Minutes

of

The Meeting of the FDIC Advisory Committee on Economic Inclusion

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

April 24, 2014 - 9:04 A.M.

The meeting of the FDIC Advisory Committee on Economic Inclusion ("ComE-IN" or "Committee") was called to order by Martin J. Gruenberg, Chairman of the Board of Directors of the Federal Deposit Insurance Corporation ("Corporation" or "FDIC").

The members of ComE-IN present at the meeting were Robert A. Annibale, Global Director, Citi Microfinance and Community Development; Michael S. Barr, Professor of Law, University of Michigan Law School; Ted Beck, President and Chief Executive Officer ("CEO"), National Endowment for Financial Education; Kelvin Boston, Executive Producer and Host of PBS' *Moneywise with Kelvin Boston;* Jose Cisneros, Treasurer, City and County of San Francisco, California; Martin Eakes, CEO, Self-Help/Center for Responsible Lending, Durham, North Carolina; Rev. Dr. Floyd H. Flake, Senior Pastor, Greater Allen AME Cathedral of New York; Andrea Levere, President, Corporation for Enterprise Development, Washington, D.C.; Patricia A. McCoy, Director of the Insurance Law Center and the Connecticut Mutual Professor of Law, University of Connecticut Law; Alden J. McDonald, Jr., President and CEO, Liberty Bank and Trust, New Orleans, Louisiana; Bruce D. Murphy, Executive Vice President and President, Community Development Banking, KeyBank National Association; John W. Ryan, Executive Vice President, Conference of State Bank Supervisors; Phillip L. Swagel, Professor in International Economic Policy, University of Maryland, Senior Fellow at the Milken Institute and a visiting scholar at the American Enterprise Institute; and John

C. Weicher, Director, Hudson Institute's Center for Housing and Financial Markets.

Ester R. Fuchs, Professor, School of International and Public Affairs, Columbia University; Wade Henderson, President and CEO, Leadership Conference on Civil Rights, and Counselor to the Leadership Conference on Civil Rights Education Fund; Wade Henderson, President and CEO, Leadership Conference on Civil Rights, and Counselor to the Leadership Conference on Civil Rights Education Fund; Manuel Orozco, Senior Associate at the Inter-American Dialogue, and Senior Researcher, Institute for the Study of International Migration, Georgetown University; J. Michael Shepherd, Chairman and CEO, Bank of the West and BancWest Corporation; Robert K. Steel, Deputy Mayor for Economic Development, The City of New York; and Peter Tufano, Peter Moores Dean and Professor of Finance, Said Business School, Oxford University andFounder and CEO of D2D Fund, were absent from the meeting.

Members of the Corporation's Board of Directors present at the meeting were Martin J. Gruenberg, Chairman, and Jeremiah O. Norton, Director (Appointive). Roberta K. McInerney, Designated Federal Officer for the Committee and Deputy General Counsel, Corporate, Consumer, Insurance, and Legislation Branch, FDIC Legal Division, also was present at the meeting.

Corporation staff who attended the meeting included Willa M. Allen, James L. Anderson, Michael L. Bachman, Michael W. Briggs, Lariece M. Brown, Susan Burhouse, Alexander S. Cheng, Karyen Chu, Patricia A. Colohan, Kymberly K. Copa, Carolyn D. Curran, Debra A. Decker, Willie B. Donaldson, Doreen R. Eberley, Keith S. Ernst, Robert E. Feldman, Lekeshia Frasure, Janet R. Gordon, Bobbie Gray, Shannon N. Greco, Matthew Homer, Shamara L. Humbles, Craig R. Jarvill, Ron Jauregui, Kathy Kalser, Arleas Upton Kea, Sally J. Kearney, Cheh Kim, Alan W. Levy, Alicia Lloro, Christopher Lucas, Jonathan N. Miller, Robert W. Mooney, Phoebe D. Morse, Thomas E. Nixon, Janet V. Norcom, Elizabeth Ortiz, Yazmin E. Osaki, Mark E. Pearce, Sylvia H. Plunkett, Luke W. Reynolds, Sherrie Rhine, Jay Rosenstein, Barbara A. Ryan, Richard M. Schwartz, Kenneth Shaw, Patience R. Singleton, Lori Thompson, Lauren A. Whitaker, and James Yagley.

William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Grovetta N. Gardineer, and Barry Wides, Office of the Comptroller of the Currency, were also present at the meeting.

Chairman Gruenberg opened and presided at the meeting.

Chairman Gruenberg began by introducing two new members to the Committee. First, he welcomed Patricia A. McCoy to the Committee. He noted that she is a Professor of Law at the University of Connecticut School of Law, serves as Director of the Insurance Law Center at the School, has had a distinguished academic career with a particular focus on consumer protection in the financial services area, and, from 2010 to 2011, served at the United States Department of the Treasury where she helped create the Consumer Financial Protection Bureau ("CFPB"). She later served as the CFPB's first Assistant Director for Mortgage Markets. He then welcomed Phillip L. Swagel to the Committee. Professor Swagel is a Professor of International Economic Policy at the University of Maryland's School of Public Policy, directs the University's Thomas Schelling Distinguished Visitor Series, is a non-resident scholar at the American Enterprise Institute, served as Assistant Secretary for Economic Policy at the Department of Treasury from 2006 to 2009, and previously served as Chief of Staff and senior economist at the White House Council of Economic Advisers.

Next, Chairman Gruenberg provided an overview of the agenda, advising that the meeting would focus on new efforts to expand banking services to consumers. With respect to the first panel, he recalled that the Committee previously discussed safe accounts; that two institutions — Bank of America, National Association ("BAC"), Charlotte, North Carolina, and Union Bank, National Association, San Francisco, California — were introducing account-based debit card products consistent with the FDIC's model transaction accounts; and that BAC and Union Bank representatives on the first panel would describe the structure of these accounts, outline the research and strategy that shaped their creation, and summarize consumer reaction. The second panel would present a paper describing the potential of mobile banking to expand access to the banking system, he advised. The paper was the first of its kind, he reported, and would provide a solid starting point for future initiatives. With respect to the third panel, he announced that the CFPB and FDIC were introducing a new financial education program designed for primary and secondary level students. The new program was built upon the FDIC's existing Money Smart Program but was designed to draw in teachers and parents as well as students. He advised that the fourth panel would deal with consumer demand for small-dollar credit. Chairman Gruenberg then introduced Jonathan Miller, Deputy Director, Policy and Research, Division of Depositor and

Consumer Protection ("DCP"), moderator for the panel discussion on "Safe Accounts."

Mr. Miller noted that the FDIC and the Committee previously discussed efforts to bring unbanked and underbanked households into mainstream banking systems; that, with the Committee's help, the FDIC designed a safe transaction account template and subsequently launched the Model Safe Accounts Pilot Program to test and refine the template; the Pilot Program confirmed that safe accounts performed on par with or better than other transaction accounts while bringing unbanked and underbanked consumers into the banking system; that, armed with its findings, FDIC staff met with financial institutions to explain the results of the Pilot Program; that various institutions agreed to design and market safe accounts; and that today's panelists, as early adopters, would describe initial consumer reaction to safe accounts. Mr. Miller then introduced the panel members: Thong Nguyen, Retail Banking Executive, BAC; and Rogger LaCruz, Vice President, Senior Product Manager for Retail Deposits, Union Bank.

