



MAYA BUENAVENTURA, VEGARD NYGAARD, KELSEY O'HOLLAREN, KATHERINE BURNHAM,
JIM MIGNANO, SHANNON PRIER, NATALIE COX, ANUJIN NERGUI, JAMES SYME, NICOLAS M.
ROBLES, ELIZABETH MARSOLAIS, JONATHAN W. WELBURN

Banking the Unbanked

CalAccount Market Study and Feasibility Assessment—
Annex I: The State of Banking in California

For more information on this publication, visit www.rand.org/t/RRA3117-1.

About RAND

RAND is a research organization that develops solutions to public policy challenges to help make communities throughout the world safer and more secure, healthier and more prosperous. RAND is nonprofit, nonpartisan, and committed to the public interest. To learn more about RAND, visit www.rand.org.

Research Integrity

Our mission to help improve policy and decisionmaking through research and analysis is enabled through our core values of quality and objectivity and our unwavering commitment to the highest level of integrity and ethical behavior. To help ensure our research and analysis are rigorous, objective, and nonpartisan, we subject our research publications to a robust and exacting quality-assurance process; avoid both the appearance and reality of financial and other conflicts of interest through staff training, project screening, and a policy of mandatory disclosure; and pursue transparency in our research engagements through our commitment to the open publication of our research findings and recommendations, disclosure of the source of funding of published research, and policies to ensure intellectual independence. For more information, visit www.rand.org/about/research-integrity.

RAND's publications do not necessarily reflect the opinions of its research clients and sponsors.

Published by the RAND Corporation, Santa Monica, Calif.

© 2024 RAND Corporation

RAND® is a registered trademark.

Limited Print and Electronic Distribution Rights

This publication and trademark(s) contained herein are protected by law. This representation of RAND intellectual property is provided for noncommercial use only. Unauthorized posting of this publication online is prohibited; linking directly to its webpage on rand.org is encouraged. Permission is required from RAND to reproduce, or reuse in another form, any of its research products for commercial purposes. For information on reprint and reuse permissions, please visit www.rand.org/pubs/permissions.

About This Annex

This annex presents Appendixes A and B to the RAND report *Banking the Unbanked: CalAccount Market Study and Feasibility Assessment*, available at www.rand.org/t/RRA3117-1. Appendix A presents an analysis of the banking landscape in California, and Appendix B presents an assessment of legal issues for CalAccount.

The study was funded by the California Treasurer's Office and led by Principal Investigator Jonathan Welburn and Project Director Robert Bozick. For all inquiries, email CalAccountProject@rand.org.

RAND Social and Economic Well-Being

RAND Social and Economic Well-Being is a division of RAND that seeks to actively improve the health and social and economic well-being of populations and communities throughout the world. This research was conducted in the Social and Behavioral Policy Program within RAND Social and Economic Well-Being. The program focuses on such topics as risk factors and prevention programs, social safety net programs and other social supports, poverty, aging, disability, child and youth health and well-being, and quality of life, as well as other policy concerns that are influenced by social and behavioral actions and systems that affect well-being. For more information, email sbp@rand.org.

Contents

About This Annex iii

Appendix A. Analyzing the California Banking Landscape 1

Appendix B. CalAccount Legal Issues 29

Abbreviations 62

References 63

Appendix A. Analyzing the California Banking Landscape

Traditional Banking Institutions

This section reports the results from a data collection that RAND conducted to examine how checking account fees vary across all banks and credit unions that offer this service in the state of California. The data on fees and minimum balance requirements that we collected are well-known barriers to banking access. This is also supported by findings from the RAND California Survey of Household Finance reported in column 4 of Table A1.1, which show that, among unbanked respondents, 41.1 percent cite "Bank or credit union account fees and service charges are too high" and 31.9 percent cite "Bank or credit union account fees are too unpredictable" as reasons for not having a checking or savings account. Similarly, 58.1 percent of these respondents cite "You don't have enough money to meet minimum balance requirements" as a reason for being unbanked.

Table A1.1. Reasons for Not Having a Bank Account: Unbanked Respondents

| Reason for Not Having a Bank Account | RAND | FDIC | RAND | FDIC |
|--|----------------|-------|----------------------|-------|
| | Primary Reason | | Check All That Apply | |
| Bank or credit union locations are inconvenient | 0.0% | 4.4% | 14.3% | 15.4% |
| Bank or credit union account fees and service charges are too high | 10.0% | 6.0% | 41.1% | 29.5% |
| Bank or credit union account fees are too unpredictable | 4.0% | 1.5% | 31.9% | 27.3% |
| Banks or credit unions do not offer products and services you need | 0.0% | 2.4% | 12.2% | 19.2% |
| You don't trust banks or credit unions | 5.0% | 13.2% | 31.8% | 33.0% |
| You don't have enough money to meet minimum balance requirements | 19.0% | 21.7% | 58.1% | 40.1% |
| Avoiding a bank or a credit union gives you more privacy | 1.0% | 8.4% | 22.4% | 34.1% |
| You don't have the personal identification required to open an account | 0.0% | 2.7% | 11.3% | 11.6% |
| You cannot open an account due to problems with past banking or credit | 10.0% | 5.3% | 23.5% | 13.6% |
| It is not easy for you to speak with bank or credit union staff in your language | 1.0% | NA | 9.6% | NA |
| Banks or credit unions do not feel welcoming or comfortable for people like | 4.0% | NA | 17.5% | NA |
| Information given by banks or credit unions on account rules and fees are | 2.0% | NA | 17.6% | NA |
| You do not have enough money to need a bank or credit union account | 11.0% | NA | 63.9% | NA |

| | RAND | FDIC | RAND | FDIC |
|--|-------|------|-------|------|
| Banks and credit unions take too long to clear checks | 1.0% | NA | 20.8% | NA |
| Banks and credit unions may close unexpectedly and you might lose all your | 4.0% | NA | 31.0% | NA |
| You do not need to write enough checks to make it worthwhile to have a | 7.0% | NA | 30.8% | NA |
| The people and businesses you usually make payments to only accept cash | 2.0% | NA | 20.8% | NA |
| You are not sure how to open and/or to manage a bank or credit union | 1.0% | NA | 23.0% | NA |
| You keep your savings in another country | 0.0% | NA | 6.0% | NA |
| You prefer to handle your transactions with cash | 19.0% | NA | 53.3% | NA |

SOURCE: The numbers in the RAND columns are from the RAND California Survey of Household Finance. The numbers in the FDIC columns are from the FDIC Survey of Unbanked and Underbanked Households.

NOTES: The table lists different reasons for not having a bank account. For the RAND columns, the “Check All That Apply” reason is based on the full sample of the unbanked, whereas the “Primary Reason” is based exclusively on those who reported a reason. For the FDIC columns, the numbers are from the 2021 version of the survey, using Appendix Tables A.8 and A.9 (link: <https://www.fdic.gov/analysis/household-survey/2021appendix.pdf>). The sample used is national and is restricted to all unbanked households. The statistics are weighted using weights that were constructed to account for undercoverage and/or underresponse.

Sample Selection Criteria

We include all active banks that are insured by the Federal Deposit Insurance Corporation (FDIC) and all active credit unions that are insured by the National Credit Union Administration (NCUA) that fulfill three criteria.¹ First, they must have a physical branch in California. For banks, this means that they must have at least one physical address in the state as reported by the Federal Financial Institutions Examination Center (FFIEC),² and for credit unions, this means that they must have at least one physical address in the state as reported by the NCUA Quarterly Call Report database.³ Second, we exclude institutions with an entity type (or institution group) classified as a data processor, financial or investment company, securities broker, foreign bank or entity, edge corporation, and non-deposit trust company.⁴ There are 478 institutions that match

¹ Unlike banks, eligibility to join credit unions is generally restricted to individuals that work for specific companies, reside in certain areas, are members of specific faith-based communities, etc. We include all credit unions that fulfill the three sample criteria independent of their eligibility criteria.

² The data can be accessed from the FFIEC National Information Center (NIC) available at <https://www.ffiec.gov/npw/> by choosing “Data Download” and downloading the file titled “Attributes – Branches.” Data file downloaded on 01/29/24. Note that banks that only offer ATMs or alternative non-branch services in the state (e.g., cafés or lounges) are not listed on the FFIEC NIC database and are not included in our sample.

³ The data can be accessed from <https://ncua.gov/analysis/credit-union-corporate-call-report-data/quarterly-data>. We use data from the September 2023 Call Report. Location information for each credit union is reported in “Credit Union Branch Information.txt” as updated on 11/22/23.

⁴ Institutions are excluded if their Entity Type is classified as “Finance Company,” “Foreign Bank,” “Foreign Banking Organization (FBO),” “Foreign Banking Organization as a BHC,” “Foreign Branch of a U.S. Bank,” “Foreign Entity Other,” “Investment Bank/Company,” “Uninsured Federal Branch of an FBO,” “Uninsured State Agency of an FBO,” “Uninsured State Branch of an FBO,” “Edge Corporation – Domestic Branch,” “Edge Corporation – Investment,” “Financial Holding Company – Domestic,” “Non-deposit Trust Company – Member,” “Non-deposit Trust Company

these two requirements in California. Then we restrict the sample to banks and credit unions that offer personal checking accounts (also referred to as *share draft accounts* by credit unions). Our final sample includes 418 institutions, of which 153 are banks and 265 are credit unions.⁵ In terms of distinct branches, the final sample consists of 7,196 branches, of which 5,629 belong to banks and 1,567 belong to credit unions.⁶

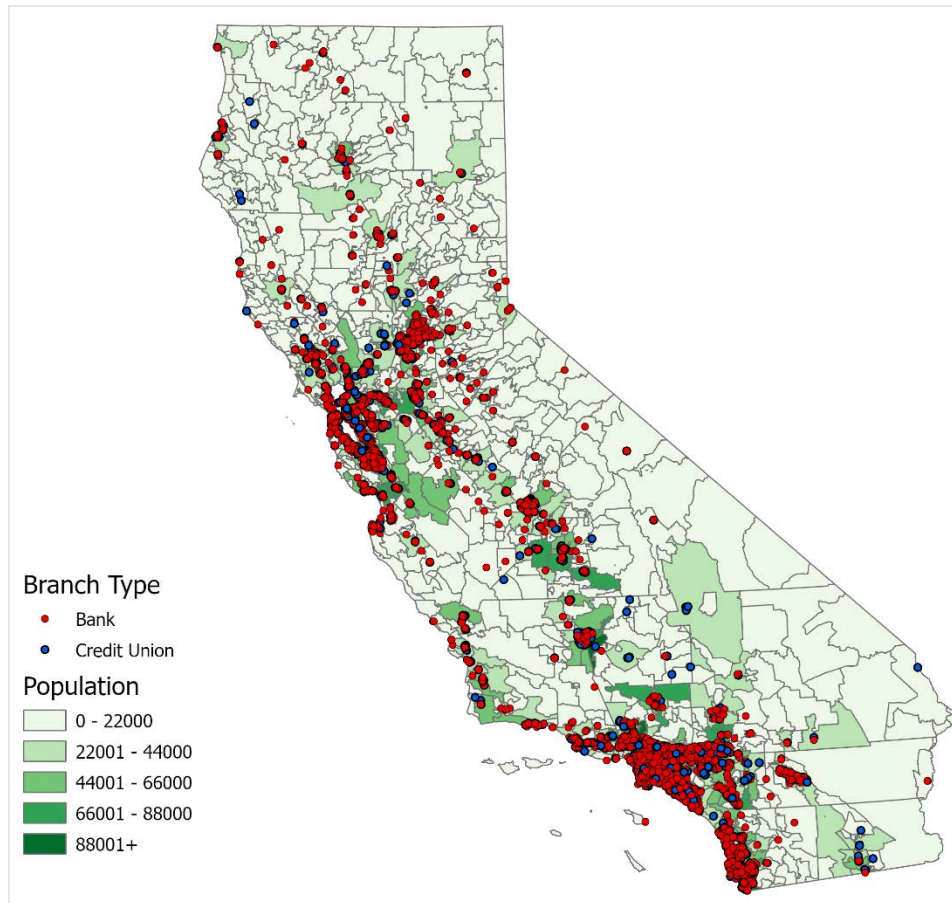
Figure A1.1 provides a map of the different branch locations in California, with banks illustrated by red dots and credit unions illustrated by blue dots. We also show the total population size for each zip code in the state. As expected, there is a strong correlation between population count and branch density, with banks and credit unions mostly located in and around major cities like Los Angeles, San Diego, San Francisco, and Sacramento. Moreover, banks and credit unions generally locate in the same areas; banks, however, cover a larger share of the state's zip codes than credit unions, especially in the Northern parts of California.

– Non-Member,” “Representative Office,” “Securities Broker/Dealer,” “Bank Holding Company,” and “Domestic Entity Other.” Information on Entity Type can be obtained from the FFIEC NIC database available from <https://www.ffiec.gov/npw/>.

⁵ We exclude institutions that provide personal checking accounts exclusively to owners or managers of businesses that have business accounts with the institution. We also exclude institutions that exclusively provide premier personal checking accounts that require minimum opening balances of at least \$10,000.

⁶ Among the 7,196 branches included in our final sample, 115 do not report a physical address.

Figure A1.1. Bank and Credit Union Branch Locations and Population Size by Zip Code



SOURCE: Bank branch locations are obtained from the FFIEC National Information Center database (accessed on 01/29/24). Credit union branch locations are obtained from the NCUA Quarterly Call Report database (using data from September 2023). Population refers to total population in the zip code.

NOTES: The graph shows the location of bank branches (red dots) and credit union branches (blue dots) in California. Only institutions that have at least one physical branch in the state and that offer personal checking accounts are included.

Methodology Used to Collect Banking Fees

We collected data on fees and minimum balance requirements for the basic checking account offered by the institutions in our sample.⁷ Data on two types of fees were collected: *monthly service charge* (also referred to as *monthly maintenance fee*) and *overdraft/non-sufficient funds* (NSF) fees that banks and credit unions levy when customers engage in transactions that exceed their account's balance. Because banks and credit unions often offer ways to waive the monthly service charge, we also collected data on whether the institution offers ways to waive the maintenance fee. Lastly, we collected data on the minimum deposit required to open a checking account.

⁷ By basic checking account, we mean a non-interest-bearing account that allows the customer to make purchases both in-store and online using a debit card linked to the account, pay bills, deposit and withdraw cash at Automated Teller Machines (ATMs), and receive online direct deposits (e.g., to receive paychecks).

Data on fees and minimum balance requirements were obtained directly from each bank and credit union. While some institutions report the data on their website in a transparent and easily accessible manner, several institutions only report this information on their *Fee Schedule* or on various *Disclosure Statements* (e.g., *Deposit Account Disclosures* and *Truth in Savings Disclosures*); forms that are generally hard, and sometimes impossible, to locate on the institution's website. Even when an institution reports these documents online, the exact details regarding potential fees might not be understandable to most, or even all, customers. And, while several banks offer low-cost checking accounts, they sometimes only promote their higher-cost accounts because of the higher profit margin they bring, which adds to the information asymmetry problem faced by prospective customers.

Missing data were obtained from phone calls with customer representatives. Note that some credit unions were unwilling to disclose any information until they had verified that the prospective customer was eligible to join the credit union, such as proof of employment in the event that membership is restricted to specific workers. Similarly, some banks were unwilling to disclose any information on the phone and required that prospective customers visit them at one of their branch locations to obtain information about their services.

