

FROM MARGINAL TO MAINSTREAM

*the case for immediate implementation
of a direct-deposit option for
welfare recipients in L.A. County*

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Strategic Actions for a Just Economy
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Banking & Low-Income People in Los Angeles

Between 1987 and 1990, 416 bank branches were shut down in Los Angeles -- primarily in inner-city neighborhoods.

By 1992, South Central Los Angeles had 19 bank branches and 133 check cashing businesses.

For the past decade, banking rights advocates in L.A. have worked to retain and increase the number of inner city bank branches and to develop new banking services for low-income people.

In 1989, a coalition of neighborhood, consumer, and development organizations came together in a coalition called Communities for Accountable Reinvestment (CAR) with a shared mission of combating the historic practice of redlining by banks and promoting community banking opportunities.

Financial services in the inner city were already restructuring. According to a study commissioned in 1991 by the City of Los Angeles, banks closed 416 branches during the three previous years. Check cashers began to fill the inner-city financial market, and by 1992, South Central Los Angeles had 19 bank branches and 133 check cashers. (see Figures 1 & 2)

For these reasons, CAR members, who now work under the umbrella of Strategic Actions for a Just Economy (SAJE), focus their current efforts on retaining and increasing the number of inner-city bank branches, as well as developing services that help bring consumers of “fringe banking” services into the mainstream.

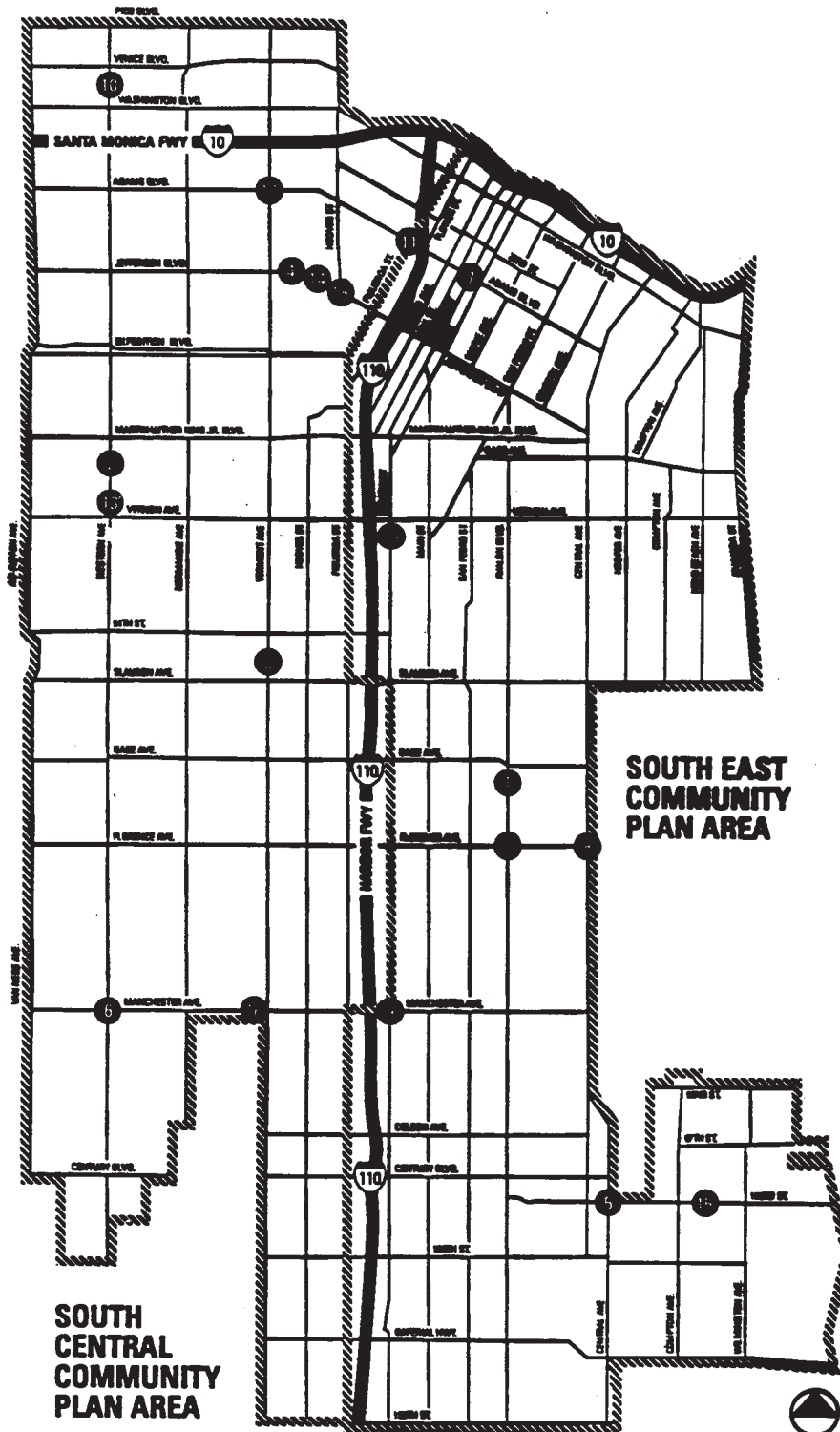
While the check cashers provide basic services, they are not an adequate replacement for banks. Check cashers do not provide a safe place for people to keep their money. They do not provide an opportunity to earn interest, but rather charge for every service. Also, they cannot provide the basic banking relationship which is a pre-requisite for access to mainstream credit. As a result, the poor end up paying more for financial services and credit.

