent) insured. However, that would not preclude a depository institution from contracting with one or more nonbank parties to provide and service the SAFE-T accounts. 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 FDIC coverage, Regulation E extension, 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. Although CIP requirements have not been defined in the prepaid space, many if not most depository institutions engaged in prepaid products have established contracts with other parties that spell out how the necessary data will be collected and retained for the requisite five years.

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. Additionally, if the source of funds are constrained to wages and salary (besides the refunds), those funding sources could be verified using the employer's identification number.²⁶

Another important regulatory consideration is FDIC insurance coverage. Protections on individuals' funds provided under FDIC or equivalent insurance are important both in terms of providing such protection and because federal protections have been shown to be important to lower income consumers. Ensuring that FDIC coverage is extended to the SAFE-T account holder could require an affirmative action by the FDIC, given the ambiguity that exists with FDIC insurance coverage on prepaid products now. That said, the way the FDIC has proposed rules regarding insurance coverage to prepaid products suggests that extending such coverage to the accounts would not be unreasonable. Currently, how a prepaid account is structured and who is deemed the depositor on the account determines whether FDIC insurance coverage is awarded to the individual holding the card product.

Although the FDIC has not issued a final rule on the applicability of FDIC insurance to prepaid products, it has issued proposed rules, which serve as a strong indication for how the FDIC will likely issue the final rule. The proposed rules indicate that as long as the depository institution (or third-party on behalf of the institution) collects and maintains records indicating which funds are attributable to which prepaid cardholder, FDIC insurance should pass through to the individual.

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. If wages and salary are the only source of loadable funds, in addition to the annual tax refund, extension of Reg E should be easily achieved.

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 the 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 those types of 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 wisely as an alternative to more costly financial services; the savings function and its accessibility; how it can be used as a cash management tool;²⁷ 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 focused on educating employers about the benefits of SAFE-T accounts, both to them and to their employees.

Community organizations would play an instrumental role in educating consumers about the SAFE-T account and providing some of the 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 important organizations to get the word out about the SAFE-T account. For example, 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 could use its network of over 300 affiliates to educate tax filers about the SAFE-T account. AARP is another example of a national nonprofit that would be instrumental for

preparing its members who do not already directly deposit their tax refunds for the SAFE-T account.

How the SAFE-T Account Could Work

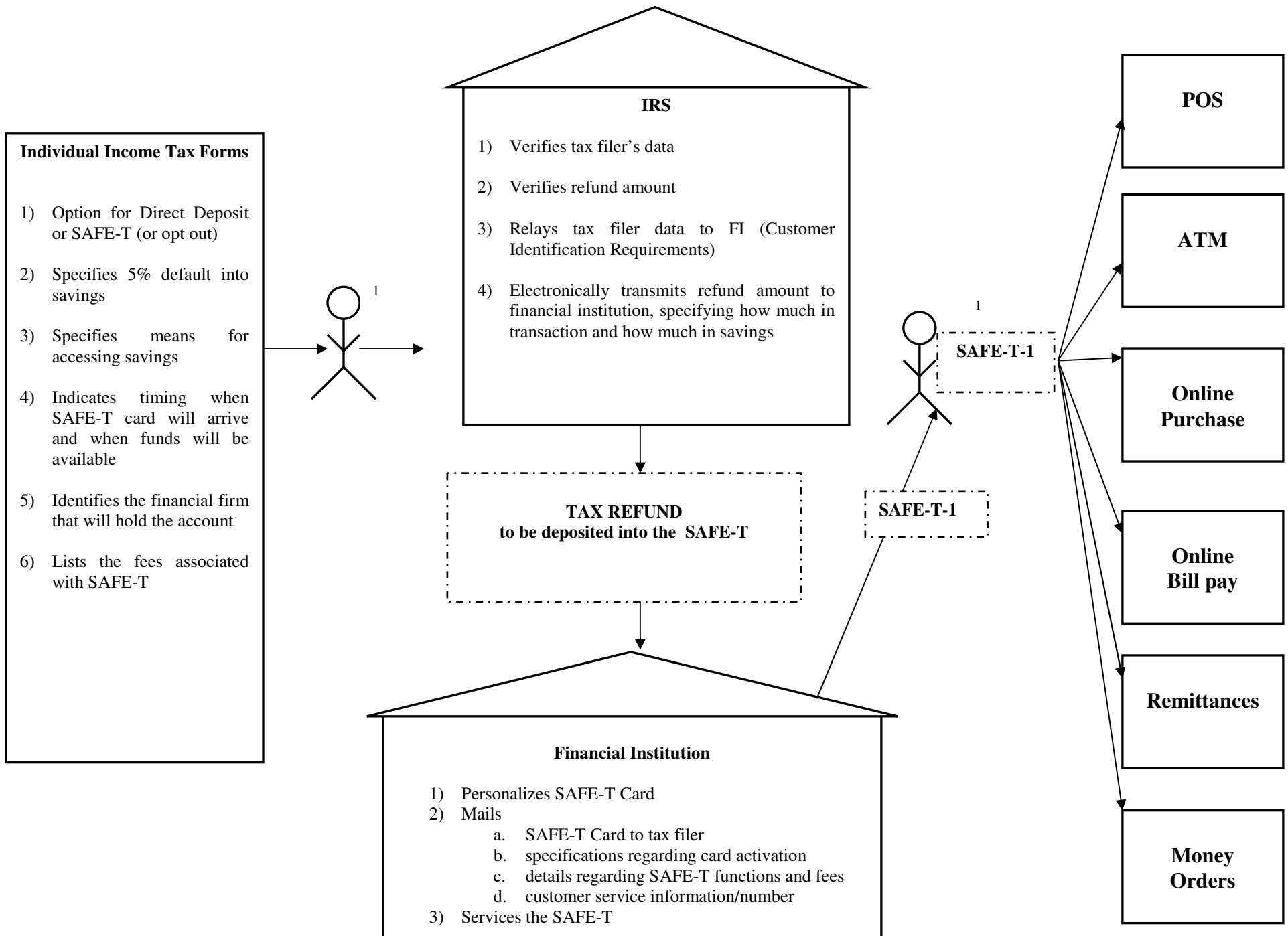
At least one year prior to the tax year in which the SAFE-T account is made available, the contracts will have been awarded, the product and infrastructure for supporting it will be in place, and a substantial education and awareness campaign will have gotten underway.