Overall, considering the amount of time that it took dedicated RAND staff to obtain the required information for all institutions, it is unreasonable to assume that a regular customer has the time or expertise required to adequately compare his or her potential banking alternatives. The distribution of fees across the various institutions discussed below should be interpreted as the lowest possible fees that institutions might offer, even though the specific checking accounts incorporated in our analysis might not be readily available to all customers.

Monthly Service Charge

The CalAccount aims to offer fee-free checking accounts with no minimum opening deposit requirements. Our data collection revealed that such accounts are nearly non-existent in California. Among the 418 banks and credit unions with a physical branch in the state, only two banks offer checking accounts with no minimum opening deposit requirement, no monthly service charge, and no overdraft or NSF fee (however, other fees that were not collected by RAND, and that would not be charged by the proposed CalAccount program, might still apply to their accounts).

Rows 1 and 4 of Table A1.2 report, respectively, the distribution of the monthly service charge (in dollars) across the banks and credit unions in our sample. Note that all institutions receive equal weight in this table; hence, while several large institutions (e.g., Bank of America, Chase Bank, and Wells Fargo) have multiple branches in the state and serve a larger share of the state's population, they receive equal weight to smaller institutions that serve only a small share of Californians and that might have only a few branches in the state when deriving the distributions reported in this table. About one-fifth of banks that operate in California provide checking accounts with no monthly service charge. Most banks, however, charge such fees, with a median fee of \$7.88 and a fee of at least \$12 per month for the banks in the top ten percent of this distribution. Conversely, most credit unions do not charge monthly service fees for their basic checking accounts. While about one-third of the credit unions charge such fees, the fee is generally lower than for banks and is less than \$10 for nearly all credit unions in our sample.

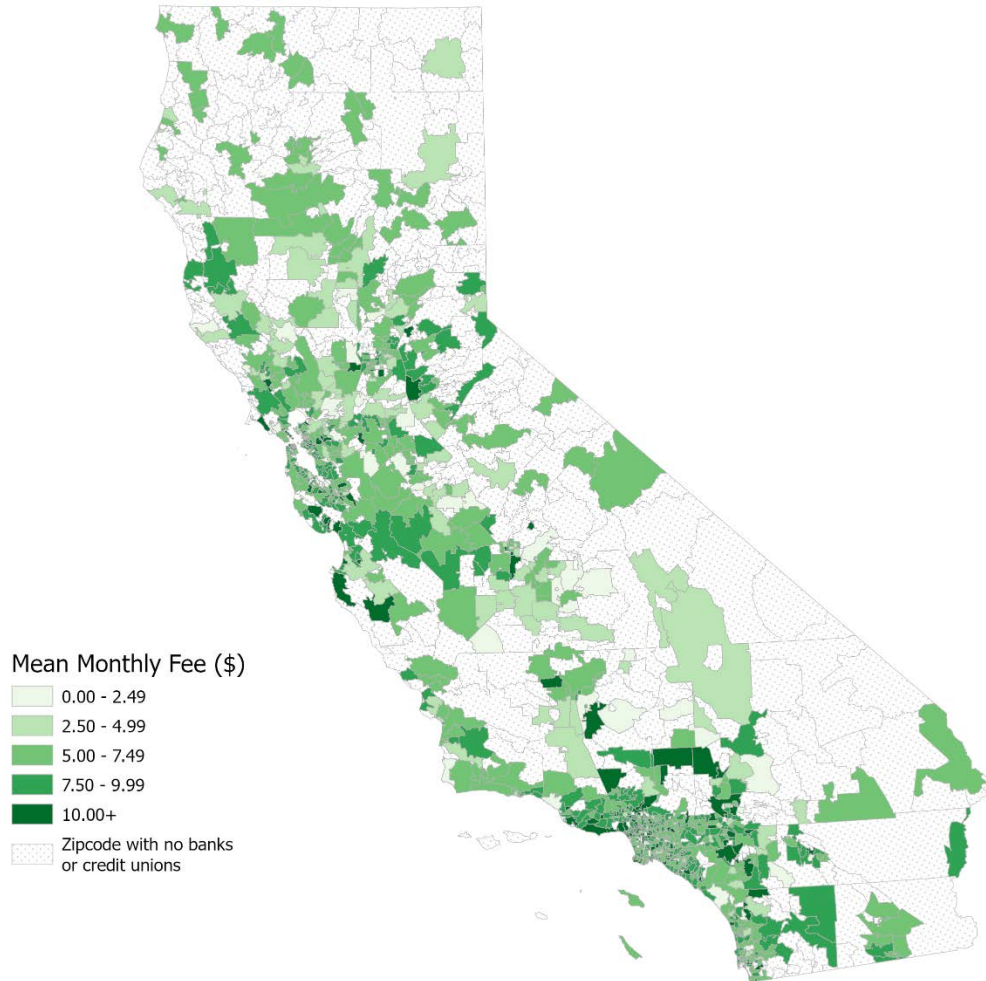
Table A1.2. Distribution Across Banks and Credit Unions by Type of Fee (in dollars)

| | Min | 10 | 25 | 50 | 75 | 90 | Max |
|-----------------------------|------------|-----------|-----------|-----------|-----------|-----------|------------|
| Banks | | | | | | | |
| Monthly Service Charge | 0.00 | 0.00 | 4.00 | 7.88 | 10.00 | 12.00 | 30.00 |
| Overdraft/NSF Fee | 0.00 | 15.00 | 25.00 | 30.00 | 35.00 | 35.00 | 49.00 |
| Minimum Deposit Requirement | 0.00 | 25.00 | 50.00 | 100.00 | 100.00 | 500.00 | 1500.00 |
| Credit Unions | | | | | | | |
| Monthly Service Charge | 0.00 | 0.00 | 0.00 | 0.00 | 4.00 | 5.50 | 10.50 |
| Overdraft/NSF Fee | 0.00 | 20.00 | 25.00 | 29.00 | 30.00 | 32.00 | 37.00 |
| Minimum Deposit Requirement | 0.00 | 0.00 | 0.00 | 20.00 | 25.00 | 50.00 | 500.00 |

SOURCE: Primary data collection from the institution's website or from phone call with customer representative.
 NOTES: Rows 1–3 report, respectively, the distribution of the monthly service charge, the overdraft/NSF fee, and minimum deposit requirement (all in dollars) for the basic checking account offered by the banks that have at least one branch office in California. Rows 4–6 report the corresponding distributions for credit unions that operate in the state. All institutions are equally weighted in this table.

Figure A1.2 shows the spatial distribution of the monthly service charge. It depicts the average monthly fee across all bank and credit union branches that are located in a particular zip code, with darker shades of green associated with higher average monthly service charges. In this map, white dotted zip codes illustrate zip codes that do not have any bank or credit union branches that fulfill the selection criteria discussed earlier, including zip codes with potentially missing data on monthly service charges. The map shows that there is limited spatial variation in the monthly service charge in California.

Figure A1.2. Average Monthly Service Charge by Zip Code



SOURCE: Primary data collection from the institution’s website or from phone call with customer representative. Bank branch locations are obtained from the FFIEC National Information Center database (accessed on 01/29/24). Credit union branch locations are obtained from the NCUA Quarterly Call Report database (using data from September 2023). NOTES: The map illustrates the average monthly service charge (also known as maintenance fee) across all bank and credit union branches that are located in a particular zip code. White dotted zip codes illustrate zip codes that do not have any bank or credit union branches, including zip codes with potentially missing data on maintenance fees.

Banks and credit unions often offer ways to waive the monthly maintenance fee; hence, the *de facto* service charge difference between banks and credit unions, assuming the customer qualifies for the waiver, is lower than what is reported in Table A1.2. Among the sample of banks and credit unions that charge a monthly maintenance fee, more than 90 percent allow for ways to waive the fee, the most common option of which is to maintain a sufficiently high account balance.⁸ For credit unions that offer this option, the monthly minimum balance requirement ranges from \$50 to \$2,500, with \$100 for the 10th percentile, \$500 for the median, and \$1,500 for the 90th percentile. The corresponding monthly minimum balance requirement for

⁸ While institutions apply different metrics to assess minimum account balances, they are mostly based on either the customer’s minimum daily balance or on the average account balance over the course of a month.

banks that offer this option ranges from \$100 to \$10,000, with \$400 for the 10th percentile, \$600 for the median, and \$1,500 for the 90th percentile. A large share of institutions also waives this fee, either partially or in full, if the customer opts to receive their monthly statements electronically (i.e., by enrolling in E-Statements) or by having monthly direct deposits that exceed a certain threshold.

Overdraft/NSF Fee

Most financial institutions that provide checking accounts charge overdraft or NSF fees if a customer engages in transactions that exceed his or her account's balance. Overdraft fees are levied when banks and credit unions choose to cover the transaction, thereby leading to a negative account balance,⁹ whereas an NSF fee is levied when a presented check is returned, or a payment cannot be made, due to insufficient funds.

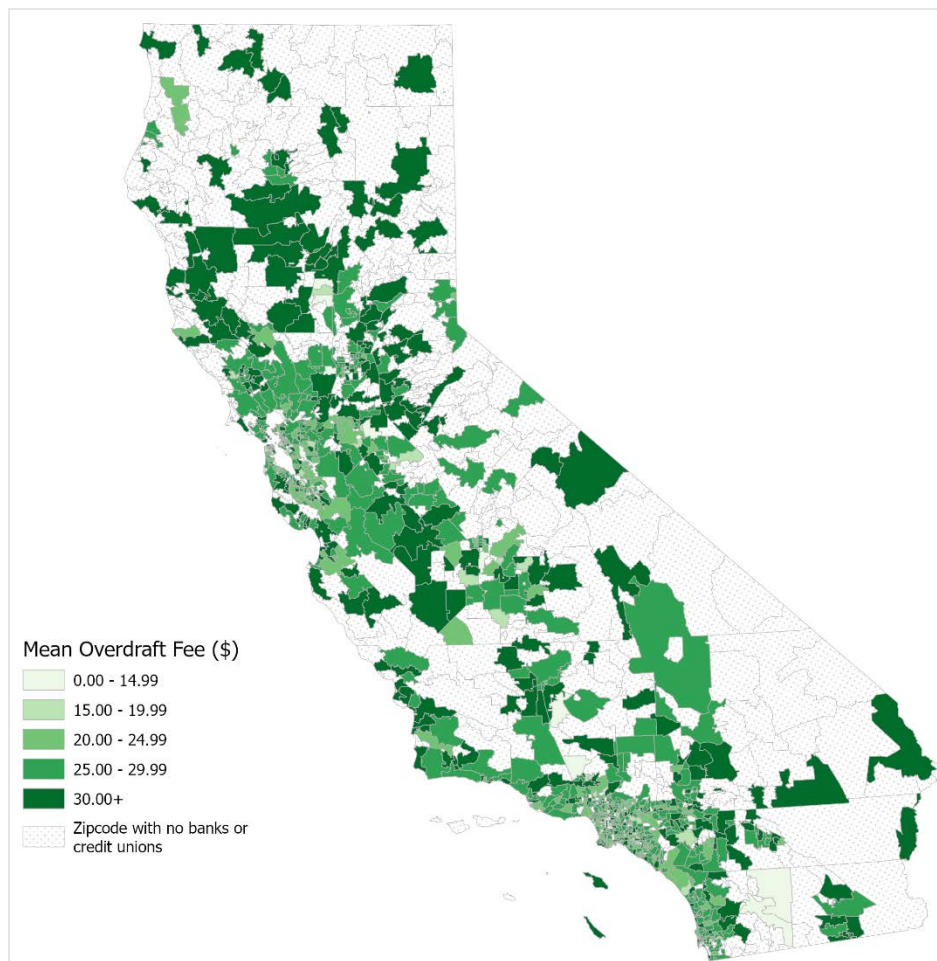
Rows 2 and 5 of Table A1.2 report show, respectively, the distribution of the overdraft or NSF fee (in dollars) across the banks and credit unions in our sample.¹⁰ Most institutions charge an overdraft/NSF fee that ranges between \$25 and \$35 per transaction. Among the banks in our sample, the overdraft/NSF fee ranges from \$0 to \$49, whereas the corresponding fee for credit unions varies from \$0 to \$37.

Figure A1.3 shows the spatial distribution of the overdraft/NSF fee by illustrating the average overdraft/NSF fee across all bank and credit union branches that are located in a particular zip code, with darker shades of green associated with higher average overdraft/NSF fees. White dotted zip codes illustrate zip codes that do not have any bank or credit union branches that fulfill the selection criteria discussed earlier, including zip codes with potentially missing data on overdraft/NSF fees.

⁹ Overdraft fees are sometimes referred to as *courtesy pay* fees due to the service, or courtesy, that the institution offers by covering transactions that exceed the customer's account balance.

¹⁰ We combine overdraft and NSF fees because nearly all banks and credit unions charge the same fee whether they cover the transaction, which results in an overdraft, or if the payment cannot be made or the presented check is returned, which results in an NSF fee.

Figure A1.3. Average Overdraft Fee by Zip Code



SOURCE: Primary data collection from the institution’s website or from phone call with customer representative. Bank branch locations are obtained from the FFIEC National Information Center database (accessed on 01/29/24). Credit union branch locations are obtained from the NCUA Quarterly Call Report database (using data from September 2023). NOTES: The map illustrates the average overdraft/NSF fee across all bank and credit union branches that are located in a particular zip code. White dotted zip codes illustrate zip codes that do not have any bank or credit union branches, including zip codes with potentially missing data on overdraft/NSF fees.

Overdraft fees are generally levied on a per-transaction basis, which means that every purchase that results in an overdraft, as well as every “bounced” check or rejected payment due to insufficient funds, can result in an overdraft or NSF fee.¹¹ Following an overdraft, customers might also be charged exorbitant interest penalties that sometimes compound daily until they

¹¹ While there are exceptions, these fees are generally independent of the size of transactions or the amount by which the customer’s account balance falls below zero (Bakker, Trevor, Nicole Kelly, Jesse Leary, and Éva Nagypál, *Data Point: Checking Account Overdraft*, Consumer Financial Protection Bureau, July, 2014.)

restore their account to a positive balance.¹² Repeat overdrafts may also result in involuntary account closures. Such involuntary account closures have long been common in the U.S., with 6.4 million accounts involuntarily closed in 2005, nearly all of which were due to repeated overdrafts and NSF activities.¹³ Note that an involuntary account closure with one financial institution might also impair a customer's ability to open accounts with another institution or limit their future options to high-fee accounts (sometimes referred to as *fresh start* or *second chance* accounts). This follows because banks usually report such activities and involuntary account closures to *ChexSystems*, an agency that collects information on customers' deposit and debit history. Several banks and credit unions use the statistics reported by *ChexSystems* to assess the financial risk that a prospective customer might present.¹⁴

Minimum Opening Deposit Requirement

Finally, rows 3 and 6 of Table A1.2. report, respectively, the distribution of the minimum deposit required to open a checking account (in dollars) across the banks and credit unions in our sample. This deposit requirement only applies at the time when the customer opens the account and is hence different from the minimum balance that several institutions require to waive the monthly service charge. The minimum opening deposit for the banks in our sample ranges from \$0 to \$1,500, with \$100 for the median.¹⁵ In contrast, nearly half the credit unions in our sample do not require minimum opening deposits for their basic checking account. Note, however, that this comparison of minimum opening deposits between banks and credit unions is somewhat misleading because prospective customers at credit unions cannot open a checking (or *draft*) account until they have opened a savings (or *share*) account with the same institution. While the minimum deposit requirement for savings accounts varies across credit unions, it mostly ranges from \$5 to \$25.¹⁶

¹² Some institutions limit the number of overdraft fees that customers can be charged daily, and some also grant customers a grace period (generally limited to at most a few days) to bring their account back to a positive balance before levying an overdraft fee. Several institutions also allow their customers to pay for an *overdraft protection* plan that enables funds from another linked account, such as a savings account, to be automatically transferred to cover transactions that exceed the customer's checking account balance. While some banks do not charge overdraft fees, customers are still liable for potential interest penalties that accrue as long as the account balance remains negative.