Mr. Nguyen noted that BAC has approximately 70 million customers in 50 million households in the United States; that a small percentage (approximately three to four million customers) consistently overdraft their accounts; that customers incurring overdraft fees often contact customer service centers at significant cost to BAC; and, even when BAC reimburses overdraft fees, customer satisfaction suffers. BAC therefore decided to create a product to resolve these issues with the primary goal being to "do the right thing." Their efforts extended over a three-year period and included meetings with advocacy groups as well as in-depth customer studies. Based upon their findings, BAC rolled-out "SafeBalance Banking," a robust mobile platform that has many of the same features and benefits of BAC's traditional checking accounts but is designed to help customers avoid overdraft fees. The product has a fixed monthly fee of $4.95, provides full access to tellers and ATMs, provides debit cards with a zero liability guarantee and optional photo security, and has full online and mobile banking access. He emphasized that timing issues can catch customers by surprise and so BAC worked to eliminate timing issues related to this product. Customers can pay individuals or businesses using their debit card in person, online and by mobile transfers, or through online bill pay but, by allowing transactions to be approved only when the customer has sufficient funds in the account, customers are prevented from falling into overdraft or insufficient-funds status. Checks are issued to recipients only after the funds have been withdrawn by the customer and, with respect to ATMs, consumers cannot withdraw funds they do not have in their account. BAC also provides online and mobile alerts so customers can avoid timing issues altogether. In short, Mr. Nguyen said BAC created a full-feature, online, mobile product with full access to the banking system, banking centers, and ATMs, but without the threat of destroying the customer's liquidity. Moreover, BAC partnered with the Khan Academy to deliver money-management training to their customers. Customers who encounter money-management problems are encouraged to join the program and, even though the program is just starting, several thousand accounts have joined the program already.

Mr. LaCruz then outlined Union Bank's efforts to create the "Union Bank Access Account" ("Access Account"). Driven by its core belief to "Do the right thing for its customers" and based upon its review of the 2009 and 2011 FDIC Unbanked and Underbanked Households Surveys, Union Bank designed the Access Account to demonstrate its commitment to providing products that serve the needs of the low-to-moderate income ("LMI") segment and other customers who may not qualify for a traditional account. He described the key features of the Access Account as follows: no direct deposit requirements, no service fees with direct deposits, no minimum balance requirements, unlimited discounted money orders in lieu of paper checks, no overdraft or insufficient-fund fees, and no hidden fees. He emphasized that Access Accounts are checkless which means customers will not be caught in the position of bouncing checks.

Mr. LaCruz then directed the Committee's attention to the challenges consumers face when they are reported to ChexSystems—a network of financial institutions that regularly share and consolidate information regarding closed checking and savings accounts for the stated purpose of enabling them to assess the risk of opening new accounts. Prior to opening an account for a consumer, financial institutions access ChexSystems and, if the consumer has been reported, typically decline the account with appropriate disclosures. Thus, this segment of the population has difficulty accessing mainstream banking. Mr. LaCruz reported that consumers who are in ChexSystems may nonetheless qualify for the Account Access product as long as they are not in ChexSystems due to fraudulent activity. He next discussed Union Bank's analysis when setting minimum deposit requirements. He explained that monthly service fees are $5.00 (with online statements) or $6.00 (with paper statements) though the account is free if the customer has a direct deposit minimum of $25.00 per month; approximately fifty percent of its customers have direct deposit and thus the accounts are free to most customers. The Bank has observed that consumers who open accounts with lesser minimum requirements typically receive a first statement from their bank showing a negative balance and so walk-away from the account or fall into overdraft status; the account is closed; the consumer is reported to ChexSystems, making it difficult to open future accounts and pushing the consumers out of the banking system and into check-cashing storefronts or alternative financial products. Thus, Account Access was designed with "guardrails" to help customers manage their accounts yet customers have full access to tellers, ATMs, online banking, and mobile banking. He closed his presentation by describing Union Bank's efforts to reach unbanked and underbanked consumers. These efforts included the use of easy-to-understand disclosure formats recommended by The Pew Charitable Trusts ("Pew"), targeted marketing to reach at-risk consumers, outreach to local community groups, and specialized in-house training.

The Committee applauded Mr. Nguyen's and Mr. LaCruz's efforts to provide affordable banking services to LMI consumers and agreed that the accounts serve as useful entry points for these consumers. The Committee then discussed at length the economics underlying safe accounts, particularly focusing on the sustainability and "marginal costs" of safe accounts. As to whether the accounts were sustainable over the long term, Mr. Nguyen advised that BAC's approach was to "break-even." He explained that, due to demographics, the product is targeted to BAC's existing customers but, given that BAC serves approximately 50 million households, that is a significant segment. Their primary objective, then, is to focus on serving current customers who are encountering money management issues. He explained that the alternatives – standing aside while customers pile-up overdraft charges or turning consumers away – were unpalatable. He also said it would be helpful to remember that many consumer complaints concern fees, most of the fees are incurred by the very population safe accounts are designed to help, and safe accounts can help avoid complaints and permit the bank to focus on other matters.

Mr. LaCruz agreed, noting that Account Access is designed to serve and retain current customers but that, over time, Union Bank believes the product will attract new customers to the bank. He noted that the program has been in place for just 11 months and they opened over 6,000 accounts. He emphasized that it is important to get the word out to customers because the goal is to reach customers before they have problems with ChexSystems or are afraid to open a checking account. Customers were excited to hear of the program, he reported, and some customers established accounts with high-dollar deposits, suggesting that they had stashed funds in their homes because they did not have a bank account. The typical user of these accounts has a smaller amount of savings compared to their general customer base, he noted. Consequently, Union Bank hopes to design a savings product that can go hand-in-hand with Access Account. As the bank learns about these customers' needs, the bank will be better situated to address their savings concerns.

Continuing on the theme of sustainability, the Committee discussed the challenges faced by banks having a different marginal cost of funds than the panelists, which might result in monthly fees higher than the $4.95 or $5.00 mentioned by the panelists; considered whether reliance on third-party vendors for components of a program would increase the costs; and urged the panelists to share substantive cost analyses of the safe account with the FDIC's research staff.

The Committee members then asked Mr. Nguyen to expand upon the challenges BAC encountered with its "no overdraft" approach in the context of point-of-sale arrangements. Mr. Nguyen advised that, with respect to operational implementation of the "no overdraft" approach, BAC had not encountered problems. Although some customers were chagrined when an attempted point-of-sale transaction was denied (even though the denial meant the customer avoided overdraft fees), most customers found it preferable to avoid going into overdraft status even if the attempted point-of-sale acquisition failed.

The Committee also discussed, in turn, the success of the "BankOn" program - a program offering services to unbanked and underbanked households; the large percentage of consumers who are unbanked because they are in ChexSystems; and consumer education. With respect to education, the Committee members expressed concern that consumers are unfamiliar with safe accounts. Mr. Nguyen agreed that outreach and engagement are essential, advised that the educational program developed with the Kahn Academy is called "Better Money Habits" at bettermoneyhabits.com, and that BAC strives to help customers find the product that is best-suited to their needs. Mr. LaCruz concurred, noting that Union Bank spent significant time with consumers in their homes in an effort to learn what would be most helpful and found that education is essential.