Since SAJE began these efforts, there have been enormous advances in electronic banking. A federal mandate now exists that requires the electronic transmittal of public benefits by all local jurisdictions by the year 2002.¹ However, the question of how this will occur has not yet been resolved in Los Angeles.

¹ Although food stamp and federal cash benefits must be distributed electronically, counties have discretion over whether or not to distribute TANF cash benefits in this manner. The overwhelming majority of counties across the country have chosen to do so. The state is requesting that all California counties make a preliminary decision regarding their participation in cash EBT by February 1, 2000.

FIGURE 1

Banks and Savings & Loan Associations
in the Los Angeles Community Reinvestment Committee's South Central Demonstration Project Area



Banks

- Bank of America**
- 1. Industrial Branch
6400 South Avalon Blvd. 291.0530
 - 2. Martin Luther King Jr. Branch
4103 South Western Ave. 291.0863
 - 3. Slauson-Vermont Branch
5700 South Vermont 291.0530
 - 4. University Village Branch
985 West Jefferson 291.0530
 - 5. Wetts Branch
10340 South Central Ave. 291.0863
 - 6. Western & 87th St. Branch
8701 S. Western Ave. 291.0863

- First Interstate Bank of California**
- 7. Adams & Broadway Branch
141 West Adams 614.3708
 - 8. Florence & Central Branch
1144 East Florence Ave. 588.8941

- Security Pacific National Bank**
- 9. Broadway & Manchester Branch
8564 South Broadway 753.1721
 - 10. 18th & Western Branch
1819 South Western Ave. 734.9324
 - 11. Figueroa & Adams Branch
2703 S. Figueroa 746.1388
 - 12. Florence & Avalon Branch
501 E. Florence Ave. 753.3501
 - 13. 43rd & Western Branch
4277 South Western Ave. 294.6171
 - 14. University Village
821 West Jefferson Blvd. 746.4188

Savings & Loan Associations

- California Federal Savings & Loan Assoc.**
- 15. South Central Los Angeles Branch
1601 East 103rd St. 564.5801
- Great Western Bank**
- 16. 1027 Manchester Ave. 852.3882
- Home Loan Counseling Center**
- 17. 1115 West Adams Blvd. 747.08
- Western Federal Savings & Loan Assoc.**
- 18. USC Branch
3301 South Hoover 746.57
- Broadway Federal Savings & L**
- 19. 4501 South Broadway 232.4271

The Evolution of the SAJE Welfare-to-Work Banking Pilot

In June of 1997, Los Angeles County initiated a new practice of distributing welfare checks through check cashers. The intention of this new distribution mechanism was to provide an alternative for postal workers who suffered frequent attacks on “check day.” The result, however, was a problematic precedent for both the immediate and future financial lives of welfare-to-work participants.