¹³ Campbell, D., F. A. Martínez-Jerez, and P. Tufano, "Bouncing out of the banking system: An empirical analysis of involuntary bank account closures," *Journal of Banking & Finance*, Vol. 36, No. 4, 2012, pp. 1224-1235.

¹⁴ See Section A1.6 for a literature review on the impact of *ChexSystems* on access to financial services for unbanked individuals.

¹⁵ The minimum opening deposit tends to be lower than the minimum balance required to waive the monthly service charge. Hence, customers often have to deposit additional funds during the first month after opening an account (in excess of the minimum opening deposit) to avoid having to pay the monthly maintenance fee at the end of the first statement cycle.

¹⁶ These savings accounts can also come with monthly service charges. While most of them do not, a subset of credit unions charge about \$5 per month for their savings accounts. Unlike for banks, prospective customers at credit unions must also pay a non-refundable membership fee, most commonly at a cost of \$5, before they can open any account with the institution.

F1.2 Non-Traditional Banking and Payment Services

We collected data on fees for non-traditional banking and payment services that are used disproportionately by unbanked households, including check cashing, money orders, nonbank money transfer services (e.g., for international remittances), and prepaid cards.¹⁷

Sample Selection Criteria

The list of registered nonbank institutions in the state that offer money orders, nonbank money transfers, and/or check cashing services are obtained from the State of California's *Check Cashier Permit Program*.¹⁸ A list of 252 establishments were sampled randomly, spanning 56 of the 58 counties in the state. Fees associated with these services were obtained from phone calls with each establishment. Several establishments did not have a phone number listed on *Google Maps* or on their website.¹⁹ Among the 124 establishments that RAND managed to contact,²⁰ 36 were either no longer providing these services or were unwilling to disclose any information on the phone, leaving a final sample of 88 establishments that provide at least one of these three services.

A random sample of 136 prepaid cards were obtained from the *Prepaid Product Agreements Database* administered by the Consumer Financial Protection Bureau (CFPB).²¹ This database provides account disclosures for each prepaid card, including detailed information on different fees. We restrict our sample to general purpose reloadable prepaid cards, excluding Play+ cards. A total of 56 cards with missing account disclosures were excluded, leaving a final sample of 80 prepaid cards.

Fees for Check Cashing, Money Orders, Money Transfers, and Prepaid Cards

Fees for check cashing services generally scale with the value of the check, with vendors either providing a schedule of fees that varies with the check amount or charging a fee that is equal to some percentage of the check amount. Because a large share of the unbanked households in the U.S. tends to be lower income according to data from the FDIC Survey of Unbanked and Underbanked Households, RAND restricted the data collection to the cost of cashing a \$100- and a \$500-check.

The first row of Table A1.3 reports the distribution of fees associated with cashing a \$100-check across the sampled vendors. This fee ranges from \$1 to \$10 in our sample, with a median fee of \$2.25. The corresponding fee to cash a \$500-check reported in the second row of the table ranges from \$1 to \$50, with a median of \$6.75 and a fee of at least \$12.50 among the top 10 percent of the sample. These fees may cause considerable financial strain for unbanked

¹⁷ Certain credit products or services are also used disproportionately by un/underbanked households, including pawn shops, payday loans, tax refund anticipation loans, and auto title loans. Given the scope of the proposed CalAccount program, and following communication with STO, RAND restricted the primary data collection to fees associated with non-credit and non-loan services.

¹⁸ State of California Office of the Attorney General, "Check Cashier Permit Program," Undated.

¹⁹ *Google Maps*: [google.com/maps](https://www.google.com/maps).

²⁰ At least three attempts were made to contact each of the sampled establishments.

²¹ Consumer Financial Protection Bureau, "Prepaid Product Agreements Database," Undated.

households, who might have to routinely rely on these services to cash paychecks or other forms of payments.

The third row in Table A1.3 reports the distribution of fees associated with money order services. This fee ranges from \$0.60 to \$4.00. Half the sampled vendors, however, charge at most \$1.00 for this service. This is mostly due to the relatively low money order fees charged by large grocery store chains (e.g., Safeway) that are included in our sample. Customers must pay this fee for each money order, with a maximum amount per money order that ranges from \$500 to \$1,000 across the sampled vendors.²² While the fees per money order for the median vendor is relatively low, the cost of using these services can result in large cumulative expenses for unbanked households that might not have access to other secure ways of sending money. A report from the Federal Reserve Bank of Boston found that the fees associated with check cashing and money order services for unbanked households can run from \$30–\$318 a year.²³

Table A1.3. Distribution of Fees for Non-Traditional Banking or Payment Services (in dollars)

| Type of Service | Min | 10 | 25 | 50 | 75 | 90 | Max |
|-----------------------------|------|------|------|------|-------|-------|-------|
| Check Cashing (\$100-check) | 1.00 | 1.00 | 1.73 | 2.25 | 2.25 | 5.00 | 10.00 |
| Check Cashing (\$500-check) | 1.00 | 5.00 | 6.38 | 6.75 | 10.00 | 12.50 | 50.00 |
| Money Order | 0.60 | 0.99 | 1.00 | 1.00 | 2.00 | 3.00 | 4.00 |
| Prepaid Cards | | | | | | | |
| Monthly | 0.00 | 0.00 | 0.00 | 0.00 | 0.75 | 5.00 | 9.95 |
| Per Purchase | 0.00 | 0.00 | 0.00 | 0.00 | 0.50 | 1.00 | 3.00 |
| ATM Withdrawal | 0.00 | 0.00 | 1.75 | 2.00 | 2.50 | 2.50 | 3.15 |
| Cash Reload | 0.00 | 0.00 | 0.00 | 4.95 | 5.95 | 5.95 | 5.95 |
| Customer Service Call | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 5.00 |
| Balance Inquiry | 0.00 | 0.00 | 0.50 | 0.90 | 1.00 | 1.50 | 3.00 |
| Inactivity | 0.00 | 0.00 | 0.00 | 2.97 | 4.95 | 5.95 | 10.00 |

SOURCE: Primary data collection from phone call with each sampled vendor.

NOTE: The table lists select percentiles of the distribution of fees (in dollars) for check cashing services and money orders, as well as the most common fees associated with general purpose reloadable prepaid cards.

²² Several traditional banks also offer check cashing and money order services to non-relationship customers. As an example, Bank of America charges \$8 per check for amounts that exceed \$50 and Chase Bank charges \$5 per money order for amounts up to \$1,000.

²³ Desmond, Tyler and Charles Springer, *Estimating the Cost of Being Unbanked*, Federal Reserve Bank of Boston, 2007.

The CFPB reports disclosure agreements for prepaid debit cards, including the various fees associated with these cards. These prepaid cards function like conventional debit cards and can be used to make purchases (both in-store and online) and to pay bills. While these cards are not linked to a checking account like conventional debit cards, they can still be reloaded with additional funds, albeit potentially at a cost to the customers.²⁴ The final rows of Table F1.3 list the 7 most common fees associated with these cards. The majority of prepaid cards do not have monthly fees; those that do, however, come at a high cost, with \$5.00 per month for the 90th percentile. Furthermore, while most prepaid cards do not charge per transaction fees, a quarter of them charge at least \$0.50 per transaction; a subset of the cards also charge percentage-based transaction fees that can be as high as 3.5 percent of the purchase amount. Similar to conventional debit cards, customers can withdraw funds from their prepaid cards at ATMs. Doing so at out-of-network ATMs, however, usually comes at a cost.

Depositing funds in a checking account generally comes at no cost to customers of banks and credit unions; conversely, reloading prepaid cards usually comes at a cost, with a fee of \$4.95 for the median prepaid card. Most prepaid cards also charge balance inquiry and inactivity fees, and 5 percent of the sampled prepaid cards also charge a fee to talk to a customer representative. Note that nearly all prepaid cards also come with additional fees. Among the prepaid cards in our sample, the median card has 7 fees in addition to those listed in Table A1.3.

Finally, we collected data on the cost of nonbank money transfer services. Both banked and unbanked households sometimes use these services to make international money transfers, for example for remittances. Given the demographics in California, we collected data on the cost of a \$1,000 money transfer to Tijuana, Mexico. There is almost no variation in this fee in our sample, with nearly all vendors charging \$10 for this service.

Benefits and Harms of Non-Traditional Banking and Payment Services

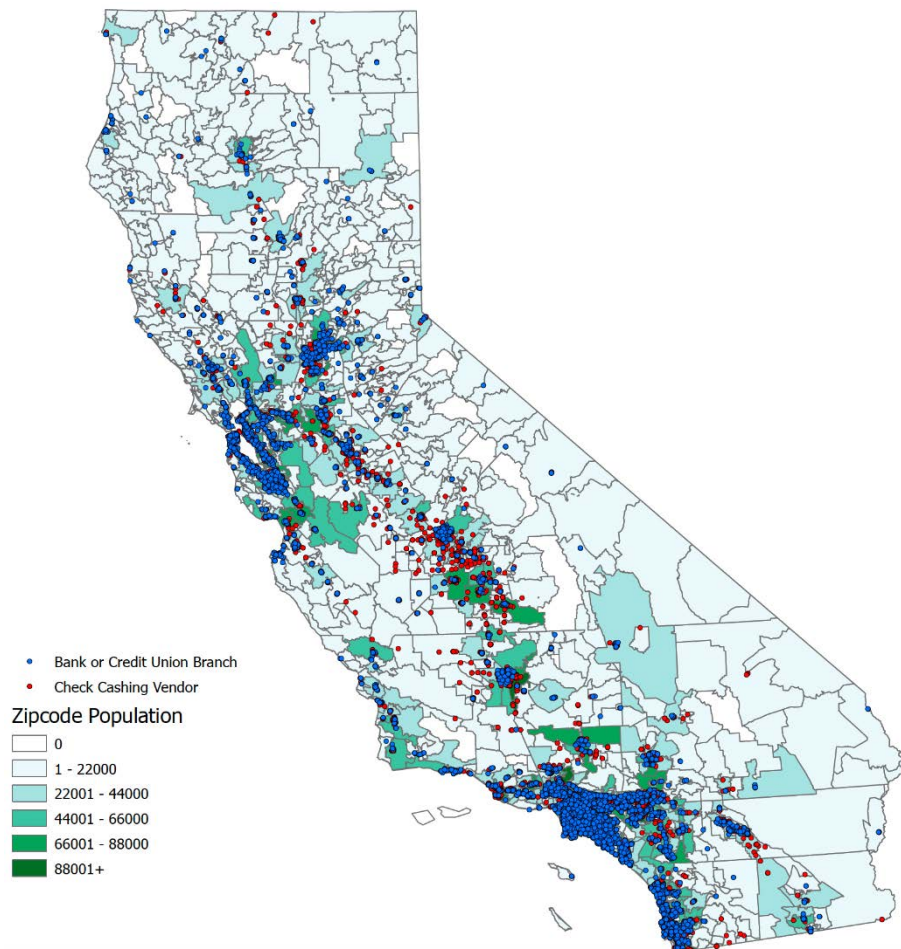
The non-traditional banking and payment services discussed above can substitute for some of the services that are available to banked households. For example, check cashing services provide a substitute for direct deposits and prepaid cards might provide a substitute for some of the services that banked customers can access by having a debit card linked to their checking account. Our data collection, however, shows that these non-traditional banking and payment services come at considerably higher costs to customers in California. CalAccount can lessen the unbanked population's financial burden by reducing their dependence on expensive non-traditional banking services. The following discussion outlines certain benefits and harms of these non-traditional services for unbanked households compared to traditional banking and payment services.

Amongst the benefits of non-traditional money services are accessibility and convenience. These services are often available in various locations, including convenience and grocery stores, making them potentially more accessible than traditional banking services in underserved areas. Figure A1.4 shows the location of all bank and credit union branches (blue dots) and all the registered nonbank institutions in the state that offer money orders, nonbank

²⁴ Our report focuses on prepaid cards issued by companies. The government, at both the federal and state level, also use these cards, for example to issue unemployment insurance benefits, Social Security payments, and Economic Impact Payments (more commonly referred to as *stimulus checks*). Such government issued cards can only be reloaded by the government and are not included in our sample.

money transfers, and/or check cashing services (red dots). The nonbank institutions are mostly located in densely populated areas of the state and are hence mostly located in the same areas as the traditional banking institutions. The nonbank institutions, however, improve access to banking and payment services in Central California and certain rural parts of the state.

Figure A1.4. Population Count and Bank, Credit Union, and Check Cashing Locations by Zip Code



SOURCE: Bank branch locations are obtained from the FFIEC National Information Center database (accessed on 01/29/24). Credit union branch locations are obtained from the NCUA Quarterly Call Report database (using data from September 2023). Check Cashing Vendors are obtained from the State of California’s *Check Cashier Permit Program*. This includes all registered nonbank institutions in the state that offer money orders, nonbank money transfers, and/or check cashing services. Population refers to total population in the zip code.

Recall from Table A1.1 that 58.1 percent of the unbanked households in the RAND California Survey of Household Finance cite “You don’t have enough money to meet minimum balance requirements” as a reason for not having a checking or savings account and that 19.0 percent of the respondents cite this as their main reason for being unbanked. The non-traditional services discussed here might offer a convenient, albeit more costly, alternative for these

unbanked households due to the barriers that they face to opening and maintaining a traditional bank account.

Greater perceived privacy and trust is another potential benefit of non-traditional banking services. This is consistent with the findings from the RAND California Survey of Household Finance reported in Table F1.1, which show that 22.4 percent of the unbanked respondents cite “Avoiding a bank or a credit union gives you more privacy” as a reason for being unbanked, with 31.8 percent citing “You don’t trust banks or credit unions” as a reason for not having a checking or savings account.

Non-traditional banking services do not provide credit-building opportunities. This leaves the unbanked without avenues to establish a credit history, which is crucial for financial mobility.²⁵ Unbanked households might therefore have to opt for high-cost credit alternatives for their borrowing needs, such as payday lenders, automobile title loans, tax refund anticipation loans, and pawn shops. Indeed, both the RAND California Survey of Household Finance and the FDIC Survey of Unbanked and Underbanked Households show that unbanked households are considerably more likely to use these high-cost credit alternatives.²⁶ While non-traditional lenders can be providers of helpful liquidity when credit-constrained households face unexpected expenses or income shocks, this liquidity comes at an incredibly high cost. Research by the CFPB found that payday loans, for example, have such high associated costs that borrowers often become “trapped” in a debt cycle, with over 80 percent of payday loans rolled over or followed by another loan within 14 days.²⁷ While having a bank account does not eliminate the risk of incurring unexpected expenses or income shocks, gaining access to traditional banking services, including loans and credit cards, might still enable unbanked households to better smooth their consumption by reducing their reliance on non-traditional alternatives with exorbitant fees.