Chairman Gruenberg advised that the meeting would continue with Keith Ernst, Associate Director for Consumer Research, DCP, moderating the second panel.

Mr. Ernst first described the context of the white paper on Mobile Financial Services ("MFS") and the progress made on the paper since the last Committee meeting. He then explained that the paper applies a three-part analytical framework for evaluating MFS' impact on economic inclusion and also identifies seven broad takeaways that will increase the economic inclusion potential of MFS. Mr. Ernst explained that the paper examines how technology may increase access for the underbanked as well as present opportunities for growth. He stated that the paper also explores the opportunities and challenges presented by the current technologies, regulatory requirements, and business environment.

Mr. Ernst then advised that Susan Burhouse, Senior Consumer Researcher, DCP, would discuss some of the challenges to economic inclusion, define the technology, and share data on the public's use of MFS, after which Yazmin Osaki, Senior Consumer Research Associate, DCP, would provide additional details about the specific analytical framework described in the paper. He stated that Matt Homer, Policy Analyst, DCP, would conclude the presentation with a discussion of the takeaways from the white paper.

Ms. Burhouse stated that, although the use of MFS has become more widespread, it is not always designed for use in ways that increase economic inclusion. Ms. Burhouse emphasized that the FDIC's research suggests that opportunities exist to fine-tune MFS offerings to better assist the underserved. Next, Ms. Burhouse explained that profitability and fraud issues present broader challenges to economic inclusion efforts. Ms. Burhouse also noted that some bankers perceive the regulatory environment and customer identification requirements as additional challenges. She stated that customer awareness regarding product availability is another concern for institutions. Recalling that many of the small dollar loan and safe account pilot banks have struggled with targeting products and disseminating information to the unbanked and underbanked consumers, Ms. Burhouse suggested that improvements in marketing methods might resolve some of the issues related to customer awareness.

Ms. Burhouse then reiterated that challenges with mainstream banking cause some consumers to resort to alternative financial services ("AFS") instead of banks. Citing a 2011 study by Pew that surveyed workers who are paid in cash only, Ms. Burhouse pointed out that even the method through which consumers receive their income is influential on banking status. Likewise, she explained that convenient banking hours and branch location are important to consumers. Ms. Burhouse further noted that all consumers, the underserved included, value transparency and predictability with regard to the prices of financial services. Additionally, Ms. Burhouse pointed out that since many households cycle in and out of the banking system, according to the 2011 FDIC National Survey of Unbanked and Underbanked Households, it is also important to consider the sustainability of banking relationships.

Next, Ms. Burhouse defined MFS as a set of technologies that enable consumers to access and use financial services on their mobile devices at any time and any place. She specifically noted that MFS is a channel and not a product in and of itself. Ms. Burhouse then stressed the importance of ensuring that underserved customers are brought into good, safe, and affordable underlying accounts and products. She pointed out that some MFS functions are accessible through any type of mobile phone while there are other functions, such as remote deposit capture ("RDC"), which are accessible only through smartphones and cameras. Closing out her discussion on MFS concepts, Ms. Burhouse noted that the white paper focused only on bank-sponsored MFS functions such as transferring funds or making payments and not non-bank products that support functions such as mobile commerce.

Continuing her presentation, Ms. Burhouse addressed the potential benefits of MFS. She pointed out that MFS has the potential to meet many of the most common concerns of the underserved. However, Ms. Burhouse cautioned that some issues such as those related to identification or income required to open a bank account cannot easily be addressed by MFS. She also mentioned that because MFS is widely used already, it will be easier to develop future offerings that will benefit the underserved population. For the purposes of demonstrating the rates of household access to mobile and smartphones, Ms. Burhouse presented some preliminary data gathered from the 2013 FDIC National Survey of Unbanked and Underbanked Households ("2013 Household Survey"). Ms. Burhouse stated that overall access to mobile phones and smartphones is widespread, especially among underbanked households. She reported that, as demonstrated by the survey, ninety percent of underbanked households have mobile phones with seventy-one percent of these being smartphones; that two-thirds of unbanked households have mobile phones with just under half of these being smartphones; that approximately fifty-two to fifty-five percent of Black, Hispanic, and White households have smartphones with relatively little difference in smartphone ownership by race. With regard to smartphone ownership patterns by age and income, Ms. Burhouse recounted that three-quarters of households under age forty-four own smartphones; that nearly ninety percent of households earning more than $75,000 own smartphones; and that in those households where income is less than $15,000 per year, only one-third of those households own a smartphone but seventy percent of those same households have access to at least a basic mobile phone. Ms. Burhouse also reported that only one-quarter of mobile phone users used mobile banking within the last year while nearly one-third of smartphone owners had done so and that forty-two percent of underbanked smartphone owners used MFS in the last year compared to thirty-four percent of fully banked households. She noted that the data again demonstrated noticeable differences by income and age stating that nearly half of the smartphone owners aged thirty-four or younger use mobile banking but only fifteen percent of smartphone owners aged sixty-five or above use mobile banking. Similarly, Ms. Burhouse demonstrated that mobile banking use ranges from about thirty percent of the lowest-income households to almost forty percent of the higher income households. Ms. Burhouse also pointed out that the use of mobile banking is still not as widespread as other methods used for account access. She stated that eighty percent of households surveyed still visited a bank teller at least once in the past year. Finally, she noted that twenty-nine percent of the underbanked households used mobile banking while only twenty-two percent of the fully banked households used mobile banking.

Next, Ms. Burhouse reviewed the framework developed in the white paper. She mentioned that the paper focused on the issues of access, which relates to bringing consumers into the banking system; sustainability, which involves keeping people in the banking system; and growth, which involves presenting opportunities to promote consumers' financial capabilities and deepen their banking relationships.

Ms. Osaki began her portion of the presentation by reviewing the ways in which the three part framework evaluates the economic inclusion potential of MFS. Ms. Osaki stated that the analysis of access depends on whether MFS can bring bank consumers to the financial mainstream by increasing the appeal of the banking system or facilitating their account opening process so that hurdles such as screen size for viewing disclosures are minimized. Ms. Osaki also pointed out that many of the systems that banks use do not provide the flexibility to link to other bank applications such as account opening. Ms. Osaki advised that banks do not perceive that the demand for mobile bank account opening is as great as the demand for services such as RDC.

Setting the context for the remainder of her remarks, Ms. Osaki reiterated some of the data from the 2013 Household Survey related to smartphone ownership amongst unbanked consumers. She then noted several important considerations contributing to access issues for the unbanked and underbanked. Ms. Osaki advised that the first consideration relates to the presumption that future smartphone ownership will be widespread among unbanked consumers. Next, she noted that MFS alone is unlikely to address economic and institutional reasons why unbanked consumers do not have a bank account. Ms. Osaki then mentioned a third consideration which requires evaluating the appeal of the various types of features. Ms. Osaki summarized her points related to MFS' potential to increase access by explaining that, although MFS will likely have only a limited role in facilitating unbanked access to the financial mainstream in the short term, as smartphone usage among banks expands, MFS could eventually play a significant role in increasing access to the mainstream banking system.