Under this new system, checks are distributed over the first ten days of the month, and are available to recipients at approximately 120 check cashing businesses around the County on or after the day of the month that corresponds to the last digit of their county-assigned case number. Thus, it is only chance that determines whether recipients receive their income on the first of the month or the tenth. Because rent and other bills are generally due on the first of the month, this new system places unequal burdens on recipients to contend with late fees, eviction notices and other problems. This remains a primary issue of concern for welfare recipients throughout the County.

In addition, and of great concern to local banking advocates, the new system reinforces the inequities in access to mainstream financial services that are illustrated in the maps in Figures 1 and 2. Further, our experience over the years in working with banks to develop products that serve the needs of low-income people led us to the conclusion that a direct deposit alternative for County welfare recipients would solve two problems and create a new opportunity:

- , Direct Deposit eliminates the need for a stagger period
- , Direct Deposit will ultimately save the County money on the cost of distributing checks
- , Direct Deposit opens up a new world of banking options for welfare recipients -- free or low-cost bank accounts in mainstream financial institutions.

On June 15, 1999 the County Board of Supervisors approved a motion to support the SAJE Transitional Banking Pilot Program for 1000 recipients. The program involves the collaboration of SAJE, Washington Mutual Bank, and the County’s Department of Public and Social Services. Currently operating in two Washington Mutual Bank branches (East Los Angeles and South Central Los Angeles), the pilot involves manual direct deposit, provides financial education to welfare-to-work participants, and enrolls them in an entry-level free

In L.A. County, welfare recipients have to pick up their benefit checks at check cashers over a 10 day stagger period.

Direct deposit eliminates the need for a stagger period, saves the County money, and provides new banking opportunities to welfare recipients.

savings account which provides five free money orders each month. Participants with pre-existing banking experience have the option of opening a free checking account. All participants receive their income on the first of the month.

Also included in the County motion were instructions to County staff to “formulate a comprehensive plan for the implementation of both EBT² and automated direct deposit” to be presented to the Board of Supervisors within 120 days.

Bank accounts contribute to long-term economic stability and are an integral part of the goals of welfare-to-work programs.

It is the purpose of this brief report to supplement the County staff report with a broader base of experience from programs and scholars around the country. This report demonstrates that direct deposit of public benefits is the best option for welfare-to-work participants who are moving into the economic mainstream, for county governments that administer welfare-to-work programs, and for banks that wish to meet their obligation under the Community Reinvestment Act to serve low-income consumers.

An appendix is provided at the end of this report which includes documents from academic experts, financial institutions, and a direct deposit survey of welfare recipients in San Diego. Based on this information and the experience of both SAJE and people working on these issues in other parts of the country, we have come to the following conclusions and recommendations:

²EBT refers to Electronic Benefit Transfer, which is the electronic distribution of state benefits (as opposed to federal benefits). EBT is mandatory for food stamps and counties may choose whether or not to use EBT for cash benefits. EBT is frequently administered in the form of debit cards which draw down cash or food stamp credit from mass accounts which serve as the repository for benefits for all public benefit recipients in a particular jurisdiction. EBT does not establish individual bank accounts, credit histories, or banking experience.

Conclusions and Recommendations

CONCLUSIONS

1. It is clear from the evidence in this report that direct deposit will ultimately save both welfare recipients and the County money. In addition, direct deposit influences the banking market to produce new financial service opportunities for low-income people.
2. Based on a consumer satisfaction survey from participating welfare recipients in San Diego where direct deposit has been an option since 1996, it appears that welfare recipients want bank accounts and that those who are involved in direct-deposit programs are highly satisfied.
3. Bank accounts lead to other benefits for welfare recipients – savings, access to credit and other mainstream financial services – which contribute to long-term economic stability and are an integral part of the goals of welfare-to-work programs.

RECOMMENDATIONS

1. Every month, welfare recipients who use check cashers spend money on financial services that could better be spent on the needs of their families – the purpose for which welfare is intended. Direct deposit is an avenue to free or low-cost bank accounts at most financial institutions in L.A. For these reasons, L.A. County should institute a direct-deposit option within three months.
2. At the present time, welfare recipients receive their checks over a ten-day stagger period, based on the last digit of their County case number. Not only does this system create unnecessary hardships and costs for some recipients, but it is inherently inequitable. The later in the month recipients receive their checks, the more likely they are to experience problems with their landlords, incur late fees on bills, and fall behind in making payments. For these reasons, L.A. County should eliminate the current stagger period for distribution of welfare checks immediately.
3. This report demonstrates that financial services are an integral and critical aspect of economic independence. The skills necessary to manage a bank account apply to many other economic endeavors of an individual's life. For these reasons, L.A. County should incorporate opportunities for welfare recipients to enroll in bank accounts as an integral part of its welfare-to-work program.