Finally, while there have been some efforts by the CFPB and state governments to monitor non-traditional banking services, they generally exist in a less regulated environment compared to traditional banks. This can potentially expose users to fewer consumer protections and exploitative practices.

A1.3 Banking Access Across Ethnic and Racial Groups

Figure A1.1 showed that certain areas of California are underserved in the sense that they are mostly void of physical bank branches. Limited access to physical branches can be a barrier to banking, with 14.3 percent of the unbanked households in the RAND California Survey of Household Finance citing inconvenient bank and credit union locations as a reason for not having a checking or savings account; none of the respondents, however, cite this as their main reason for being unbanked (confer Table A1.1).

²⁵ For a literature review on the importance of a credit history for the ability to receive loans (mortgages or auto loans) or to receive these loans at a good rate see: Toh, Ying Lei, "Addressing Traditional Credit Scores as a Barrier to Accessing Affordable Credit," 2023.

²⁶ Federal Deposit Insurance Corporation, "2021 FDIC National Survey of Unbanked and Underbanked Households," July 24, 2023.

²⁷ Burke, Kathleen, Jonathan Lanning, Jesse Leary, and Jialan Wang, *Data Point: Payday lending*, Consumer Financial Protection Bureau, March, 2014.

Current Banking Access

RAND leveraged 2020 Decennial Census block level data to quantify the share of the population located in underserved areas.²⁸ To do so, we first computed the share of the total population that reside more than *x* miles from the nearest branch office. Given the large differences in travel times between urban and rural areas, we computed this statistic using a locale-specific range, where the locales are as defined by the National Center for Education Statistics: city, suburban, town, and rural.²⁹ We also used the block level demographic data reported by the Census to compute this statistic separately for different ethnic and racial groups to examine whether certain demographic groups are more likely to be located in underserved areas.³⁰

The findings are reported in Table A1.4. Most Californians that live in cities have good access to branch offices. While about one-quarter of the population that live in cities reside more than 1 mile from a branch office, only 4 percent reside more than 2 miles from the nearest branch. A comparison across demographic groups shows moderately worse banking access for certain minorities conditional on living in cities, with 29.3–31.7 percent of the Black, Hispanic, and Native American population residing more than a mile from the nearest branch, compared to 25.7–26.8 percent for the Asian American and White population. Banking access is worse in less densely populated areas of the state. It is particularly poor for Native Americans that reside rurally, with nearly one-third of this demographic group residing more than 10 miles from the nearest branch office and about 10 percent residing more than 20 miles away.

Table A1.4. Population Living with Poor Physical Bank Access

| Demographic Group | | | | | |
|-------------------|-------|----------|-----------------|-------|-----------------|
| Asian American | Black | Hispanic | Native American | White | Full Population |

²⁸ "California Census 2020 Redistricting Blocks," edited by ArcGIS: ESRI, 2021.

²⁹ Given that travel times can differ between urban and rural areas. WRAND conducted an additional analysis where we compared the average distance to the nearest branch with the average travel time (by car) to the nearest branch. We did this by merging our data on branch offices with travel time from *Google Maps*. Doing this at scale for the entire state is computationally very costly due to the number of combinations that must be considered. We therefore restricted this analysis to four locations. We found that the two measures are positively correlated for this small sample of areas, suggesting that our results based on travel distance are likely robust to an alternative measure based on travel time.

³⁰ RAND examined whether areas that were subjected more extensively to *redlining*, a discriminatory practice embedded in the history of mortgage lending, have worse banking access as measured by the share of the population residing more than *x* miles away from the nearest branch. Due to data limitations, this analysis was restricted to cities for which we have historical redlining data from the ArcGIS Living Atlas (Lavery, Diana, "Historical redlining data now in ArcGIS Living Atlas," in *ArcGIS Living Atlas*: ESRI, 2020. <https://www.esri.com/arcgis-blog/products/arcgis-living-atlas/announcements/redlining-data-now-in-arcgis-living-atlas/>). We did not find a clear relationship between the severity of redlining and banking access. However, given that this study is restricted to a few cities in California, it is not necessarily representative of the implications of redlining for the overall state (e.g., our data does not include cities such as Oakland). Future research using other measures of banking access and more comprehensive data on redlining should therefore re-examine the relationship between redlining and banking access in California. See Section F1.6 for a literature review on the impact of redlining on the unbanked population.

| Locale | Range | Demographic Group | | | | | |
|----------|----------|-------------------|-------|-------|-------|-------|-------|
| | | | | | | | |
| City | 1 mile | 25.7% | 31.7% | 29.3% | 31.4% | 26.8% | 27.9% |
| | 2 miles | 3.9% | 4.4% | 3.6% | 5.3% | 4.4% | 4.0% |
| Suburban | 2 miles | 6.4% | 10.5% | 9.9% | 15.6% | 13.2% | 10.6% |
| | 5 miles | 0.2% | 0.8% | 0.8% | 1.7% | 0.8% | 0.7% |
| Town | 5 miles | 21.6% | 22.5% | 11.4% | 10.7% | 11.9% | 12.2% |
| | 10 miles | 3.4% | 10.9% | 5.0% | 2.6% | 3.2% | 4.3% |
| Rural | 10 miles | 5.3% | 12.2% | 16.9% | 31.2% | 17.1% | 16.4% |
| | 20 miles | 0.7% | 4.6% | 4.5% | 10.3% | 3.5% | 3.8% |

SOURCE: Bank branch locations are obtained from the FFIEC National Information Center database (accessed on 01/29/24). Credit union branch locations are obtained from the NCUA Quarterly Call Report database (using data from September 2023). Population count for each demographic group is obtained from the 2020 Decennial Census block level data.

NOTE: For a given locale, percentages represent the share of either the total population or a particular demographic group that resides more than x miles from the nearest branch office. Resident locations are approximated by the centerpoints of U.S. Census Blocks.

Banking Access Under Alternative Scenarios

Academics, policy researchers, and politicians have advocated for reviving the U.S. postal banking system, which was robust while active in the U.S. from 1910 until 1966.³¹ Post offices could use their natural economies of scale and scope to offer transaction services at a lower cost than banks.³² Piloting postal banking in California is one avenue that could be explored with the U.S. Postal Service (USPS) and its Postmaster General.³³

Given this, RAND examined how banking access would be affected under an alternative scenario where post offices are used as CalAccount branch offices, using location data reported by the U.S. Geological Survey: Government Structures. We also examined the implications of using town halls and schools as potential branch offices. Overall, we found that expanding the network of branches to include post offices would lead to improved banking access, especially in rural areas. The share of the rural population that resides more than 10 miles from the nearest branch would decline would 16.4 percent to 3.5 percent. This would also result in better banking

³¹ Baradaran, Mehrsa, "Credit, Morality, and the Small-Dollar Loan," *Harvard Civil Rights- Civil Liberties Law Review*, Vol. 55, No. 1, September 8, 2021. Noting endorsements of postal banking by Senators Bernie Sanders and Kirsten Gillibrand and the 2016 Democratic National Platform. See also American Postal Workers Union, "Postal Banking," Undated. <https://apwu.org/postal-banking>. ; Solomon, Danyelle, Mehrsa Baradaran, and Lily Roberts, *Creating a Postal Banking System Would Help Address Structural Inequality*, Center for American Progress, October 15, 2020.

³² Baradaran.

³³ ⁴⁵ Note, however, that a 2021 postal pilot program launched in four locations across Baltimore, Maryland; the Bronx, New York; Falls Church, Virginia; and Washington, D.C., which allowed customers to transfer business and payroll checks up to \$500 to gift cards for a flat fee of \$5.95 notably only had six customers (see Anthony, Nicholas, "Only Six People Used the Postal Banking Pilot Program," in *CATO at Liberty*: CATO Institute, March 30, 2022.) Thus, exploring a pilot with USPS for CalAccount purposes should involve an examination of why this 2021 pilot failed.

access for certain minorities. For example, while nearly one-third of Native Americans that reside rurally currently reside more than 10 miles from the nearest branch, this share would decline to 5.2 percent if post offices are used as branch offices.

We also conducted additional analyses to examine how banking access varies across racial and ethnic community boundaries, such as majority White, majority Black, and majority Native American Census blocks. We also considered alternative banking access measures (e.g., the average number of residents per traditional bank for the different communities) and how those measures would change under the alternative scenarios discussed above. The findings from these analyses are in line with the findings above: expanding the network of branch offices would improve banking access across all communities.

A1.4 Bank Fee Revenues

While the banking fees discussed in Section A1.1 come at a cost to customers, they also represent key sources of revenues for financial institutions. Given that an implementation of CalAccount may result in lower bank revenues, we report the annual revenues that banks make from specific fees next. This analysis is restricted to *national* bank revenues because corresponding state-level revenue statistics are not available.

Banks with assets exceeding \$1 billion are mandated to report their revenues from four specific fees on *Schedule RI – Income Statement* of their quarterly Consolidated Reports of Condition and Income (more commonly known as Call Reports): overdraft-related service charges, periodic maintenance charges, ATM fees, and all other service charges on deposit accounts.³⁴ Table A1.5 reports these fees for the year 2023 for the banks in our sample with the 10 highest fee revenues. Aggregate fee revenues are correlated with the size of a bank’s customer base, which in turn tends to be positively correlated with total assets. It is therefore not surprising that the largest banks in the country (Chase Bank, Wells Fargo, and Bank of America) are at the top of the list in terms of total fee revenues, with revenues of \$3.5–\$4.6 billion in 2023. The third column reports annual revenues from overdraft or NSF-related activities. Both Chase Bank and Wells Fargo made more than \$900 million in overdraft/NSF fees in 2023, more than three times the amount that any of the other banks made from these activities. Most banks, however, have recently experienced considerable reductions in their overdraft and NSF fee revenues. Between 2019 and 2023, inflation-adjusted annual revenues from overdraft/NSF charges declined by \$1.0 billion, \$1.3 billion, and \$1.7 billion for Wells Fargo, Chase Bank, and Bank of America, respectively, with similar proportional reductions experienced by most of the other banks listed in Table F1.5.³⁵

³⁴ Credit unions file their call reports with NCUA and are not subject to similar requirements regarding reporting of specific fee revenues (Nagypál, Éva, *Data Point: Overdraft/NSF Fee Reliance Since 2015 – Evidence from Bank Call Reports*, Consumer Financial Protection Bureau, December, 2021.)

³⁵ Similar findings were reported by the CFPB, whose report showed that aggregate overdraft/NSF fee revenues were stable between 2015 and 2019 but started declining rapidly during the pandemic (———.)

Table A1.5. Banks' National Fee Revenues for 2023 (in millions of dollars)

| Institution | Total | Overdraft | Maintenance | ATM | Other |
|-------------------------------------|-------|-----------|-------------|-----|-------|
| CHASE BANK | 4,642 | 1,104 | 831 | 307 | 2,400 |
| WELLS FARGO BANK | 4,132 | 937 | 554 | 309 | 2,332 |
| BANK OF AMERICA | 3,482 | 140 | 1,047 | 290 | 2,005 |
| PNC BANK | 1,604 | 258 | 178 | 82 | 1,085 |
| CITIBANK | 1,112 | 2 | 131 | 17 | 962 |
| U.S. BANK | 1,081 | 214 | 147 | 39 | 682 |
| BMO BANK | 385 | 27 | 18 | 22 | 319 |
| COMERICA BANK | 189 | 14 | 8 | 5 | 162 |
| ZIONS BANCORPORATION | 187 | 17 | 12 | 3 | 154 |
| FIRST-CITIZENS BANK & TRUST COMPANY | 157 | 22 | 11 | 0 | 125 |

SOURCE: Call Reports as of 12/31/23 reported by the FFIEC Central Data Repository's Public Data Distribution.

NOTE: The table lists *national* fee revenues (in millions of dollars) for the year 2023 for the banks in our sample with the 10 highest total fee revenues. The four last columns report annual revenues from overdraft and NSF fees, monthly maintenance fees, ATM withdrawal fees, and all other service charges.

The next two columns report revenues from maintenance charges and ATM withdrawal fees. Revenues from maintenance fees are generally lower than the revenues from overdraft/NSF fees; however, 6 of the banks (Chase Bank, Wells Fargo, Bank of America, PNC, Citibank, and U.S. Bank) made at least \$131 million from monthly service charges, with Bank of America making more than \$1 billion from these periodic maintenance fees. Although banks often allow their customers to withdraw cash from in-network ATMs free-of-charge, albeit potentially limited to a few withdrawals per month, these institutions generally charge fees for out-of-network ATM withdrawals. Table A1.5 shows that each of the 3 largest banks made about \$300 million from ATM withdrawal charges. The final column reports revenues from all other charges on deposit accounts, one example of which is the cost of printing checks. These fees account for the majority of bank fee revenues for most institutions, with 2023-revenues exceeding \$2 billion for each of the 3 largest banks.

A1.5 Bank Profitability Indicators

The State of California might choose to contract with major banking institutions in the state to provide CalAccount. Given the recent banking failures in the U.S., this section provides an assessment of the “healthiness” of the 20 largest banks in the country that offer personal checking accounts and that have branch offices in California. While a complete stress test of each potential collaborator bank is outside the scope of RAND’s analysis, this section can help inform the State of California on the current financial well-being of the largest banks.

We use *Call Reports* for December 2023 to compute 6 commonly used measures of financial profitability indicators: total assets, equity-to-assets, net income-to-assets, net interest margin, loans-to-assets, and non-performing loans to total loans. The findings are reported in Table A1.6.

Column two reports total assets (in millions of dollars) for each of the banks. Chase Bank is the most dominant by this measure, followed by Bank of America, Wells Fargo, and Citibank, all of which have total assets exceeding \$1 trillion. While this measure is a proxy for bank size, it is not necessarily a good indicator of profitability or financial health. For example, banks with high total assets do not necessarily make a lot of income on those assets or might have a large proportion of risky, non-performing loans. Therefore, we look at ratios of other key metrics to total assets next. Equity-to-assets reports the ratio of book equity to total assets. If there are any write-downs or losses on assets, equity holders will absorb those losses first; therefore, equity-to-assets can be interpreted as a measure of how much risk-absorption capacity a bank has. Holding the riskiness of bank assets fixed, a higher equity-to-assets ratio implies a larger “distance to default.” In our sample, this ratio is consistently above 5 percent.

The net interest margin reported in column four is informative about how profitable a bank’s business is when abstracting from loan charge-offs. It measures the difference between the interest earned on loans net of the interest paid on deposits and other liabilities. If loans were risk free, it would provide a proxy for the profitability of the classic bank business of lending and borrowing. Among the banks in our sample, the net interest margin typically ranges between 2–4 percent. However, given that loans can default and because banks face fixed and variable operating costs, a more accurate measure of bank profitability must account for these additional factors.

Net income-to-assets (column five) provides this measure of realized bank profitability. It takes into account a bank’s fixed costs to operate and charge-offs on non-performing loans, as well as the net interest margin. While this measure can vary from year-to-year, the December 2023 data show that the largest banks typically have positive profitability between 1–2 percent. We do not observe a clear correlation between bank size and the net income-to-assets ratio.

The remaining columns of Table A1.6 analyze the banks’ loan business. The loan-to-assets ratio is an indicator of a bank’s dependence on lending. Small and medium sized banks tend to do more lending to firms and households, whereas larger banks generally do more trading and securities activities, which suppresses the loan number. Therefore, we generally see an inverse relationship between bank assets and loans-to-assets.