Next, Ms. Osaki discussed the importance of sustainable banking relationships for underserved consumers. She indicated that implementation of services which would allow for easier access to timely and accurate available funds account information as well as the implementation of RDC and mobile payment systems would help to create sustainable relationships. She also pointed out several challenges to offering these services. She stated that one such challenge is the delay in processing of transactions before posting to a customer's account. She advised that it will be important for banks to set effective risk-management strategies that allow them to offer these types of services with more attractive terms than non-bank providers. Ms. Osaki then identified another challenge to sustainability in that some mobile banking users may not be able to access the online desktop mobile banking platform if they are only able to access the internet on their mobile device. Ms. Osaki also noted that the persistent need to make payments in cash or via paper instruments is one that should not be minimized.

Ms. Osaki then went on to discuss the opportunities to change the economics of serving underserved consumers through MFS. She explained that, as consumers increase their usage of

MFS, the need and cost of other channels such as bank tellers and customer service calls will decrease, thus reducing the cost of banking for underserved consumers. She reported that some banks have experienced higher loyalty levels and increased retention of mobile banking users, therefore increasing feasibility for the financial institutions. Ms. Osaki stated that security concerns could be addressed up front by implementing a fraud alert system, image capture technology to validate identification, or the use of fingerprints or voice recognition tools for authentication of identification. With respect to the broader question of whether MFS can assist financial institutions in serving consumers, Ms. Osaki explained that short-term investment costs in the mobile platform are currently additive as opposed to cost-saving for banks. She pointed out that cost concerns coupled with concerns related to security have caused many institutions to focus on serving more well-established customers.

Moving to growth as the third and final dimension in the economic inclusion framework, Ms. Osaki posed the question of whether it is possible for MFS to help consumers improve their financial capabilities. She described various methods by which underserved consumers may take advantage of Mobile Personal Financial Management ("MPFM") tools. She indicated that more work needs to be done to identify exactly the type of MPFM tools that would be most effective to the underserved. Ms. Osaki summarized her presentation by explaining that MFS has the potential to enhance banking relationships with underserved consumers through increased access, sustainability, and growth. She stated that improving the sustainability of banking relationships seems the most achievable in the short-term. She then advised that Mr. Homer would subsequently present seven different takeaways that identify ways to fine-tune MFS strategies along the three economic growth framework dimensions.

Mr. Homer first mentioned that as MFS becomes more widespread, choices about what features to deploy would affect how responsive MFS can be to the needs of the underserved. He explained that although he would provide illustrative examples of different MFS strategies, it still was too early to determine which were the most effective. He then stated that the first takeaway relates to the likelihood that MFS will be most effective as an economic inclusion tool when it is part of a larger economic inclusion strategy. He noted that utilizing various approaches to address the access and growth dimensions of the framework would be particularly important. Mr. Homer suggested that creating partnerships with community organizations to provide hands-on guidance as to how to properly use MFS features would resolve some of the access issues. He stated that instructional, online videos could increase consumer familiarity with MFS by showing customers how to use specific mobile features.

Next, Mr. Homer indicated that the second takeaway focuses on the importance of providing underserved consumers with the opportunity for one-on-one interaction. Mr. Homer stated that one MFS provider did this by partnering with a prepaid mobile store so that the store clerks could demonstrate how to use MFS features. He explained that the third takeaway relates to the importance of the implementation of risk management strategies that take into consideration the needs of the underserved consumers. He cautioned banks against imposing restricted eligibility standards or new fees which could prevent useful features from becoming available to the underserved. Mr. Homer emphasized that finding risk management approaches that help institutions guard against risk but also preserve access for the underserved is a key element of making MFS a tool of economic inclusion.

Mr. Homer next stated that the fourth takeaway relates to the incorporation of increased convenience and speed into MFS features. Noting that increasing the speed of MFS probably requires some significant changes to market-wide systems as well as to individual bank infrastructure, Mr. Homer advised that there are, however, some short term changes that banks could make to increase the accuracy of information available to consumers. He recommended the implementation of a real time alert system or virtual check book that would allow customers to log payments that have been initiated but not yet posted. Acknowledging that MFS will not answer all challenges, Mr. Homer emphasized that in order for MFS to be most effective, it must be as comprehensive as possible in the features that it does offer.

Mr. Homer stated that the fifth takeaway suggests that banks make MFS a more comprehensive tool by implementing features such as standalone bill pay, alert management systems, and mobile account-opening. Next, Mr. Homer explained that the sixth takeaway calls upon stakeholders to identify and share case studies of profitable and feasible MFS implementation strategies. He acknowledged the upfront costs associated with MFS but also stated that MFS has proven to be cheaper than other delivery methods on a transaction basis, thus suggesting that cost savings are likely to be realized over time. For the seventh and final takeaway, Mr. Homer pointed out that there are many underserved consumers who still rely on cash and other instruments to make payments. Because of this tendency, he recommended that banks consider various ways to link traditional paper payment methods to MFS offerings. In conclusion, Mr. Homer noted that there are many ways in which MFS implementation could have a beneficial economic inclusion impact.

In the discussion that followed, Committee members offered a number of suggestions to the panel members. Mr. McDonald briefly explained that the implementation of MFS at his institution demonstrated promise with regard to cost control, however, he also pointed out that compliance issues remain a concern for community banks. Mr. McDonald recommended that the FDIC examine compliance challenges, affecting cost and pricing, as related to MFS and use this to guide policy-making in the future. Lastly, Mr. McDonald suggested that upgrading the Money Smart program so that instructional videos are included would be helpful to the smaller banks. Mr. Ernst then asked the panelists if their research suggested that compliance concerns related to customer identification and fraud were amongst the most common expressed by stakeholders. Ms. Burhouse responded that the bankers also expressed concerns related to disclosures and properly fitting the disclosure information on the small mobile screens. Mr. McDonald suggested that a reduction of the amount of information required in the disclosures might make it easier to display on a mobile device.

Mr. Murphy then shared his experience at a larger bank where mobile transactions will soon outnumber branch transactions. Acknowledging that there are still challenges posed by moving away from branches and towards MFS, he noted that community education on MFS will be key to its successful implementation. He stated that the consolidation of branches would affect one-on-one relationships with customers as well.

Continuing the discussion, Ms. McCoy reiterated the previously mentioned statistic that the underbanked use MFS more than the fully banked. She suggested that Mr. Ernst focus on how security issues may discourage both banks and customers from using MFS. Ms. McCoy stated that both the consumers and the banks are in need of additional legal and technological protections. Ms. Levere, noting that a connection could be made between the current panel discussion and the next panel discussion, emphasized the importance of maintaining a personal element while implementing MFS. Reverend Flake stated that his youth population has begun to make significant tithes and offerings as they are increasingly using the phone to make payments.