L.A. County should:

- *institute direct-deposit*
- *eliminate the stagger period*
- *include bank accounts in welfare-to-work programs*

How Direct Deposit Saves Counties Money

At the present time, Los Angeles County is not set up to take advantage of the cost savings that direct deposit can yield. The largest body of evidence regarding how direct deposit saves counties money can be found in Missouri, where an aggressive state-wide initiative to move all counties to a direct-deposit model was spearheaded by the State Department of Social Services. This initiative was intended both to save the government money, as well as to integrate banking services into a comprehensive welfare-to-work program.

Cost of Distributing Benefits in Missouri	
check	58 cents
EBT	58 cents
direct-deposit	10 cents

THE MISSOURI EXAMPLE

The Missouri Department of Social Services spent two years marketing direct deposit to bankers. To reduce banks' costs, the department developed an automated system that banks could use to enroll welfare recipients in direct deposit. The system is accessible with a toll-free phone call, and banks use the telephone keypad to enter enrollment data. By April 1999, 284 banks providing more than 600 access points in all of Missouri's 115 counties -- an estimated 64 percent of all banks in the state -- were offering no- or low-cost bank accounts. In effect, Missouri's program opened up a whole new world of banking services to poor people in the state.

In Missouri, it costs counties 58 cents per client per month to generate and mail a paper check. It costs an equivalent amount to put a client on Electronic Benefit Transfer (EBT). It costs the counties only 10 cents per client per check to have benefits direct deposited into the clients' personal bank account.³ If all 50,000 recipients were to open bank accounts and use direct deposit instead of EBT, Missouri would save approximately \$375,000 per year.

³Telephone interview with Melba Price, Director of Missouri State Department of Social Services.

Direct Deposit and Counties (cont'd)

The state of Missouri (population 5.1 million) has been able to achieve remarkable results over a relatively short period of time, while having to deal with multiple jurisdictions in 115 counties. It should be easier, less expensive and more efficient for the single jurisdiction of L.A. County (population 9.4 million) to produce similar benefits.

MASSACHUSETTS

The Massachusetts community banking council – a consortium of 175 banks – offers a low-cost direct deposit checking account for welfare recipients. Fees on these accounts are limited to \$3/month, account holders are permitted 8 free withdrawals a month and no minimum balance is required. As a result, in 1998 approximately 31% of benefit recipients took advantage of direct deposit.

CONNECTICUT

In Connecticut, about 75% of the major banks offer direct-deposit accounts. Although the accounts are not widely marketed, in 1998 about 10,000 of the state's welfare recipients received their benefits into these accounts via direct deposit. In Connecticut, EBT costs \$1.30 per recipient per month, whereas direct deposit costs five cents per recipient per month.

SAN DIEGO

The County of San Diego implemented direct deposit as an option in 1996 completely independent of electronic benefit transfer requirements, primarily because direct deposit is less expensive than warrants or the projected costs of EBT. Since then, San Diego realizes monthly cost savings of thirty cents per participant.

At the present time, 22% of San Diego Calworks recipients are on direct deposit, and according to a November 1997 survey of San Diego welfare recipients the program enjoys a 98% satisfaction rate. The survey also showed a relatively high interest in bank accounts among welfare recipients. When asked, "If you do not have a bank account, would you be interested in opening a bank account in order to have direct deposit," 63.5% of welfare recipient respondents answered, "Yes." (*Survey attached*)

In California, the statute that governs use of EBT for cash benefits requires that recipients have access to their benefits through four free withdrawals each month. Since Missouri does not offer this free access to recipients under their EBT program, the cost of EBT in California is likely to be higher than the 58 cents Missouri pays to Citibank for each client on EBT. The savings offered by direct deposit to Los Angeles County would therefore be that much greater.

Successful direct deposit programs require strong public sector leadership; a committed social services bureaucracy; and a cooperative financial services sector.