In the tax filing season in which the SAFE-T account is made available, individual tax filers will see on their tax forms two options for receiving their refunds: direct deposit into an existing account or a SAFE-T account. The form will specify that if they do not choose an existing account to deposit their refund, 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 for example), 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, along with instructions for directly depositing wages and salary into the account through their employer.

Once the IRS receives the tax return indicating that the tax filer will receive a SAFE-T account, it would verify the tax filer's data, confirm the refund amount, 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 depository 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 and instructions for activating the SAFE-T account, further details regarding the SAFE-T account functions and associated costs, 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 already occurred through the tax filing process. Once activated, the individual could use their SAFE-T account card to access their refunds in a variety of ways. After the first year, when the tax filer will already have a SAFE-T account card, the refunds will be automatically deposited into the SAFE-T account (unless the tax filer directs otherwise), 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 to build something that will have a lasting impact for lower income families. 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.

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 2006.²⁸

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.²⁹ They typically operate on ATM and credit card networks, with either PIN- or signature-based transactions,³⁰ 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. This year alone, \$143 billion is expected in payroll card transaction volume, up from \$6.3 billion in 2005. 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 \$246.48.³¹

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 just announced it will enable Social Security and Supplemental Security Income to be delivered on a debit card to check recipients. This follows a one year demonstration of the program, *Direct Express*, 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.³²

Direct Express will be reloadable with federal benefits and contain FDIC insurance and Regulation E consumer protections for card-holders. The card will be network branded and include both PIN- and signature-based transactions at both point-of-sale and ATM locations. Treasury is developing a plan to educate cardholders on 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.

Endnotes

¹ “Lower income” is the term used throughout the paper to refer to households of low, moderate, and middle incomes, which is defined as households with incomes equal to or less than \$37,771, based on the 2006 Current Population Survey of the U.S. Census Bureau.

² Arthur B. Kennickell et al., *Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances*, 86 Federal Reserve Bulletin. 2000.

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

⁷ Robert Haveman, Edward Wolff, and Jerome Levy, *Who are the Asset Poor?* April 2001.

⁸ Financial Services Centers of America Inc. <http://www.fisca.org/about.htm>. Accessed October 25, 2007.

⁹ 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.

¹⁰ 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.

¹¹ 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.

¹² 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.

¹³ 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.

¹⁴ 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.

¹⁵ 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.

¹⁶ Manuel Orozco, October 2007.

¹⁷ IRS data: <http://www.irs.gov/pub/irs-soi/06ifss12.xls>. Accessed November 19, 2007.

¹⁸ For a full description of prepaid products, including general spending, payroll and government cards, see the Appendix.

¹⁹ 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.

²⁰ For more information about government benefits provided on in a prepaid product, see the Appendix.

²¹ Financial Service Centers of America, 2007.

²² Michael Barr, 2006.

²³ 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.

²⁴ Manuel Orozco, October 2007.

²⁵ 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.

²⁶ The decision to limit the funds that can be deposited into the SAFE-T account to wages and salary should be weighed heavily against the number of lower income households that have sources of income outside of wages and salary.

²⁷ 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.

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

²⁹ 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.

³⁰ 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.

³¹ 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.

³² Ronda Kent, 2007.