Next, Mr. Eakes asked if the Federal Reserve had actually promulgated a rule which would hold the first bank who accepts a RDC responsible for any subsequent fraudulent redeposit of those checks. Mr. Eakes then proposed the establishment of a national check registry where one could verify if a check had already been deposited. Mr. Ernst suggested that he consult the FDIC's Legal Division regarding any of the Federal Reserve's specific RDC rules and provide an answer later. Also responding to Mr. Eakes' question, Ms. Osaki pointed out that there is currently no national database that tracks duplicate checks but that there are some private initiatives in this area in development. Mr. Homer stated that fraud with RDC has been less of an issue than actually anticipated. Mr. Eakes insisted that once people discover this unverified gap in the RDC system, the problem will become more widely spread.

Mr. Barr next raised the issue of whether technologies used in the non-bank sector could affect the current MFS technologies used by banks. Ms. Osaki acknowledged that many of the non-bank technologies do impact payment processing systems but that this was outside of the scope of the FDIC paper. Mr. Ernst also posed the question of whether differences in the technologies used by the non-bank sector and the banking sector are due to differences in regulation or differences in design. In response, Mr. Barr stated that both regulation and design have affected the non-bank sector technology. Mr. Barr then recommended an approach which would harness innovation and create a safe regulatory space for financial institutions. Mr. Boston pointed out that it is important to examine the technology that all consumers use, not just those used by LMI families. Mr. Boston also mentioned that the increased use of tablets is another possible area for MFS development as some people may feel more comfortable using tablets than they do using cell phones.

Next, Mr. Annibale emphasized the importance of gathering data on the timing and accuracy of information supplied to the consumers from the banks. He also mentioned that the research should be applied internationally and that some of the information contained within the paper might be relevant to the United Kingdom. Additionally, Mr. Annibale pointed out that the opening of more mobile bank accounts raises some Community Reinvestment Act ("CRA") concerns such as those related to the base locations of the mobile accounts. Mr. Annibale emphasized the relevance of a bank-sponsored parallel payments platform to the MFS discussion. Mr. Annibale attributed the increased use of payment systems to the ease of use and lighter regulation.

Concluding the panel, Chairman Gruenberg thanked the staff for laying a foundation for the MFS data. He also suggested that, for the next committee meeting, the staff develop an action plan of steps required for implementation of some of the ideas presented in the paper. Chairman Gruenberg recommended that the action plan include an examination of non-bank activity and its relation to the potential in banking sector.

Elizabeth Ortiz, Deputy Director, DCP, began the next panel by introducing herself. Ms. Ortiz recalled that, during the last meeting, the panel explored ways that the FDIC and CFPB could help young people obtain financial management skills. Ms. Ortiz reported that the CFPB and FDIC recently signed a Memorandum of Understanding establishing a multi-year strategic partnership that applies each agency's strengths to the task of improving financial management amongst American youth. Ms. Ortiz explained that some of the goals of the collaboration include enhancing the available resources as well as providing support to parents and teachers so that they can better assist young people.

Providing background information on the Financial Literacy and Education Commission ("FLEC"), Ms. Ortiz explained that it consists of twenty-two federal agencies, including the FDIC and CFPB, collaborating to promote financial literacy among American youth through FLEC's Starting Early for Financial Success Initiative. Next, Ms. Ortiz reported that the FDIC and CFPB will work together to provide teachers with resources needed to teach financial education with confidence; empower parents and caregivers with tools to discuss financial topics with children; and encourage experiential learning of financial concepts. She stated that the CFPB and FDIC would do this by working on the ground with financial institutions, schools, and community partners to engage in experiential approaches, such as youth savings programs. Pointing out that the development of new resources is only one answer to financial education challenges, Ms. Ortiz stated that another goal of the partnership is to look for new ways to link Money Smart and other resources to community partners that are similarly committed to fostering economic inclusion.

Introducing the other members of the panel, Ms. Ortiz explained that Camille Busette, Assistant Director, Office of Financial Education of the CFPB would discuss the FDIC and CFPB's plan for reaching out to teachers and parents while Luke Reynolds, Chief, Office of Outreach and Program Development Section, DCP, would discuss a program which could be used to promote experiential learning involving schools and financial institutions. She stated that Louisa Quittman, Director of the Financial Education Office of Consumer Policy at the Department of Treasury also would report on findings from the Department of Treasury's study entitled "Assessing Financial Capability Outcomes."

Ms. Busette reminded the Committee that at the last meeting she discussed the CFPB's ongoing efforts to improve the financial literacy of all Americans through partnership with other federal agencies. She recalled four areas on which the CFPB's Office of Financial Education focuses including outreach, resources, research, and innovation. Ms. Busette noted that with regard to outreach, the CFPB focuses on forming sustainable partnerships that serve all Americans. She also underscored the importance of engaging in activities that benefit the LMI community. Elaborating on these activities, she mentioned a program where various libraries across the nation serve as community centers for financial education. Next, she described the CFPB's multilingual and multiplatform campaign to promote the CFPB's new remittance rule. Ms. Busette stated that the CFPB has been working both independently and also with the FLEC and the FDIC to promote financial education in the K-through-12 space. She then described efforts underway to expand the FDIC and CFPB's Money Smart program for older Americans to those who work with the youth population. She mentioned that the Money Smart youth curriculum is a stand-alone program which can be used in extracurricular activities while the new parent program will build upon the information in the youth Money Smart program. Ms. Busette also explained that the CFPB plans to coordinate with intermediaries to hold focus groups that will promote their programs to parents and caregivers. Ms. Busette mentioned that the CFPB would solicit the teachers' feedback on materials and resources and then create an online resource center for them by the beginning of the upcoming school year.

Concluding her presentation, Ms. Busette stated that economic inclusion efforts should start with young people. She mentioned that the awareness campaign for parents and teachers as well as the partnership with the FDIC would allow for the promotion of financial literacy for a broad sector of the population.

Next, Mr. Reynolds began his presentation by reiterating research shared at the last Committee meeting indicating that school-based financial education programs appear to have long-term positive impacts when paired with experiential-based programs. He pointed out that, while the institutions do view the programs as beneficial, they also believe that they pose regulatory or cost challenges. Mr. Reynolds stated that banks may have this perception because they are not aware of other available options for school-based savings programs.

Mr. Reynolds then explained that the FDIC has developed a pilot program for financial institutions with the goal of increasing awareness and fostering development of new programs. Describing the pilot program in more detail, Mr. Reynolds stated that the FDIC, working with partners, would solicit institutions to apply for a pilot. He indicated that a small group of institutions and the operation of their school-based savings programs would be selected and monitored over a one to two year period. Mr. Reynolds emphasized that the pilot programs would be mutually beneficial in that the FDIC would learn from these programs but the institutions and their partners would benefit from their access to FDIC resources. Mr. Reynolds next advised that, using the information gained from the pilot programs, the FDIC would develop a report setting out a plan for the establishment of additional school savings programs. He stressed the importance of collaboration between schools, community-based organizations, and financial institutions in this effort.

Further detailing the technical aspects of the pilot programs, Mr. Reynolds stated that the FDIC would monitor between five to twenty programs with a specific focus on programs in markets that present unbanked and underbanked concerns as well as those where a bank's involvement may be CRA qualified. He explained that the FDIC would require banks to, first, apply in partnership with a school or other community entity and second, demonstrate its plan for managing the relationship with the school or community partner. In conclusion, Mr. Reynolds solicited input from Committee members on the pilot program plan.