LESSONS FROM THE PROGRAMS

According to Michael Stegman, former policy advisor to the Clinton Administration and author of *Savings for the Poor: The Hidden Benefits of Electronic Banking*, three key factors are required to implement a successful direct-deposit program: strong public sector leadership, a committed social services bureaucracy and a cooperative financial services sector.

The current SAJE pilot with Los Angeles County demonstrates that this kind of leadership, support and cooperation is possible in Los Angeles. It is now time to invest our local experience as well as the experiences described above to take this program to scale, through a countywide direct-deposit program.

Economic Benefits of Direct Deposit for Recipients

Almost every bank in California offers a free or low-cost account of some kind to people whose income is direct deposited. The absence of direct-deposit opportunities for L.A. welfare recipients has made this financial opportunity unattainable. Having a bank account is part of the road to mainstream economic independence. All other mainstream financial opportunities, including credit cards and conventional loans for cars, homes, education or business, require a banking history as a basic prerequisite. Access to credit is possible without a bank account – however at an exponentially higher cost. For example, Central Financial⁴, a lender in Spanish-speaking communities in Los Angeles, is very accessible to low-income people and charges approximately 32% interest.

When Los Angeles welfare recipients pick up their benefit checks at a check cashing business they typically pay between \$15 and \$25 for the cost of cashing their check and purchasing the money orders they need to pay their basic monthly bills. There are clearly better uses for this money. If the same recipient takes her check to her bank, but does not receive direct deposit, monthly service fees are likely to be between \$5 and \$8 a month.

With direct deposit, most banks will waive all service fees. Because they receive regular, monthly deposits from the customer's source of income, banks are more likely to provide a broader range of services on these accounts, reduce onerous identification requirements, and require lower opening and minimum balances. In these ways, direct deposit makes bank accounts more accessible to poor people.

There are some basic safety costs that accompany the "cash and carry" lifestyle that is encouraged when people are required to pick up their checks at a check casher. Welfare recipients -- primarily women with their children -- who leave the check cashers with their month's income in hand are frequently prey to robberies. It is ironic that the distribution system that was designed to protect postal workers simply transferred the hazards to an even more vulnerable population.

"I've been trying to get a bank account since 1993 – the banks either wanted too much money to start the account or to keep it open. I'm so excited about having direct deposit."

Gretta Smith

"Once you mess up, no one wants to give you a chance. With direct deposit, now I have a chance."

Monique Tyler

Direct deposit bank accounts "substantially reduce the fees that many benefit recipients pay to obtain basic payments services."

*John Caskey
author of Fringe Banking:
Check-Cashing Outlets,
Pawn-Shops, and the Poor.*

⁴ According to a 1997 *L.A. Times* report, Wells Fargo owns 17% of Central Financial.

To date, 67 Los Angeles Welfare-to-Work participants have enrolled in the SAJE Transitional Banking Pilot Program and will have bank accounts opened by the end of October. The pilot began its first outreach July 1, 1999 and transitional accounts are currently offered at two Washington Mutual bank branches. Even in these small beginnings, substantial benefits can be observed.

By having the opportunity to build a new banking history through a savings account before she obtained a job, as a worker, Ms. Daniels now has a checking account and a credit card and is now well on her way to attaining financial stability.

Rochelle Daniels joined the SAJE pilot in July and received her first direct deposit on August 1. Shortly thereafter, she secured a job and took advantage of the opportunity for her paycheck to be direct deposited. Having been in ChexSystems,⁵ which precludes people from opening new accounts, Ms. Daniels would not have had an opportunity to have a bank account outside of the SAJE program. By having the opportunity to build a new banking history through a savings account before she obtained a job, as a worker, Ms. Daniels now has access to a full range of financial services. She now has a checking account and a credit card and is now well on her way to attaining financial stability.

Pamela Henderson previously paid \$8.00 per month to maintain a checking account at Bank of America. She also received her County check on the tenth of the month, which seriously strained her relationship with her landlord. She jumped at the opportunity to solve both problems – a relatively high-priced account and an angry landlord — by being one of the first participants in the SAJE pilot. She now has a free checking account at Washington Mutual and a much more amicable relationship with her landlord.

In the case of L.A. County, direct deposit allows everyone to receive their checks on the same day, eliminating the inequitable hardships faced by people who receive their checks later in the month. It provides people on welfare who choose to take advantage of direct deposit with a myriad of new banking opportunities and a foundation of experience that they can take into their future as employed individuals.