Finally, the non-performing loan ratio (NPL-to-total loans) is a backward-looking measure of how past investments are currently performing. A higher value indicates that, among the bank’s total loan portfolio, there is a higher proportion of loans that are currently behind on their scheduled payments, which poses a risk of loss to the bank. Most banks have an NPL ratio at or below 1 percent.

Table A1.6. Bank Profitability Indicators

| Institution | Total assets (millions \$) | Equity-to-assets (%) | Net interest margin (%) | Net income-to-assets (%) | Loans-to-assets (%) | NPL-to-total loans (%) |
|-------------------------------------|----------------------------|----------------------|-------------------------|--------------------------|---------------------|------------------------|
| CHASE BANK | 3,395,126 | 8.8% | 2.7% | 1.4% | 35.7% | 0.8% |
| BANK OF AMERICA | 2,540,116 | 9.3% | 2.4% | 1.1% | 37.1% | 0.8% |
| WELLS FARGO BANK | 1,733,244 | 9.4% | 3.2% | 1.3% | 50.0% | 1.4% |
| CITIBANK | 1,684,710 | 9.7% | 2.8% | 0.7% | 26.7% | 1.2% |
| U.S. BANK | 650,659 | 9.5% | 2.8% | 0.9% | 57.7% | 1.1% |
| PNC BANK | 557,463 | 9.0% | 2.6% | 1.0% | 56.9% | 1.0% |
| BMO BANK | 265,658 | 12.4% | 2.9% | 0.2% | 55.9% | 1.0% |
| FIRST-CITIZENS BANK & TRUST COMPANY | 213,618 | 10.0% | 3.2% | 5.4% | 62.5% | 0.8% |
| FLAGSTAR BANK | 116,257 | 10.0% | 2.7% | 2.1% | 73.8% | 1.4% |
| CITY NATIONAL BANK | 93,373 | 11.0% | 2.9% | -1.7% | 68.8% | 0.5% |
| ZIONS BANCORPORATION | 87,203 | 6.5% | 2.8% | 0.8% | 66.3% | 0.4% |
| COMERICA BANK | 85,902 | 6.6% | 3.0% | 1.0% | 60.5% | 0.4% |
| EAST WEST BANK | 69,479 | 9.4% | 3.3% | 1.7% | 71.9% | 0.2% |
| VALLEY NATIONAL BANK | 60,944 | 11.9% | 2.8% | 0.9% | 82.4% | 0.6% |
| CIBC BANK USA | 54,847 | 16.7% | 3.2% | 1.5% | 60.8% | 1.0% |
| UMPQUA BANK | 52,167 | 10.3% | 3.5% | 0.7% | 71.8% | 0.3% |
| MIDFIRST BANK | 36,651 | 10.0% | 2.7% | 1.3% | 82.4% | 9.5% |
| BANK OZK | 34,237 | 15.0% | 4.2% | 2.0% | 77.3% | 0.3% |
| FIRSTBANK | 28,121 | 5.1% | 2.4% | 1.0% | 58.2% | 0.1% |
| SOFI BANK | 24,063 | 14.1% | 4.7% | 1.5% | 82.4% | 0.1% |

SOURCE: Call Reports as of 12/31/23 reported by the FFIEC Central Data Repository's Public Data Distribution.

NOTE: The table lists different bank profitability indicators for the year 2023 for the banks in our sample on the top-20 list in terms of total assets.

A1.6 Literature Reviews

Redlining

Redlining, a discriminatory practice embedded in the history of mortgage lending, continues to significantly contribute towards financial exclusion in the U.S. To explore the impact of redlining on the unbanked population in California, a literature search was conducted using

Google Scholar.³⁶ The search focused on publications from 1984 onwards using the keywords “bank* desert AND California AND redlin*”, resulting in 125 relevant articles.

Each article was initially reviewed to determine its relevance to the impact of redlining on the unbanked. Out of these, 11 articles that addressed this impact were selected for further analysis. The key findings from the selected articles were synthesized to summarize the broader implications of redlining on access to banking services and financial inclusion.

Analysis shows that redlining continues to significantly contribute to financial exclusion.³⁷ Literature highlighting the impact of redlining on unbanked populations focuses on long-standing urban infrastructure inequities and the effectiveness of regulatory mechanisms designed to promote fair access to credit, such as the *Community Reinvestment Act (CRA)*.

Established in 1977, the CRA requires lenders to be rated based on their success in serving the diverse credit needs across all income segments within their communities. Despite its critical role as a benchmark for assessing bank performance and community access to financial services, the effectiveness of the CRA and similar measures continues to face scrutiny. A key issue identified in the literature review is grade inflation with CRA evaluations, whereby a disproportionate number of banks receive high ratings that do not accurately reflect their actual service to low- and moderate-income communities. The findings suggest that introducing a grading curve could establish a relative ranking among banks based on their actual performance, thus limiting the number of top ratings and compelling a more discerning and potentially more accurate assessment of bank activities. Expanding CRA regulation to include non-bank lenders is also recommended to ensure broader investment in communities impacted by redlining.³⁸

Research findings further indicate that historical discriminatory practices have resulted in persistent disparities in urban neighborhood infrastructures.³⁹ These disparities are likely contributors to the high rates of unbanked households in certain areas, particularly in predominantly low-income and marginalized areas. Limited access to banking services in these communities intensifies their financial exclusion.

The role of data mining in identifying discriminatory practices like redlining is critically examined. Challenges such as frequent reliance on statistical analysis to detect discrimination, data misuse, and the potential for misinterpreting statistical results complicate efforts to address the root cause of financial exclusion.⁴⁰

³⁶ Google, "Google Scholar." <https://scholar.google.com/>

³⁷ Bybee, Jared, "Fair Lending 2.0: A Borrower-Based Solution to Discrimination in Mortgage Lending," *University of Michigan Journal of Law Reform*, Vol. 45, No. 1, 2011.

³⁸ Conti-Brown, Peter and Brian Feinstein, "Banking on a Curve: How to Restore the Community Reinvestment Act," *Harvard Business Law Review* Vol. 13, No. 2, 2023. .

³⁹ Li, Zheng, *Equity Of Urban Neighborhood Infrastructure: A Data-Driven Assessment*, Civil and Environmental Engineering Theses and Dissertations: Southern Methodist University, 2022.

⁴⁰ Bunting, William, "The Impact of Data Mining on Information Disclosure by Regulatory Agencies: With an Application to Redlining," *Harvard Journal on Legislation*, Vol. 355, August 20, 2018, 2019.

Additional research on historically redlined areas shows persistent issues, including lower income levels, poor health outcomes,⁴¹ and pronounced segregation. These areas are also targeted by predatory lending practices, a trend that was particularly notable during the 2008 financial crisis.⁴²

These findings underscore the need for targeted reforms to address redlining and enhance financial inclusion. Such measures are essential to effectively reduce the rate of unbanked individuals.

ChexSystems

We conducted a systematic literature review on the impact of *ChexSystems* on access to financial services for unbanked individuals. We reviewed academic journals and government reports by searching multiple databases with a Title-Abstract keyword search for “ChexSystem*”: *EBSCO* (Academic Search Complete, Business Search Complete, Military & Government Collection), *Web of Science*, and *Google Scholar*. When the full text of an article was not available, we reviewed the abstract. This initial search yielded 43 non-duplicative results, of which 3 were not relevant to the CalAccount proposal. We reviewed and summarized each relevant article.⁴³

The articles included in the literature review highlighted the possible significant impact that *ChexSystems* has on both individuals and financial institutions. Much of the available literature consists of articles and announcements from financial industry trade publications or news stories around former New York State Attorney General Eric Schneiderman’s efforts to change the banking industry’s use of *ChexSystems*. Some banks reported increased customer satisfaction after adopting *ChexSystems* due to the decreased time needed to open an account. Several articles interviewed individuals that were negatively impacted by *ChexSystems* and raised concerns around the use of *ChexSystems* data disproportionately impacting low-income individuals. Another area of the literature that included reference to *ChexSystems* focuses on the impact of financial education and benefits programs broadly, to the extent that the programs mention participants reported to *ChexSystems* or interventions designed to respond to *ChexSystems*.

ChexSystems Literature Review Reference List

The following reference list includes relevant articles identified as part of the *ChexSystems* literature review.

⁴¹ Rocha, Erika and Gabriela Herrera, "Salinas’ Health Struggles as Manifestations of Historical Processes: A Report on the History of Health of Salinas Residents," *Pathways: Stanford Journal of Public Health*, Vol. 1, No. 1, 2023.

⁴² Ray, Rashawn and Hoda Mahmoudi, *Systemic Racism in America Sociological Theory, Education Inequality, and Social Change*: Routledge, 2022.

⁴³ This annotated reference list is included as appendix F.1 to this annex.

"Your Customer's First Checking Account"

The article describes how Putnam State Bank in Connecticut supports individuals opening their first checking account, including explaining the bank's use of ChexSystems.

(Wollenberg)

Provides instructions for consumers to access ChexSystems reports.

(Campbell)

The article describes how one bank, Central Bank, uses ChexSystems and considered using QualiFile to inform decisions around account opening and its impact on the number of accounts opened.

(Beckett)

Articles describes changes made by banks, including Wells Fargo and Washington Mutual, to change their use of ChexSystems data.

(Beckett)

Article describes bank's agreement to consider changes in their use of ChexSystems data in response to concerns from stakeholders.

(Beckett)

Articles describes criticism of bank's use of ChexSystems data to prevent individuals from opening bank accounts.

(Bjerke)

Describes how credit unions can use ChexSystems to reduce fraud risk.

(Boel)

This article reviews reasons individuals are underbanked in the United States, including NSF fees. The article explains the role of ChexSystems in reporting checking account information, such as overdrafts, but notes that limited information is available on how banks use ChexSystems information to inform decisions around opening accounts.

(Callaway),

The article responds to a question and clarifies that ChexSystems is considered a consumer reporting agency according to the Fair Credit Reporting Act. [RAND summary]

(Collins)

This article describes the literature on financial education programs, including a program for individuals who have been reported to ChexSystems. The article reported mixed results on the effectiveness of financial literacy programs and noted concerns related to selection bias and attrition in examining program effectiveness.

(Collins)

This paper describes financial coaching as a separate model from financial planning and financial counseling. It described the theory and training opportunities informing financial planning. It specifically speaks to the role financial coaching can play to low-income individuals.

(Campbell)

This paper describes a multivariate analysis to identify driving factors of involuntary bank account closures using data from a variety of sources, including ChexSystems. The analysis found that increased and/or more frequent involuntary account closures were related to several variables, including low wealth and education levels and high rates of property crime.

(Chu)

Describes how banks use ChexSystems and how identify theft may impact consumers.

(Emple)

This report describes an HUD rental assistance program that aims to help participants build wealth by providing credits equal to a portion of rent equivalent to any rent increases due to wage increases into an escrow account on their behalf. The report summarizes evaluations of the program. The report mentions that participants may receive financial education services, including assistance accessing financial services after receiving a report in ChexSystems.

(Fellowes)

This article discusses the reasons that some individuals do not have checking accounts, including nonfinancial reasons. The article further discusses the geographic distribution of banks and non-bank institutions at the national level. The calculates the potential impact of access to checking accounts on wealth building. The article describes the possibility of a public-private partnership increasing access to checking accounts.

(Franz)

This dissertation uses mixed methods research to examine the extent to which the Family Scholar House program impacted health and financial outcomes of participants. One variable considered was whether the participant knew they had a ChexSystems report.

(Gerstner)

The article explains identify theft risks associated with bank accounts. The article describes the information collected by ChexSystems and how consumers can access their ChexSystems reports.

(Kim)

This article summarizes concerns about low-income individuals being negatively affected by ChexSystems.

(Miller)

This meta-analysis reviews the impact of financial education interventions. One of the included papers examines an interventions specifically targeted to individuals who had been reported to ChexSystems.⁴⁴

(Murphy)

⁴⁴ Haynes-Bordas, Rebecca, D. E. Kiss, and Tansel Yilmazer, "Effectiveness of Financial Education on Financial Management Behavior and Account Usage: Evidence from a 'Second Chance' Program," *Journal of Family and Economic Issues*, Vol. 29, 2008.

Article describes services, including ChexSystems, that help companies identify sources of fraud risk.

(Newberger)

Article describes challenges immigrants face in opening bank accounts, including ChexSystems, as well as ways in which banks accommodate the specific needs of immigrants.

(Perez)

At the time of the article, “ChexSystems maintains negative records on more than 19 million checking accounts.” Perez (2005) argues that standards for reporting can vary by the customer where minor infractions may lead to disproportionate impacts to a customer’s ability to bank as banks can reject customers for a single infraction. With these characteristics in mind, Perez argues that ChexSystems gives a disproportionate amount of power to banks. Notably, this system does not identify problematic banking behavior as you may expect from a credit reporting system. Rather, banks report accounts and what constitutes as problematic behavior is up to the reporting bank. Furthermore, positive banking information is not required for reporting.

Part I of this article explains the development of banking services and their impact on low-income communities. Part II discusses ChexSystems in more detail, including how the system differs from credit bureau reporting. Part III outlines the implications of the system described in Part II on the population described in Part I.

(Peterson)

The articles describes Gold Coast Federal Credit Union’s Fresh Start Checking Account, which is available to individuals with a ChexSystems report.

Articles about New York State ChexSystems Changes: The news and industry articles below report on former New York State Attorney General Eric Schneiderman’s efforts to change the banking industry’s use of ChexSystems, including which announcements of the banks that made changes in response to his efforts.

("Expanding Low-Income Consumers’ Access to Bank Accounts,")

(Caruthers)

(Huang)

(McCormick)

Announcements of Banks Adopting ChexSystems: The news and industry articles below report on individual banks adopting ChexSystems.

(Bills)

(Jepson)

(Jepson)

(Ramsaran)

("Tech Bytes: Small Ark. Bank to Use An MI Core System,")

Full Text Unavailable (list currently includes source summary):

("Eye On The Competition,")

The article presents information about the Fresh Start Checking Account scheme offered by First Class American Credit Union for members who fail to qualify for regular checking accounts due to past account and check abuse or overdrawn accounts. In the process of account review after 12 months, if the member is found responsible for the account and has settled the ChexSystems claims, his account will be converted to the free checking account of the credit union with over-draft protection.

("NY AG Announces Capital One Commitment to Expand Access to Bank Accounts,")

The article reports on the statement of New York Attorney General Eric T. Schneiderman claiming on June 16, 2014 that bank holding company Capital One Financial Corp. has agreed to adopt policies governing its ChexSystems, a consumer credit reporting agency. He commends the company for working the government in eliminating unnecessary barrier in opening a checking or savings account. Schneiderman adds that the system pushes lower-income Americans for relatively small financial errors.

("Citibank Commits to Eliminate Checking and Savings Account Barriers,")

The article reports on the announcement of New York attorney general Eric T. Schneiderman regarding the commitment of Citibank NA to adopt new policies concerning its consumer reporting agency ChexSystem, which screens customers who want to open checking or savings accounts.

(Bills)

eFunds Corp. of Scottsdale, Arizona, said Monday that MicroBilt Corp., a division of the venture firm Bristol Investments Ltd., will offer its financial services clients identity-verification services from eFunds' ChexSystems Inc. MicroBilt, of Kennesaw, Georgia, already provides financial companies with credit bureau reports and other data on criminal convictions, bankruptcies, liens, judgments, motor vehicle, employment background, and bank history. Financial companies can access the offerings through MicroBilt's CreditCommander.com Web site or integrate them into an in-house system using MicroBilt's software tools.