Setting the stage for her remarks, Ms. Quittman stated that she would share findings from a recent study completed for the Department of Treasury and also provide suggestions on how to use this research to promote the financial capability of youth. She explained that the Department of Treasury commissioned the Assessing Financial Capability Outcome Pilot to examine the combined impact of classroom financial education and the presence of a bank or credit union at the school on the building of financial knowledge of young students. Next, Ms. Quittman described four different research issues addressed in the study including the amount of knowledge students gain by participating in financial education in the classroom; whether they gain more knowledge when they also attend a school with a bank or credit union branch in it; whether students are more likely to open a savings account or make deposits in such account if they are participating in financial education; and, finally, whether students have better attitudes towards savings if they have access to a school branch. Explaining the methodology of the study, she stated that the programs were monitored for either one or two year periods with fourth and fifth graders in Wisconsin and Texas. She pointed out that the monitoring of the site in Amarillo, Texas also provided the opportunity to examine the effect of the implementation of new state financial literacy standards in math.

She then explained that six, forty-five minute lessons on financial education were taught over a five or six week period. She further stated that teachers received training on the curriculum which included lessons on savings account usage, wants versus needs, as well as interest and income. She noted that the students mainly opened joint ownership savings accounts for children that could be set up online, at a branch, or through the school. Ms. Quittman also described the various methods used to promote the bank days including posters, announcements, newsletters, and posting on the school's website.

Next, she identified knowledge, attitude, and account activity as the categories of data examined in the study. Ms. Quittman pointed out that the researchers used a pre- and post-test survey to assess the students' knowledge and attitudes. Ms. Quittman then stated that the data gathered from the observation of the 1400 students over the two sites demonstrated that financial education had a significant effect on the knowledge category. She also mentioned that the study did not demonstrate that the presence of a branch in the school led to an increase in financial knowledge but did impact the students' attitudes about savings and banks. Noting higher program participation in schools with more economically-distressed students, Ms. Quittman attributed this to the engagement of the parents, bank staff, and the school staff at those sites. She, then, advised the Committee members that the full report had been provided to them and also was available on the Department of Treasury website.

Turning to future research possibilities, Ms. Quittman stated that areas for future research include tracking long-term impacts on students, implementing methods to teach financial education effectively, analyzing connections between financial education and academic performance, and studying the effects of the school's culture of savings on students' attitudes. Ms. Quittman also advised that the Department of Treasury's new

Financial Empowerment Innovation Fund would soon be used to test and assess concepts such as mobile banking tools and their impact on the financial well-being of low income individuals. She then expressed interest in receiving feedback from the Committee related to other types of innovations and concepts that the Department of Treasury should study through the Financial Empowerment Innovation Fund.

Next, Ms. Quittman reiterated a few policy and practical considerations including the effect of classroom-based financial education on students' knowledge and the impact of school banking access on attitudes about financial institutions. She then described a few other observations such as the need for better guidance to financial institutions on the children's savings marketplace. Ms. Quittman emphasized that school support for the program was vital to its success. She also pointed out that the recently established President's Advisory Council on the Financial Capability of Young Americans ("the Advisory Council"), which provides advice to the President and Secretary of the Department of Treasury, would address some of the private sector's concerns and thoughts on ways that the government and community-based organizations can most effectively support their work to promote the financial capability of young people.

Next, Ms. Quittman elaborated on the FLEC, which Ms. Ortiz mentioned earlier, by describing how it seeks to help students make informed decisions related to managing the cost of higher education and also provides workplace guidance on managing debt and expenses. Highlighting the FDIC and CFPB's collaborative effort in this area, she underscored the importance of working through existing federal programs and channels to improve resources available to young people and their families.

During the ensuing discussion, Committee members presented a number of questions and suggestions, with Professor Barr first raising the issue of teacher and administrator buy-in for these types of programs. Ms. Quittman responded by explaining that active participation of teachers and administrators, who value the development of life skills in their students, could be achieved by providing resources and training which make it easy for them to teach and promote these financial education lessons. Ms. Quittman also pointed out the importance and benefit of having a well-known financial institution partner at both pilot sites. Mr. Beck, expanding on Ms. Quittman's statements, stated that active engagement from both school administrators and community leaders is important. He explained that teachers and the school system are more likely to support an established program that addresses common issues rather than just pointing out problems. Mr. Beck also emphasized that collaborative programs, such as the CFPB and FDIC program, make it easier for teachers to decide which curriculum they would like to use.

Mr. Cisneros noting that, in San Francisco, a children's savings account program already exists where every child receives a college savings account after entering the public school system, acknowledged that the panel's work would be helpful in implementing San Francisco's next phase of the program requiring linkage of those accounts to in - classroom financial education. Mr. Cisneros then mentioned that programs such as the summer youth jobs programs provide opportunities outside of the classroom to reach out to youth. Ms. Levere pointed out that there is a need for regulators to develop policy which will promote children's savings skills. Noting the moral aspects related to inequality issues, Ms. Levere suggested that while children's savings accounts are one way to address these issues, parental involvement is also important towards the development of financial well-being. She lastly encouraged Committee members to attend the Children's Savings Account Conference. Referencing the success seen in San Francisco in the KIPP schools, Mr. Annibale stressed the importance of collaboration with the school systems. Mr. Annibale likewise acknowledged that schools are important intermediaries as they are already recognized by the state and can readily identify the students within its system, thus facilitating these types of programs quickly and on a larger scale.

Chairman Gruenberg then announced that the meeting would recess for lunch. Accordingly, at 12:48 p.m., the meeting stood in recess.

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The meeting reconvened at 2:07 p.m. that same day, at which time Chairman Gruenberg introduced Mark Pearce, Director, DCP, moderator for the panel discussion on "Consumer Demand for Small-Dollar Credit."

At its first meeting in 2007, Mr. Pearce recalled, the Committee discussed the pros and cons of initiating a pilot program to review small-dollar loan programs in financial institutions; in 2008 the FDIC established a two-year pilot program involving 28 institutions ranging in size from $28 million to $10 billion in assets; those institutions made 34,000 loans that were safe, affordable, and feasible, and extended approximately $40 million in credit. Moreover, the FDIC found in its National Survey of Banks' Efforts to Serve the Unbanked and Underbanked, that eight out of ten banks reported offering small-dollar loans with two-thirds indicating those loans were consistent with the 2007 Affordable Small-Dollar Loan Guidelines and template. Households need consumer credit but too often they reject the mainstream financial system and turn to alternative products, such as payday lenders, pawn shops, rent-to-own stores, and refund anticipation loans, Mr. Pearce reported. Recent research has enhanced our understanding of payday loan borrowers, he advised: they are not monolithic. Building on this research, the final panel would focus on consumer demand for small-dollar credit. Mr. Pearce then introduced Jeanne Hogarth, Vice President, Policy, Center for Financial Services Innovation ("CFSI"), Compass Principles on Small-Dollar Lending; Nick Bourke, Director, Small-Dollar Lending Research Project, Pew; Jeremy Tobacman, Assistant Professor of Business Economics and Public Policy, The Wharton School at the University of Pennsylvania.