⁵ ChexSystems is a data service that provides its client network of approximately 78,000 banks and credit unions with information about “closed-for-cause” bank accounts. The system paints everyone in it with the same brush -- ranging from fraudulent check-kitters to law-abiding people who wrote a bad check or two by mistake or low-income people whose accounts were consumed by increasing bank fees. People whose names appear in ChexSystems almost always cannot open a bank account. The SAJE pilot provides a new chance for participants to prove themselves as bank-worthy with a fee-less savings account that also protects the bank from risks.

How Direct Deposit Affects Banks

The National Automated Clearing House Association (NACHA) is a bank trade association with the largest number of financial institutions in the country. NACHA was organized in 1974 by a group of bankers who envisioned electronic payments as an alternative to the large number of checks written each year. In 1998, more than 5.3 billion ACH transactions were made and the total dollars transferred exceeded \$16 trillion.

According to NACHA, financial institutions advocate direct deposit for several reasons. “For every Direct Deposit, a customer does not need to walk into a branch. This results in a cost-savings of over \$1 for the institutions. “

SAJE is less concerned with saving money for banks than the impact that these savings have on generating new opportunities for low-income consumers to join the financial mainstream. We are particularly interested in the the powerful impact a County-wide direct deposit policy will have on generating new consumer power for welfare-to-work participants in the banking arena.

NACHA concurs with our assessment. According to Michael Herd, Director of Public Relations for NACHA:

Opening an account with Direct Deposit is often the first step in establishing good financial, credit and payment histories, as well as personal savings. Direct Deposit encourages savings because funds can automatically be added to a savings account before being earmarked for expenses. An account with Direct Deposit is an opportunity for many people to move into this country’s financial mainstream, which is a win-win situation for both the individual and the financial institution.

Many financial institutions have lower minimum balance requirements and account fees for customers that have a regular source of income through Direct Deposit, such as payroll, Social Security, or welfare benefits. Many institutions eliminate these requirements and fees altogether.

SAJE has found these national trends to be true in Los Angeles. Both Washington Mutual bank and Union Bank have free bank accounts particularly designed to meet the needs of people on public assistance. These accounts, as well as similar ones offered by other institutions, however, require direct deposit.

“Opening an account with Direct Deposit is often the first step in establishing good financial, credit and payment histories, as well as personal savings.”

*Michael Herd
Director, Public Relations,
National Automated
Clearing House Association
(NACHA)*

Long-Term Advantages of Bank Accounts

The use of direct deposit to move recipients into bank accounts in Missouri has provided additional opportunities for counties to assist recipients in their transition to self sufficiency.

For example, Missouri has set up a collaboration with the Internal Revenue Service to encourage the use of the Earned Income Tax Credit. These lump sum payments can be used as a first “nest egg” savings account for Missouri recipients whose savings may be matched through a special asset-building program called an Individual Development Account, or IDA. IDAs are grounded in the premise that the development of some wealth or assets is an essential aspect of ensuring financial stability for low-income people. This is particularly important for people moving from welfare systems which limit how much people can save or own while receiving benefits.

Mainstream vs. Marginal	
bank	check casher
checks	money orders
credit card	rent-to-own
conventional loans	high-interest lenders

These ideas are shared by the planning division of L.A. County’s Department of Public Social Services, which is currently investigating the potential of an IDA program for L.A. recipients. It is essential to understand the prerequisites of such a program -- asset building accounts require a basic bank account. Missouri’s IDA program is built upon the success of their direct deposit initiative which both helped poor people open accounts and helped banks develop a new customer base from a previously untapped market.

Appendix

1. Letter from Michael Stegmann, former Clinton policy advisor, Professor, University of North Carolina at Chapel Hill, author of *Savings for the Poor: The Hidden Benefits of Electronic Banking*.
2. Letter from John Caskey, Professor, Swarthmore College, author of *Fringe Banking: Check-Cashing Outlets, Pawnshops and the Poor*.
3. Letters from Washington Mutual Bank and Union Bank regarding their commitments to low- and no-cost bank accounts for welfare recipients who participate in direct-deposit programs.
4. Letter from the National Automated Clearinghouse Association.
5. San Diego 1997 Direct Deposit Client Satisfaction Survey Summary
6. Features of SAJE Transitional Banking Pilot Program