(Hollister)

This chapter reviews both attempts to evaluate the impacts of community development financial institutions (CDFIs) and methods of evaluation.

(McKendry)

New York Attorney General Eric Schneiderman is urging banks to reevaluate how they use credit bureaus like ChexSystems, after his investigation found that inaccurate data reported by banks is preventing some consumers from opening checking and savings accounts. Three banks already have agreed to modify their use of ChexSystems in screening potential customers.

(Nemeroff)

The article reports on the decision of financial services firm Citigroup to change its policies as of January 2015 that prevented low-income consumers from opening checking and savings accounts. Topics include the plan of the company to update its use of ChexSystems, a consumer reporting agency, the revamp to be done on its account-base screening, and Citi's

support for U.S. Attorney General Eric Schneiderman's aim to remove unnecessary barriers to banking products and services.

(Passy)

The article details the plan of Santander Bank to change its customer screening policies in 2015. Topics discussed include the bank's decision to allow more lower-income applications to open checking and savings accounts, the changes in the way the company uses the ChexSystems consumer reporting database, and New York attorney general Eric Schneiderman's inquiry into the ChexSystems' role in the screening process.

(Robins)

Reports on the creation of the Bankcheck Fraud Task Force by the National Retail Federation (NRF) and the American Bankers Association (ABA). Goals; Participation of banks in Southern California; Data sharing program for closed accounts; SCAN and ChexSystems.

Not Relevant:

(Sun)

Appendix B. CalAccount Legal Issues

This appendix analyzes potential legal issues posed by CalAccount. Below, we discuss law related to CalAccount features described in AB 1177, legal issues noted in the RFP for this study, and legal issues raised during stakeholder interviews.

Bank Secrecy Act/Anti-Money Laundering (“BSA/AML”), Know Your Customer, and Customer Identification Program obligations

Background

Bank Secrecy Act/Anti-Money Laundering (“BSA/AML”) compliance obligations consist of an intertwined set of statutes and regulations.⁴⁵ Although the sections below discuss the three separate types BSA/AML compliance obligations, an overarching theme is that compliance obligations will vary by each financial institution. As one commentator notes: “[T]he core concept of BSA/AML compliance is one of a risk-based approach, that is, that a financial institution should match regulatory obligations to methodologies of revenue generation and operations as applicable to different financial institutions, based on a myriad of factors such as the size, business model, and geographic location of the bank.”⁴⁶ As further detailed below, three primary categories of BSA/AML compliance obligations include: (1) Know Your Customer (“KYC”), (2) reporting requirements, and (3) sanctions compliance.⁴⁷ **Of these three compliance obligations, the language of the California Public Banking Option Act (AB 1177) and our interviewees suggest that KYC obligations (and particularly Customer Identification Programs implemented pursuant to KYC obligations) are of primary concern.** As further detailed below, KYC obligations require banks to verify the identity of customers using documents, non-documentary methods, or a combination of both.

The California Public Banking Option Act (AB 1177) notes that CalAccount is intended to serve:

- “individuals who may not have federal or state government-issued photo identification”⁴⁸ and

⁴⁵ Howard, Cory, "The Applicability of the BSA/AML Regulatory Regime to Indirect Lending Business Models," *Transactions: The Tennessee Journal of Business Law*, Vol. 19, No. 1, 2017. .

⁴⁶ _____.

⁴⁷ *See* _____, 19, 45, 52-56.

⁴⁸ Section 100104(a)(1)(K) of the California Public Banking Option Act (AB 1177) states, in part, that “the board, in establishing processes for enrollment in the CalAccount Program: (i) Shall facilitate the opening of a CalAccount by individuals who may not have federal or state government-issued photo identification while taking all reasonable steps to maintain the confidentiality of personal information consistent with all applicable law.”

- “individuals who do not have permanent housing.”⁴⁹

Some interviewees⁵⁰ noted that BSA/AML compliance, and KYC obligations in particular, may pose one of the greatest risks for financial institutions partnering to provide CalAccounts, but other interviewees,⁵¹ including interviewees with knowledge of the Bank On program and an attorney who represents unbanked and underbanked individuals in California, do not believe that KYC obligations would pose a particularly high risk.⁵² Interviewees who took the latter position noted that financial institutions can accept tribal IDs, passports from other countries, consular IDs, and city-issued IDs like those offered in San Francisco.⁵³

Relevant Laws, Policy, and Guidance

Know Your Customer – Customer Identification Program, Generally

Federal anti-money laundering (AML) laws, notably the Bank Secrecy Act (BSA), 31 U.S.C. § 5311 *et seq.*, aim to prevent the flow of illicit money by requiring financial institutions authenticate customer identities. After the events of September 11, 2001, the USA PATRIOT Act, which requires banks to adopt a customer identification program (CIP), was incorporated into the BSA.⁵⁴ The regulations define customers as (1) “[a] person that opens a new account” or (2) “[a]n individual who opens a new account for [a]n individual who lacks legal capacity, such as a minor or “[a]n entity that is not a legal person, such as a civic club.”⁵⁵ Federal regulations require banks, savings associations, credit unions, and certain non-federally regulated banks⁵⁶ to implement a CIP “based on the bank’s assessment of the relevant risks, including those presented by the various types of accounts maintained by the bank, the various methods of opening accounts provided by the bank, the various types of identifying information available, and the bank’s size, location, and customer base.”⁵⁷ However, at a minimum, the procedures for opening

⁴⁹ Section 100104(a)(1)(K) of the California Public Banking Option Act (AB 1177) states, in part, that “the board, in establishing processes for enrollment in the CalAccount Program: ... (ii) Shall design and establish rules governing the enrollment and participation in the program of individuals who do not have permanent housing.”

⁵⁰ Interviews with banking services and industry experts (Participants 108, 109, and 110)/

⁵¹ Interviews with State and legal SMEs (Participants 131-133).

⁵² Interviews with Participants 131-133.

⁵³ Interviews with Participants 131-133..

⁵⁴ Office of the Comptroller of the Currency, "Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual." As of October 31:

<https://www.occ.treas.gov/topics/supervision-and-examination/bsa/index-bsa.html>

⁵⁵ 31 C.F.R. § 1020.100(c).

⁵⁶ The regulations refer to “banks” when describing CIP requirements, but as noted in the title of 31 C.F.R. § 1020.220, CIP regulations apply to banks and credit unions. The CIP requirements described in this section of the Appendix apply to both banks and credit unions.

⁵⁷ 31 C.F.R. § 1020.220(a)(2).

an account must include collection of: (1) name, (2) date of birth for an individual, (3) address (see section below on *Individuals who do not have permanent housing*), and (4) identification number (taxpayer identification number for “U.S. people,” other options for “non-U.S. people”).⁵⁸ With respect to the identification number requirement, the regulations explicitly allow noncitizens to provide Individual Taxpayer Identification Numbers (ITINs) from the U.S. government, foreign passports, or “any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.”⁵⁹ Banks may not always need to collect customer information directly, as they can rely on information collected by another financial institution where the second institution has established similar banking services.⁶⁰ However, this reliance must be reasonable, evidenced by a written contract, and subject to anti-money laundering compliance responsibilities.⁶¹ A person, including a bank employee, who willfully violates the BSA or its implementing regulations is subject to a criminal fine of up to \$250,000 or five years in prison, or both.⁶²

Individuals who may not have federal or state government-issued photo identification

On their website, the CFPB addresses the question of whether individuals can get bank accounts without a driver’s license. The CFPB notes:

“Banks and credit unions are required to verify your identity when you apply to open an account. If you don’t have a driver’s license, ask what other types of identification will be accepted. The most common way to verify your identity is with a driver’s license. There are other ways banks and credit unions can verify your identity, so if you don’t have a driver’s license, ask the bank or credit union what types of identification it will accept.

The rules leave some discretion to banks and credit unions on what forms of ID to accept” (emphasis added).⁶³

Federal regulations require banks to include **a description of how banks verify the identity of customers, including “when the bank will use documents, non-documentary methods, or**

⁵⁸ 31 C.F.R. § 1020.220(a)(2)(i)(A). See Federal Financial Institutions Examination Council, *BSA/AML Manual*, 2014. <https://bsaaml.ffiec.gov/manual/Introduction/01#:~:text=For%20example%2C%20a%20person%2C%20including,years%20in%20prison%2C%20or%20,> p. 3, footnote 15.

For “non-U.S. people, identification numbers may include: “Customer’s TIN, Passport number and country of issuance, Alien identification card number, and Number and country of issuance of any other (foreign) government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.” p. 8.1-10.

⁵⁹ 31 C.F.R. § 1020.220(a)(2)(i)(A)(4)(ii).

⁶⁰ Howard.

⁶¹ ———., citing 31 C.F.R. § 1020.220(a)(6); 31 U.S.C. § 5318(h)(1).

⁶² Federal Financial Institutions Examination Council.

⁶³ Consumer Financial Protection Bureau, “Can I get a checking account without a driver's license?,” August 19, 2020. As of 2023:

a combination of both methods.” The regulations explicitly provide for verification through both documentary and nondocumentary methods:

“(A) Verification through documents. For a bank relying on documents, the CIP must contain procedures that set forth the documents that the bank will use. These documents may include:

(1) For an individual, unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver’s license or passport; and

(2) For a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or trust instrument.

(B) Verification through non-documentary methods. For a bank relying on non-documentary methods, the CIP must contain procedures that describe the non-documentary methods the bank will use.

(1) These methods may include contacting a customer; independently verifying the customer’s identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source; checking references with other financial institutions; and obtaining a financial statement.

(2) The bank’s non-documentary procedures must address situations where an individual is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard; the bank is not familiar with the documents presented; the account is opened without obtaining documents; the customer opens the account without appearing in person at the bank; and where the bank is otherwise presented with circumstances that increase the risk that the bank will be unable to verify the true identity of a customer through documents” (emphasis added).⁶⁴

Note that under 31 C.F.R. § 1020.220(a)(2)(ii)(B), financial institutions relying on non-documentary methods must already address “situations where an individual is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard” in their CIPs.

With respect to documentary methods, the FDIC notes: “A bank that accepts items that are considered secondary forms of identification, such as utility bills and college ID cards, is encouraged to review more than a single document to ensure that it has formed a ‘reasonable belief’ of the customer’s true identity.”⁶⁵ In official guidance, the National Credit Union (NCUA) association has noted that although CIP regulations reflect an “expectation that banks

⁶⁴ 31 C.F.R. § 1020.220(a)(2)(ii)(B).

⁶⁵ Federal Deposit Insurance Corporation, *DSC Risk Management Manual of Examination Policies 8.1-55 Bank Secrecy Act (12-04)*. As of October 31, 2023:

will obtain government-issued identification from most customers,... other forms of identification may be used if they enable the bank to form a reasonable belief that it knows the true identity of the customer.”⁶⁶ In light of this, the NCUA notes that other forms of identification, including an employee identification card, “may be used if they enable the bank to form a reasonable belief that it knows the true identity of the customer,” but cautions that, “given the availability of counterfeit and fraudulently obtained documents, a bank is encouraged to obtain more than a single document to ensure that it has a reasonable belief that it knows the customer’s true identity.”⁶⁷

With respect to non-documentary methods, the FDIC also notes that “**in instances when an account is opened over the Internet**, a bank may be able to obtain an electronic credential, such as a digital certificate, as one of the methods it uses to verify a customer’s identity” (emphasis added).⁶⁸

In addition, the FDIC provides the following guidance on verifying customer identity information:

“The CIP should rely on a risk-focused approach when developing procedures for verifying the identity of each customer to the extent reasonable and practicable. **A bank need not establish the accuracy of every element of identifying information obtained in the account opening process, but must do so for enough information to form a “reasonable belief” that it knows the true identity of each customer.** At a minimum, the risk-focused procedures must be based on, but not limited to, the following factors:

- Risks presented by the various types of accounts offered by the bank;
- Various methods of opening accounts provided by the bank;
- Various sources and types of identifying information available; and
- The bank’s size, location, and customer base” (emphasis added).⁶⁹

Implementation of REAL ID requirements likely will not impact the analysis above. In its *Final Rule on Minimum Standards for Driver's Licenses and Identification Cards Acceptable by Federal Agencies for Official Purposes*, DHS noted that it “does not intend that REAL ID

⁶⁶ National Credit Union Administration National Credit Union Administration, "Interagency Interpretive Guidance on Customer Identification Program Requirements under Section 326 of the USA PATRIOT Act," April 28, 2005. As of October 31:

<https://www.fincen.gov/resources/statutes-regulations/guidance/interagency-interpretive-guidance-customer-identification>.

⁶⁷ _____.

⁶⁸ Federal Deposit Insurance Corporation.

⁶⁹ Federal Deposit Insurance Corporation. “DSC Risk Management Manual of Examination Policies 8.1-55 Bank Secrecy Act (12-04),” p. 8.1-10. Accessed on Oct. 31, 2023, <https://www.fdic.gov/regulations/safety/manual/section8-1.pdf>. See also <https://www.fdic.gov/news/financial-institution-letters/2021/fil21012b.pdf>.

documents become a de facto national ID and does not support the creation of a national ID” and that it has “limited ‘official purposes’ to those set forth in the Act--accessing Federal facilities, boarding Federally-regulated commercial aircraft, and entering nuclear power plants.”

As one interviewee noted, financial institutions sometimes use third-party KYC services such as Socure.⁷⁰

Individuals who do not have permanent housing

According to federal CIP regulations, for an individual, banks need to obtain “a residential or business street address, or if the individual does not have such an address, an Army Post Office (APO) or Fleet Post Office (FPO) box number, or the residential or business street address of next of kin or of another contact individual.”⁷¹ Guidance provided by the Board of Governors of the Federal Reserve System, the FDIC, Financial Crimes Enforcement Network, the NCUA, the OCC, the Office of Thrift Supervision, and the U.S. Department of the Treasury notes that for purposes of compliance with this requirement, the number on the roadside mailbox on a rural route, a residential or business address for next of kin or another contact individual, or a description of a customer’s physical location will suffice:

“[T]he number on the roadside mailbox on a rural route is acceptable as an address. A rural route number, unlike a post office box number, is a description of the approximate area where the customer can be located. In the absence of such a number, and in the absence of a residential or business address for next of kin or another contact individual, a description of the customer’s physical location will suffice.”⁷²

In the context of veterans experiencing homelessness who wish to open a bank account, the Department of Veterans’ Affairs (VA) notes that “A VA Homeless Coordinator’s office address can be used in place of a home address when the accountholder has a valid VA ID and does not have a permanent address to provide to the financial institution. A financial institution can accept the residential or business address of another contact individual, such as the aforementioned VA Homeless Coordinator.”⁷³

⁷⁰ Interview with banking industry and service experts (Participants 121 and 122). *See also* PYMNTS, “Dibbs Taps Socure for ‘Know Your Customer’ Platform, Identity Verification,” 2022. <https://www.pymnts.com/nfts/2022/dibbs-taps-socure-for-know-your-customer-platform-identity-verification/>.

⁷¹ 31 C.F.R. § 1020.220(a)(2)(i)(A)(3).

⁷² Financial Crimes Enforcement Network, *Interagency Interpretive Guidance on Customer Identification Program Requirements under Section 326 of the USA PATRIOT Act*, Treasury, U.S. Department of the, 2005.