Ms. Hogarth opened her comments by outlining some of the scenarios that push consumers into the small-dollar credit market. Thirty-two percent faced unanticipated emergencies (such as burst-pipe repairs); thirty-two percent needed help with income-smoothing, that is, cash income and cash outgo balance over time but at any given point may be misaligned due to income volatility; nine percent had planned purchases but did not have all of the money immediately needed to make the purchase; and thirty percent never had their income and expenses in alignment – their income was consistently less than expenses. She explained that the data derived from two CFSI datasets: a quantitative survey consisting of about 1,100 people of whom 900 used small-dollar credit, and a series of qualitative interviews. In addition, CFSI issued a number of profiles and briefs on the U.S. Financial Diaries website where readers can dig deeper into the lives of the households interviewed by CFSI. Overall, CFSI research shows there is a $21 billion demand for very short-term credit, a $49 billion demand for other kinds of short-term credit (such as buy here/pay here auto loans and subprime auto loans), as well as a demand for subprime credit cards, rent-to-own, title and pawn loans, and short-term installment loans. Thus, Ms. Hogarth suggested, the small-dollar credit market is in the $70 billion range.

Ms. Hogarth then turned to the "Compass Principles": embrace inclusion, build trust, promote success, and create opportunity. Using these principles as the starting point, CFSI recently issued a "Compass Guide to Small-Dollar Credit" setting forth the following guidelines: (1) high confidence in the borrower's ability to repay; (2) structured to support repayment; (3) priced to align profitability for the provider with success for the consumer; (4) create opportunities for upward mobility and greater financial health; (5) transparent marketing, communications, and disclosures; (6) accessible and convenient; and (7) with rights and support for borrowers. CFSI is about to launch a project to design, test, and evaluate products for the small-dollar credit market based on these guidelines, she advised. At Professor Swagel's request, Ms. Hogarth clarified that the principle "create opportunity" contemplates opportunities for upward mobility. For example, she said, consumers should receive credit for paying off small-dollar credit loans on their credit reports and, in turn, small-dollar lenders may need access to the credit-reporting system.

Mr. Bourke opened his presentation by stating that Pew is one of the country's largest independent, nonprofit organizations; when Pew began its Small-Dollar Lending Research Project, its goal was to review small dollar lending, especially payday lending, in order to gather the information needed to develop better policies in this area; his work has therefore focused on issues involving family economic security and he has been leading the small-dollar loans project for the past three-and-a-half years; Pew has published three reports in their Payday Lending in America Series to date; and the reports are available at pewtrusts.org/small-loans. He then posed the following questions for discussion: "Why do people use payday loans? What are the outcomes?"

By way of background he explained that payday loans are small loans (usually a few hundred dollars) packaged as short-term loans for temporary needs; they are available from storefronts and online; there is little to no underwriting involved; lenders who operate in the payday loans business are given special exemptions to various laws with the result that they are not required to do "ability-to-repay" underwriting but they still have the ability to collateralize the borrower's checking account. Consequently, the payday lender has the right, through a postdated check or through an electronic authorization, to take payment on the loan immediately when the borrower is paid. The payment period is short and tied to the borrower's payment cycle, usually every two weeks, with an average loan size of $375.00 for a $55.00 fee at a payday loan store. As a result, if you take out a $375.00 loan today, $420.00 will be due in two weeks. Researchers have assembled rich demographic data drawn from in-depth interviews with pay-day borrowers, he noted. This data shows people from all walks of life use payday loans. What binds them together is that they routinely have trouble paying bills. Overall, there are about 12 million payday loan borrowers per year; they spend approximately $7.5 billion on finance charges for these loans; they have income, on average, of $30,000.00 a year. Payday borrowers are not striving to get into the mainstream credit market. Rather, they are falling out of it. Moreover, payday borrowers have a checking account; they are bank customers. The fact that they have checking accounts is the linchpin to making this business model work, reported Mr. Bourke. Payday lenders need access to a borrower's checking account so they can get paid first. Mr. Bourke then summarized data regarding the borrower's ability to repay, noting that consumers who are persistently having trouble paying their bills have debt other than the payday loan and, when the full amount is due two weeks later, plus a sizable finance charge, and using the previous example of $420.00 due, the amount owed equals thirty-six percent of the average borrower's pre-tax paycheck. Imagine having a third of your paycheck taken away from you on your next payday, Mr. Bourke said, and you can see that payday loans harm a borrower's ability to repay. Pew found most borrowers cannot afford to relinquish more than five percent of their paycheck; this is an important benchmark, Mr. Bourke cautioned. Mr. Bourke then illustrated the "decision-making mismatch" using the example of a consumer who believes he/she can afford the bi-weekly $55.00 fixed-fee but not the $430.00 lump-sum payment and so decides to renew the loan. When loans exceed borrower capacity in this way, Pew research shows the average borrower is in debt for five months during the year and pays $520.00 in fees during the year. Many who take out payday loans are responding to the fixed-fee nature of the loan, Mr. Bourke observed; borrowers feel they have more control with fixed-fees. He then directed the Committee's attention to measures of "need" and warned that measures such as volume and renewal are not good measures of need. In fact, nearly all payday loans go to repeat borrowers; consecutive usage is the norm. Once a consumer gets a payday loan, they are typically in debt sequentially for a long period so if you look at the number of loans and volume of credit, you will find that eighty percent is driven by churn and that the true, underlying need is closer to twenty percent of the volume; simply counting the number of loans overinflates the measure of need.

Mr. Bourke summarized the "lessons learned" from the Pew data as follows: borrowers have other options; when consumers get a payday loan, they are not shopping for credit or trying to reach a goal; consumers are responding to an urgent situation where they are having trouble paying their bills; the decision to use payday loans is driven by unrealistic expectations in the sense that the payday loan looks like a fixed-fee product that the consumer can get out of quickly; the decision is also driven by desperation, with thirty-seven percent of borrowers saying they were in such poor financial circumstances that they would take any loan on any terms. Next, Mr. Bourke touched upon the issue of overdrafts, noting that payday loans do not eliminate the risk of overdraft. In fact, fifty-two percent of payday borrowers had overdrafts in the past year. He noted that payday borrowers themselves had a number of suggestions to improve payday loans, including reducing the amount of each payment due, additional time to pay, and permitting installment payments. He closed his presentation by saying the research is inconclusive as to whether high-cost credit is ultimately helpful or harmful but, if it is to be helpful, it must give consumers a chance to payoff the loans and get back on their feet.

Next, Professor Tobacman discussed the "Behavioral Welfare Economics of Consumer Credit." On April 2, 2014, Professor Tobacman published a paper entitled "Payday Loan Choices and Consequences," with Neil Bhutta and Paige Marta Skiba. During his presentation before the Committee, Professor Tobacman referred to the datasets considered and methodologies used for purposes of that paper, and summarized the insights reported in the paper.