⁷³ Veterans Benefits Administration, *Opening an Account at A Financial Institution for Veterans without Permanent Housing*, U.S. Department of Veterans Affairs.

Responsibility For Customer Identification Programs

Agent responsibility for Customer Identification Programs will also require legal analysis once the structure of the program is more certain. As reflected in the statutory history of AB 1177: “Banks and credit unions oppose this bill and cite a number of challenges that prevent their participation. **The program’s structure – with enrollment facilitated through a state could raise issues about who is fulfilling Know Your Customer (KYC) regulatory obligations or federal obligations around consumer privacy and security**” (emphasis added).⁷⁴

Because the CalAccount program design is in early stages, it is difficult to determine whether an agency relationship will exist between the program and banks for CIP purposes. Nonetheless, guidance issued by the Board of Governors of the Federal Reserve System, the FDIC, Financial Crimes Enforcement Network, the NCUA, the OCC, the Office of Thrift Supervision, and the U.S. Department of the Treasury on the subject of CIP requirements and holders of prepaid cards seems instructive.⁷⁵ The purpose of this guidance was to clarify that “a bank should apply its CIP to the cardholders of certain prepaid cards issued by the bank” even if “a bank issues prepaid cards under arrangements with third-party program managers that sell, distribute, promote, or market the prepaid cards issued by the bank.”⁷⁶ As the guidance notes:

“General purpose prepaid cards can be used at multiple, unaffiliated merchants and can allow cardholders to perform a variety of functions, including those that have traditionally been conducted using other payment mechanisms, such as checks, debit cards tied to bank accounts, or credit cards. These functions include withdrawing cash at automated teller machines (ATMs), paying bills, purchasing goods and services, and transferring funds to other cardholders and receiving funds transfers. Employers use prepaid cards to provide wages and other compensation or benefits, such as pre-tax flexible spending arrangements for healthcare expenses or dependent care. State, federal, and local governments use these financial products to distribute government benefits and tax refunds.”

Although the CalAccount program is not a pre-paid card program, like third-party providers of prepaid cards, CalAccount administrators will be conducting outreach/marketing, interfacing with customers, and providing them with a tool to withdraw cash, pay bills, make purchases, and receive wages and benefits. The guidance notes:

“Third-party program managers should be treated as agents of the bank for purposes of the CIP rule, rather than as the bank’s customer. The preamble to the final CIP rule makes clear that the rule does not affect a bank’s authority to contract for services to be performed by a third party either on or off the bank's premises, nor does it alter a bank’s

⁷⁴ *AB-1177 California Public Banking Option Act*, 2021.

⁷⁵ Financial Crimes Enforcement Network.

⁷⁶ _____.

authority to use an agent to perform services on its behalf. However, as with any other activity performed on behalf of the bank, the bank ultimately is responsible for compliance with the requirements of the bank’s CIP rule as performed by that agent or other contracted third party.

Third-party program managers may establish pooled accounts in their names for the purpose of holding funds ‘on behalf of’ or ‘in trust for’ cardholders or processing transactions on behalf of other issuing banks. However, the fact that these funds are held in a pooled account should not affect the status of the cardholder as a bank customer, assuming the cardholder has established an account with the bank by activating the reloadable functionalities of a general purpose prepaid card, or its credit or overdraft features.”⁷⁷

The guidance concludes by recommending that banks “enter into well-constructed, enforceable contracts with third-party program managers that clearly define the expectations, duties, rights, and obligations of each party.”⁷⁸ The contract or binding agreement should:

- “outline CIP obligations of the parties;
- ensure the right of the issuing bank to transfer, store, or otherwise obtain immediate access to all CIP information collected by the third-party program manager on cardholders;
- provide for the issuing bank’s right to audit the third-party program manager and to monitor its performance (generally, banks need to ensure that periodic independent internal and external audits are conducted to ensure prudent operations and compliance with applicable laws and regulations); and
- if applicable, indicate that, pursuant to the Bank Service Company Act (BSCA) or other appropriate legal authority, the relevant regulatory body has the right to examine the third-party program manager.”⁷⁹

One of our interviewees who works for a bank noted that liability for CIP requirements will depend on how CalAccount is structured, *e.g.*, will the individuals with CalAccounts have their own individual accounts with a participating financial institutions or will the state-run program hold FBO accounts (umbrella account that pools funds “for the benefit of” end-users.)⁸⁰ The interviewee noted that from a practical perspective, CIP/KYC requirements may ultimately be handled through a third-party entity like Socure that specializes in CIP/KYC requirements.⁸¹

⁷⁷ _____.

⁷⁸ _____.

⁷⁹ _____.

⁸⁰ Interview with banking industry and services experts on January 3, 2024 (Participants 121 and 122).

⁸¹ Interview with Participants 121 and 122.

Know Your Customer – Customer Due Diligence Programs

Financial institutions must also develop Customer Due Diligence programs to understand “the nature and purpose of customer relationships for the purpose of developing a customer risk profile” so that the institution can monitor transactions and detect and report suspicious transactions.⁸² A customer risk profile (which rate customers for potential money laundering and terrorist financing risks) is a key part of these requirements.⁸³ High-risk customers may require “Enhanced Due Diligence.”⁸⁴

Reporting Requirements

Financial institutions are subject to reporting requirements as part of the anti-money laundering regulatory framework.⁸⁵ Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs) are two of “the more prominent and encompassing” reporting obligations.⁸⁶ CTRs must be filed when there has been a “deposit, withdrawal, exchange of currency or other payment or transfer, by through, or to such financial institution which involves a transaction in currency of more than \$10,000.”⁸⁷ SARs must be filed when a transaction is suspected to violate a law or regulation.⁸⁸

Sanctions Compliance

Financial institutions must comply with economic and trade sanctions imposed by the federal government on entities, people, ports, and vessels.⁸⁹ The Treasury Department’s Office of Foreign Asset Control (OFAC) maintains sanctions lists of entities with whom it is generally illegal for U.S. entities to do business.⁹⁰ Like other BSA/AML requirements, sanctions compliance practices vary based on risks and OFAC does not mandate how financial institutions should comply.⁹¹ Sanctions screening is a standard practice in the industry, involving screening the names of parties, entities, and vessels involved in a transaction.⁹²

⁸²Howard.

⁸³ _____.

⁸⁴ _____.

⁸⁵ _____.

⁸⁶ _____.

⁸⁷_____, citing 31 C.F.R. § 103.22(b)(1) (2011).

⁸⁸_____, citing 31 U.S.C. 5318(g)(1).

⁸⁹ _____.

⁹⁰ _____.

⁹¹ _____.

⁹²_____.

Takeaway

Financial institutions must comply with three primary categories of BSA/AML compliance obligations include: (1) Know Your Customer (“KYC”), (2) reporting requirements, and (3) sanctions compliance. Practical aspects of compliance with these obligations will vary by financial institution because these risk-based obligations will vary based on factors such as the size, business model, and geographic location of the bank.

Of these three compliance obligations, the language of the California Public Banking Option Act (AB 1177) and our interviewees suggest that KYC obligations (and particularly Customer Identification Programs implemented pursuant to KYC obligations) are of primary concern.

Under 31 C.F.R. § 1020.220(a)(2)(ii)(B), financial institutions relying on non-documentary methods must already address “situations where an individual is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard” in their CIPs.

Regulations and official guidance afford considerable discretion to financial institutions to verify accountholder identity, but financial institutions are responsible for weighing the risk of accepting non-governmental identification. Under CIP regulations, banks must collect: (1) name, (2) date of birth for an individual, (3) address (see Section 4 below on *Individuals Without Permanent Housing*), and (4) identification number (taxpayer identification number for “U.S. people,” other options for “non-U.S. people”) of its customers. Banks can use documents and non-documentary method to verify the identifying information obtained in the account opening process, but CIP procedures must ensure that banks have a “reasonable belief” that it knows the true identity of each customer. Bank employees who willfully violate the BSA are subject to criminal fines and/or imprisonment.

The address requirement under federal CIP regulations appears to be flexible. Official guidance suggests that a rural route number, a residential or business address for next of kin or another contact individual, a description of a customer’s physical location, or the office address of a VA Homeless Coordinator would suffice.

Given official guidance on third-party prepaid card programs (which are analogous to CalAccount, though CalAccount is not a prepaid card), banks would likely still be responsible for fulfilling CIP requirements for CalAccount users. CalAccount and partner financial institutions should enter into agreements that clearly define CIP obligations of the parties.

Individuals under the age of 18 (but at least 14)

Background

Section 100104(a)(1)(K) of the California Public Banking Option Act (AB 1177) states, in part, that “the board, in establishing processes for enrollment in the CalAccount Program: ... (iii) May design and establish rules governing the enrollment and participation in the program of

individuals who are under 18 years of age, including rules governing the opening of a CalAccount by a person who is at least 14 years of age without a cosigner or guarantor on the account consistent with all applicable law.”

Relevant Laws, Policy, and Guidance

According to the Federal Reserve:

“No federal law prohibits minors from opening savings accounts. Rather, a deposit account relationship is based on a contract governed by state law. In general, minors are deemed to not have the legal capacity to enter into a contract, including opening an account at a financial institution, meaning that a contract with a minor is potentially ‘voidable.’ However, some states specifically allow a minor to open a savings account.”⁹³

California law appears to allow minors to open non-custodial deposit accounts.⁹⁴

The Federal Reserve further notes that CIP regulations do not prohibit a minor from opening an account, but “the minor is the financial institution’s customer” and therefore the institution should use reasonable documentary or non-documentary methods to verify a minor’s identity and the CIP must contain “procedures that describe the non-documentary methods that the financial institution will use to verify a minor’s identity.” In addition,

“[t]hese methods may include contacting a customer or independently verifying the minor’s identity through the comparison of information provided by the minor with information obtained from a consumer reporting agency, public database, or other source.

⁹³ Federal Reserve, *Guidance to Encourage Financial Institutions’ Youth Savings Programs and Address Related Frequently Asked Questions* Treasury, U.S. Department of the, 2015. As of October 31, 2023:

⁹⁴ Conference of State Bank Supervisors, "Statutory Requirements for Opening Bank Accounts for Minors," 2021. As of October 31:

<https://www.csbs.org/statutory-requirements-opening-bank-accounts-minors>

- Cal. Fam. Code § 6700: Except as provided in Section 6701, a minor may make a contract in the same manner as an adult, subject to the power of disaffirmance under Chapter 2 (commencing with Section 6710), and subject to Part 1 (commencing with Section 300) of Division 3 (validity of marriage).
- Cal. Fam. Code § 6710. Right of disaffirmance: Except as otherwise provided by statute, a contract of a minor may be disaffirmed by the minor before majority or within a reasonable time afterwards or, in case of the minor's death within that period, by the minor's heirs or personal representative.
- Cal. Fam. Code § 6711. Contract made under express statutory authority: A minor cannot disaffirm an obligation, otherwise valid, entered into by the minor under the express authority or direction of a statute.
- Cal. Financial Code § 1400. Minors: A bank account by or in the name of a minor shall be held for the exclusive right and benefit of such minor and shall be paid to such minor or to his order and payment so made is a valid release and discharge to the bank for such deposit or any part thereof.
- Cal. Financial Code Sec. 850: A bank account by or in the name of a minor shall be held for the exclusive right and benefit of such minor and shall be paid to such minor or to his order and payment so made is a valid release and discharge to the bank for such deposit or any part thereof.

For example, the financial institution might verify a minor’s identity in an in-school program by having a teacher confirm the minor’s identity.”⁹⁵

Note that the Children’s Online Privacy Protection Act (COPPA), Pub. L. No. 105-277 (codified at 15 U.S.C. §§ 6501-6506), which restricts the collection of personal information from children, only applies to children under 13 years of age.

Takeaway

There do not appear to be any state or federal laws that would prohibit minors from participating in the CalAccount program.

1. Employer Direct Deposit

Background

Section 100104(a)(1)(O) of the California Public Banking Option Act (AB 1177) requires that:

“an employer with more than 25 employees and a hiring entity with more than 25 independent contractors performing the same or similar labor or service, excluding the federal government, to do all of the following: (i) Have and maintain a payroll direct deposit arrangement that enables voluntary worker participation in the program. (ii) Deposit all wages and other payments due a worker that the worker has authorized to be directly deposited by electronic fund transfer into the worker’s CalAccount in accordance with the worker’s authorization. (iii) Coordinate its payroll process with the program administrator’s application program interface to facilitate accurate and seamless payment by direct deposit in accordance with the authorization of each worker participant. (iv) Cooperate with the program administrator in providing all requested information available to the employer or hiring entity necessary for the opening and administration of a worker’s CalAccount. (v) Upon request of the administrator, provide additional forms or notifications to a worker. (vi) Refrain from discharging, disciplining, threatening to discharge or discipline, or in any other manner retaliating or taking an adverse action against a worker or applicant because of the individual’s participation or manner of participation in the CalAccount Program.”

As noted during the hearings on AB 1177:

⁹⁵ Federal Reserve.

“This bill also requires an employer, upon an employee’s request, to pay that employee’s wages via direct deposit into their BankCal account. This is a new type of requirement for employers. **Under current state law, an employer is not required to pay workers’ wages via direct deposit**”. Though worker participation in direct deposit is voluntary under the bill, an employer would have to maintain a payroll direct deposit arrangement in order to honor the employee’s request (emphasis added).”⁹⁶

Relevant Laws, Policy, and Guidance

The federal Electronic Fund Transfer Act (EFTA), also known as federal Regulation E, permits employers to make direct deposit mandatory, as long as the employee is able to choose the bank that his or her wages will be deposited into. Similarly, California Labor Code section 213 permits employers to pay employees via direct deposit, so long as the employee authorizes direct deposit.

The Federal EFTA and California Labor Code prohibit employers from making direct deposit mandatory. Citing California Labor Code Section 213 and the EFTA, the California Labor Commissioner’s Office’s Division of Labor Standards Enforcement (DLSE) notes:

“Employee choice is thus a fundamental condition for payment methods utilizing direct deposits under California wage payment law.” Also, the optional nature of an employee’s participation is further mandated under FRB’s Regulation E which states: ‘No financial institution or other person may require a consumer to establish an account for receipt of electronic fund transfers with a particular institution as a condition of employment or receipt of governmental benefit’ (12 CFR § 205.10(e)).”⁹⁷

Direct deposit is voluntary for employees under California Public Banking Option Act (AB 1177), so no EFTA or Section 213 issues are apparent.

Though state and federal law prohibit employers from making direct deposit mandatory for *employees*, there do not appear to be any laws that prohibit making direct deposit mandatory for *employers*. In fact, as reflected in California Public Banking Option Act (AB 1177) statutory history, California has already implemented a similar mandate under the CalSavers program, “which is an **automatic payroll deduction retirement savings program** for private sector

⁹⁶ AB-1177 California Public Banking Option Act.