Professor Tobacman first outlined a framework for discussing the meaning of "demand" in the consumer credit realm. When we think about consumer credit transactions, he suggested, we typically think about the initial borrowing decision (immediate benefits) and then the delayed costs (repayment, interest, fees, cost of possible default). Recent studies present useful data to help guide our analysis of initial benefits and delayed costs and complement prior research, he advised. The data indicates, for example, that prior to defaulting, many consumers service their payday loans; consumers are choosing to pay a great deal of interest prior to defaulting. Many of the costs associated with defaulting on a payday loan arrive when the check bounces; that is, when the bank and lender impose bounced check fees, the psychological costs of being pressured to repay kick-in. Thus, data focusing on the distribution of pre-insufficient-fund fees shows that over half of the borrowers in the example have a bounced check on a payday loan within a year of their first loan; and forty-one percent incurred pre-bounced-check finance charges that were greater than the initial loan amount. Data regarding defaults (over and above bounced checks) show that over forty-six percent incurred pre-default finance charges that were greater than the initial loan amount. Professor Tobacman noted that these loans illustrate the observation made by psychologist Daniel Kahneman that, "Decision utility is about wanting; experienced utility is about enjoyment," and this, he explained, is a key distinction in thinking about "demand" and how it relates to policy choices. The experienced utility of borrowing would be the benefit minus the cost when there is a true cost of repayment but, he cautioned, the crucial distinction that Kahneman and others have drawn is that the decision utility (the utility that is relevant for choice) involves a distortion of these costs. In other words, consumers might be overly optimistic or excessively pessimistic about the probability of repayments; consumers might be aware or unaware of subsequent fees or the type of collection efforts that will be pursued. To the extent that these things are not fully appreciated, the consumer's decisions will not fully reflect the consumer's well-being.

Expanding upon this theme, Professor Tobacman explained that we ordinarily think that markets react to decision utility; decision utility governs voluntary choice; consumers will choose to borrow if the benefits are greater than the perceived costs; and when a consumer walks away from a payday lender with funds in-hand, the consumer believes he/she understands the arrangement. In fact, however, the costs are delayed and the consumer may not fully understand the costs. Some observers therefore contend that governments should craft policy based on experienced utility because it actually measures consumer welfare; it measures the consequences that arise from payday loans. The fact that consumers are paying large amounts of interest and then defaulting suggests that consumers underestimate borrowing costs, that experienced costs are high, and that payday loans might exploit overly optimistic consumers. The central implication, suggested Professor Tobacman, is that observed demand is not always a good guide to consumer welfare; additional data on forecasts, intentions, and aggregate outcomes could help clarify our understanding of consumer behavior.

Professor Tobacman concluded his formal remarks by discussing the vulnerabilities of these consumers, as further detailed in his paper, "Payday Loan Choices and Consequences." Payday applicants appeared to be having major financial difficulties; their average credit scores remained extremely low for an extended period and this was true whether or not they got the loan; they were rarely able to accumulate savings and were persistently short of cash; very few could borrow on credit cards; and in fact, only fifty-nine percent of payday loan applicants have a general-purpose credit card but, even so, little credit ($100.00) remains available on the card for most applicants. Overall, Professor Tobacman advised, payday loan applicants have limited access to mainstream credit, and the needs of this population seem to go substantially beyond the products offered by payday lenders.

Mr. Swagel opened the discussion by asking if there were competing datasets and asking how a reader should balance divergent perspectives of paternalism versus useful borrowing. He suggested that borrowers in the study presumably knew of alternatives but still chose payday lenders. Ms. Hogarth responded that many small-dollar credit products are available but payday loans receive all the media attention. Adding to the puzzle, she said, is the fact that many consumers using payday loans have savings accounts but, instead of tapping into their savings, they get a payday loan. Mr. Tobacman observed that we do not know the universe of alternatives and innovations that might rise if payday loans are restricted. Mr. Pearce added that consumers borrow for different reasons and thus the question might be, how should financial institutions cater to these different needs? Mr. Bourke countered that he did not see a reason why the products would differ in that the fundamentals would be the same whether a consumer had a car breakdown or had trouble paying ongoing bills; he suggested that consumers seeking small-dollar loans are dealing with a finite need and do not have the immediate capacity to fill that need. Thus, Mr. Bourke concluded, the solution must tie to the consumer's capacity to pay off over time. He reminded the participants that the payday-revenue stream is derived from consumers who obtain extended renewals and so they drive the business model.

Mr. Barr asked whether the discussion was framed too narrowly; and whether, the conversation should extend beyond payday loans and small-dollar loans and, instead, encompass household financial well-being and a "household stability plan." Ms. LeVere agreed, indicating that the focus may need to be on building short-term and long-term savings. Mr. Annibale agreed that it was essential to engage consumers earlier in the process because, once they fell into payday loans, it is difficult to know how the loans can be refinanced since there is almost no debt reduction. Ms. McCoy concurred, noting that the intractable proof is the fact that expenses exceed their income on a regular basis. She then asked Mr. Bourke if his datasets distinguish between those who are so desperately poor that they cannot pay for simple necessities versus those who have discretionary income but are not using it wisely. Mr. Bourke responded that a segment of consumers are bouncing off of some kind of a bottom where desperation is driving their decision-making. Even though usage of payday loans skews toward lower-income level consumers, these consumers by-and-large have jobs and checking accounts; they are essentially mainstream working poor people. So, while they have resources, they are over-indebted, Mr. Bourke observed and, ironically, they pay an amount of money down towards a loan, carry it for a while, and at the end of five or six months when they still owe the entire lump-sum, they realize they can no longer pay and massive default rates kick-in. Ms. Hogarth observed that CFSI's research suggested consumers use an array of products and, she said, in those states where payday loans were restricted, more consumers turned to pawn shops.

Mr. Eakes observed that a consumer's ability to repay should be a key measure when evaluating any product. He advised the Committee that his organization, the Center for Responsible Lending, has worked in approximately three dozen states to curtail payday lending because the Center believes the business model is broken; when North Carolina prohibited payday lending, the Center saw a jump of almost $60 million in outstanding loans by finance companies the next year but, on the positive side, finance-company loans were loans that were regulated and had less than a thirty percent interest rate; and the migration from payday loans to finance companies was beneficial for consumers who could afford to repay the loan, he said. Mr. Eakes also pointed out that payday lenders prefer to focus discussions on "the average borrower" but, in Mr. Eakes' view, it is essential to focus on "the average transaction" so as not to skew the data. When the data is scrubbed, he suggested, you will see as Mr. Bourke explained, that the payday lending model is premised on grabbing a large number of repeat fees during the year. The actual cost of a payday loan ends up being greater than the anticipated benefits in almost every case, indicting that this model presents serious dangers to consumers.

Chairman Gruenberg then observed that the presentations and Committee member comments and suggestions had been very helpful. He suggested that at future Committee meetings staff would follow up on the mobile banking discussion. In addition, staff would continue to provide progress reports to the Committee regarding development of model transaction accounts. Chairman Gruenberg assured the Committee members that staff would continue their efforts to promote financial education and keep the Committee apprised of their efforts. Finally, he advised that the development of small-dollar products would continue to be an issue on future agendas. He again thanked the Committee members for devoting their time to working on these important financial issues.

There being no further business, the meeting was adjourned at 3:23 p.m.

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
And Committee Management Officer
FDIC Advisory Committee on Economic
Inclusion

April 24, 2014

Minutes

of

The Meeting of the FDIC Advisory Committee on Economic Inclusion

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

April 24, 2014 - 9:04 A.M.

I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.

Martin J. Gruenberg
Chairman
Board of Directors
Federal Deposit Insurance Corporation