⁹⁷ California Division of Labor Standards Enforcement (DLSE). “Re: Payroll/Debit Cards -Payment of Wages Labor Code §§ 212 and 213.” Accessed on October 31, 2023, <https://www.dir.ca.gov/dlse/opinions/2008-07-07.pdf>.

employees in California who lack access to a workplace retirement plan.”⁹⁸ As noted during the hearings on AB 1177:

“The proposed employer mandate is similar to the CalSavers employer requirement. As part of the CalSavers retirement program, an employer without an employer-sponsored retirement plan must facilitate the opening of a CalSavers retirement account. The mandate is the primary mechanism to boost participation so that more Californians save for retirement and CalSavers has enough participants to be sustainable.”⁹⁹

In addition, as opined during the hearing, the CalAccount mandate might be easier to implement than the CalSavers mandate because many employers already offer direct deposit:

“[A] vast majority of employers offer direct deposit already: According to an industry-sponsored survey, 82% of US workers in 2016 received their paychecks via direct deposit. In contrast, around half of US workers did not have access to an employer-based retirement account when CalSavers began. Thus, the environment that necessitated the creation of CalSavers’ employer requirement was much different than the environment in which the direct deposit requirement is being proposed.”¹⁰⁰

(Note that CalSavers has been challenged in court, but not on grounds that would apply to the CalAccount context. The CalSavers lawsuit argued that this state law on retirement accounts was preempted by federal law on retirement accounts. In addition, the U.S. Supreme Court declined to hear the lawsuit and the CalSavers program continues.¹⁰¹)

Takeaway

Requiring employers to have and maintain a payroll direct deposit arrangement that enables voluntary worker participation in the program does not pose any immediately apparent legal issues.

⁹⁸ California Secure Choice Retirement Savings Investment Board, *Summary of Senate Bill 1234*, Office, State Treasurer’s, October 24, 2016. .

⁹⁹AB-1177 California Public Banking Option Act.

¹⁰⁰ “California Public Banking Option Act: Hearing on A.B.1177 Before the Assemb. Comm. on Banking & Fin., 2020-2021 Reg. Sess. 7 (Cal. 2021).” Accessed on October 31, 2023, https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202120220AB1177#.

¹⁰¹ Adams, Nevin E. “SCOTUS Scuttles CalSavers Challenge.” National Association of Plan Advisors. March 01, 2022. Accessed on October 31, 2023, <https://www.napa-net.org/news-info/daily-news/scotus-scuttles-calsavers-challenge>.

2. Limiting the late payment fees and penalties that registered payees can impose

Background

Section 100104(a)(1)(I) of the California Public Banking Option Act (AB 1177) requires: “the board to establish the process and terms and conditions for becoming a registered payee, which shall at a minimum require the payee’s agreement to specified terms and conditions to be established by the board in exchange for the benefits of transparency and accountability afforded by participation in an automated payment system and which shall be designed to incentivize account holders’ preauthorized electronic fund transfers to registered payees and application of voluntary automatic disbursement rules by limiting the late payment fees and penalties that registered payees can impose on accountholders who pay them using preauthorized electronic fund transfers from their CalAccounts.”

Relevant Laws, Policy, and Guidance

Local governments prohibited late fees in the wake of the Covid pandemic.¹⁰² However, the legality and feasibility of requiring entities who register as payees to “limit[] the late payment fees and penalties that registered payees can impose on accountholders” is unclear. A consumer rights attorney whom we interviewed noted that they did not see any legal issues raised by this requirement but noted that from a logistics standpoint, utility companies and other entities may choose not to register as payees because of the late fee limitation.¹⁰³

Takeaway

Though limitation of late fees that registered payees may charge does not raise any immediately apparent legal issues, from a logistics standpoint, utility companies and other entities may choose not to register as payees because of the late fee limitation.

3. Payment of Rent via ETF from CalAccount

Background

Section 100104(a)(1)(P) of the California Public Banking Option Act (AB 1177) requires “a landlord or a landlord’s agent to allow a tenant to pay rent and deposit of security by an

¹⁰² For example, CA Civ Code § 1942.9 provides, in part: “a landlord shall not, with respect to a tenant who has COVID-19 rental debt, as that term is defined in Section 1179.02 of the Code of Civil Procedure, and who has submitted a declaration of COVID-19-related financial distress, as defined in Section 1179.02 of the Code of Civil Procedure, do either of the following: (1) Charge a tenant, or attempt to collect from a tenant, fees assessed for the late payment of that COVID-19 rental debt...”

¹⁰³ Interview with legal expert on December 13, 2023 (Participant 111).

electronic funds transfer from a CalAccount, except as provided in paragraph (2) of subdivision (a) of Section 1947.3 of the California Civil Code.” [Section 1947.3(a)(2) provides that “[a] landlord or a landlord’s agent may demand or require cash as the exclusive form of payment of rent or deposit of security if the tenant has previously attempted to pay the landlord or landlord’s agent with a check drawn on insufficient funds or the tenant has instructed the drawee to stop payment on a check, draft, or order for the payment of money. The landlord may demand or require cash as the exclusive form of payment only for a period not exceeding three months following an attempt to pay with a check on insufficient funds or following a tenant’s instruction to stop payment.”]

Section 100104(a)(1)(P) of the California Public Banking Option Act (AB 1177) makes clear that rental payments made using electronic funds transfer to the landlord do not waive the landlord’s right to establish the amount that the landlord charges for rent: “a landlord’s, or a landlord’s agent’s, receipt of payment from a CalAccount pursuant to the requirements of the CalAccount Program shall not be considered a waiver of any right the landlord or landlord’s agent may otherwise have to establish the base rent on, or to raise rent for, the rental unit.”¹⁰⁴

Relevant Laws, Policy, and Guidance

There do not appear to be any state or federal laws that would prohibit the CalAccount program from requiring a landlord or a landlord’s agent to allow a tenant to pay rent and deposit of security by an electronic funds transfer from a CalAccount. A consumer rights attorney whom we interviewed noted that they did not see any legal issues raised by this requirement, nor any reason why landlords would object to being paid through a CalAccount electronic funds transfer.¹⁰⁵

Though not directly on point, other California laws reflect a general intent to allow tenants to pay rent via a method of their choosing: Under California Civil Code Section 1947.3(a)(a), “a landlord or a landlord’s agent shall allow a tenant to pay rent and deposit of security by at least one form of payment that is neither cash nor electronic funds transfer.” Assembly Bill 2219 (codified as an amendment to Civil Code § 1947.3) requires a landlord or landlord’s agent to allow a tenant to pay rent through a third party.

Takeaway

Requiring a landlord or a landlord’s agent to allow a tenant to pay rent and deposit of security by an electronic funds transfer from a CalAccount does not pose any immediately apparent legal issues.

¹⁰⁴ AB-1177 California Public Banking Option Act.

¹⁰⁵ Interview with legal expert Participant 111.

4. Authority for respective credit unions to admit members for purposes of establishing a CalAccount

Background

California State Treasurer’s Office RFP No. SA000004-23 (p. 16 of 43) states that the CalAccount Market Study and Feasibility Report should consider the following: “Do current state and federal laws provide sufficient authority for respective credit unions to admit members for purposes of establishing a CalAccount?”

Relevant Laws, Policy, and Guidance

A consumer rights attorney whom we interviewed noted that they did not see any statutory or regulatory barriers or other immediately apparent legal issues associated with credit unions admitting members for the purposes of establishing a CalAccount. However, the interviewee noted that some credit unions charge very high overdraft fees and thus partnering with credit unions may not be the best option.¹⁰⁶ That said, credit unions do participate in BankOn¹⁰⁷ and thus some credit unions are able to provide accounts without overdraft fees (a core feature of Bank On accounts).¹⁰⁸ The general legal framework for credit union membership is summarized below.

Common Bond/Field of Membership

The NCUA regulates federal-chartered credit unions¹⁰⁹ and the DFPI regulates California state-chartered credit unions.¹¹⁰ Federal-¹¹¹ and state-chartered credit unions “are based on a common bond, which establishes the membership eligibility requirements.”¹¹² There are three types of federal credit union charters:

“(1) a single common bond (occupation or association based),

¹⁰⁶ Interview with legal expert on December 13, 2023 (Participant 111).

¹⁰⁷ BankOn, "Coalition Map." As of October 31:
<https://joinbankon.org/coalition-map/>.

¹⁰⁸ Cities for Financial Empowerment Fund, "Bank On National Account Standards (2021-2022)," Undated.
<https://cfefund.org/bank-on-national-account-standards-2021-2022/>.

¹⁰⁹ National Credit Union Administration, "About NCUA," May 9, 2024. As of October 31:
<https://ncua.gov/about/>.

¹¹⁰ Department of Financial Protection and Innovation, "Credit Unions," March 15, 2024. As of October 31:
<https://dfpi.ca.gov/credit-unions/>.

¹¹¹ “The National Credit Union Administration (NCUA), an independent federal agency, charters and supervises national-chartered credit unions for safety and soundness and insures members’ share deposits.” ()Congressional Research Service, *Introduction to Financial Services: Credit Unions*, U.S. Congress, IF11713, January 13, 2022.

¹¹² _____.

(2) a multiple common bond (more than one group each having a common bond of occupation or association), and

(3) a community-based (geographically defined) common bond.”¹¹³

The common bond is referred to as the credit union’s “field of membership.”¹¹⁴

California similarly requires a common bond amongst credit union members. Under California Financial Code § 14155(a), the Commissioner of Financial Protection and Innovation may deny “an application for a certificate to act as a credit union or an expansion of the field of membership of an existing credit union” if “[t]he field of membership of the applicant is contrary to the principles of organizing credit unions, including principles of organizing credit unions based on **common bond of occupation, association, or groups within a well-defined neighborhood, community or rural district**” (emphasis added).¹¹⁵

As the Brookings Institution noted in a July 2017 Op-Ed (entitled “‘Everyone’ is the wrong way to define credit union members”), the “restriction on field membership has been watered down” and “essentially allowing national credit unions to be open to everyone appears to be the direction the industry and its regulators are headed.”¹¹⁶ In this Op-Ed, Brookings cautioned that “[p]olicymakers need to engage and rethink the right role and mission for people who share a common bond and want to engage in low-cost financial services, thereby pooling risk and sharing reward.”¹¹⁷

Close Relationship with a Common Bond Group

Under federal regulations, persons with a close relationship with a common bond group may become members of the credit union. Specifically, 12 CFR, Appendix B to Part 701 states: “A number of persons, by virtue of their close relationship to a common bond group, may be included, at the charter applicant's option, in the field of membership. These include the following:

- Spouses of persons who died while within the field of membership of this credit union;
- Employees of this credit union;
- Persons retired as pensioners or annuitants from the above employment;
- Volunteers;
- Members of the immediate family or household;
- Honorably discharged veterans who served in any of the Armed Services of the United States listed in this charter;

¹¹³ _____.

¹¹⁴ National Credit Union Administration, "Choose a Field of Membership," May 17, 2024. As of October 31:

¹¹⁵ See also Business Consumer Services and Housing Agency, *Organizing a State Credit Union: Information Booklet*, Department of Financial Protection and Innovation, State of California DFPI-391, Rev. 2023. , p. 3.

¹¹⁶ Klein, Aaron, "‘Everyone’ is the Wrong Way to Define Credit Union Members," July 12, 2017.

¹¹⁷ _____.

- Organizations of such persons; and
- Corporate or other legal entities in this charter.”

Expanding Field of Membership & Underserved Area Expansion

Federally chartered credit unions must receive approval from the National Credit Union Administration prior to make changes in a field-of-membership.¹¹⁸ The following expansions are permissible:

- “Occupational common-bond expansion – an employer-based group or persons employed within a Trade, Industry or Profession;
- Associational common bond expansion – a member-based group meeting the NCUA’s threshold requirement and totality of circumstances test;
- Underserved area expansion – a geographic area meeting the NCUA’s underserved area requirements (available to only multiple common bonds);
- Community – a geographic area meeting the NCUA’s definition of a well-defined local community or rural district; and
- Merged (or purchase and assumption) credit union’s field of membership meeting the NCUA’s requirements.”¹¹⁹

With respect to the underserved area expansion, the Credit Union Membership Access Act (CUMAA)¹²⁰ states that the NCUA Board has the discretion to allow a credit union to expand its membership into that underserved area if: (1) the area is an “investment area,” as defined in section 103(16) of the Community Development Banking and Financial Institutions Act of 1994” (i.e., it must either “meet objective criteria of economic distress,” have “significant unmet needs for loans or equity investments,” or encompass or be “located in an empowerment zone or enterprise community designated under section 1391 of the Internal Revenue Code of 1986); (2) the area is underserved by other banks, credit unions, or similar institutions, using data compiled by both NCUA Board and other agencies; and (3) the credit union will “establish[] and maintain an office” in the area where “credit union services are available.”

Under California law, a state-chartered credit union may expand its field of membership if the Commissioner of the DFPI approves an application to expand the field of membership.¹²¹ This application must include:

“(1) If the applicant proposes to serve an occupational group or association, the application shall include the name and description of the proposed group or association.

¹¹⁸ National Credit Union Administration, "Field of Membership Expansion," December 13, 2021. As of October 31:

<https://ncua.gov/support-services/credit-union-resources-expansion/field-membership-expansion>.

¹¹⁹ _____.

¹²⁰ 105th Congress, *Credit Union Membership Access Act*, H.R.1151.

¹²¹ 10 CA Code of Regs 30.60.

If the proposed field of membership includes more than one group or association, the application shall contain the name and description of each group or association. Other than groups of employees of a common employer, the application shall include the bylaws of each group or association, if the group or association has adopted bylaws.

(2) A complete list of the organizations, associations, and communities in the credit union's current field of membership.

(3) If the applicant proposes to serve one or more communities, the application shall include information sufficient to demonstrate a common bond with regard to each community.

(4) The number of potential members in each group or community to be included in the field of membership.

(5) The geographic location of each group or community to be included in the field of membership.

(6) If the proposed field of membership is a group the membership of which is equal to or greater than 20 percent of the current membership of the credit union or the proposed field of membership is a community, a copy of the business plan, and a copy of the marketing plan which shall include the methods by which the credit union intends to serve its expanded field of membership.

(7) Such other information that bears upon a finding that the proposed field of membership is not contrary to the principles of organizing credit unions, including principles of organizing credit unions based upon common bond of occupation, association, or groups within a well-defined neighborhood, community or rural district.”¹²²

Non-Member Accounts

Section 701.34 of the regulations of the NCUA (12 C.F.R. Sec. 701.34) provides that a credit union may request a low-income designation if the majority of its members have household incomes of 80% or less of the area median income as defined in Section 701.34. Under federal and state law, low-income designated credit unions can accept nonmember accounts. According to the NCUA

“Low-income designated credit unions can accept nonmember accounts. They can use these nonmember accounts to (1) fund loans, (2) arbitrage and build reserves, or (3) cover expansion or services costs. Generally, these deposits have interest rates at or below market rates.”¹²³

¹²² 10 CA Code of Regs 30.60.

¹²³ National Credit Union Administration, *Low-Income Credit Unions*, p. 23-5.

However, “[u]nless the regional director has approved a greater amount, the maximum amount of all public unit and nonmember shares cannot, at any given time, exceed the greater of 20 percent of the credit union’s total shares or \$1.5 million.”¹²⁴

Under the California Financial Code:

“A credit union that has a low-income designation pursuant to Section 701.34 of the regulations of the National Credit Union Administration (12 C.F.R. Sec. 701.34) may issue shares to nonmembers. Except with the written approval of the commissioner, the total number of shares issued by the credit union to nonmembers pursuant to this subdivision shall not exceed 20 percent of the unimpaired capital and surplus of the credit union.”¹²⁵

Par Value Shares

Under the Federal Credit Union Act, membership in a federal credit union requires an approved membership application and payment and maintenance of at least a par value share (as well as any applicable entrance fee).¹²⁶ However, the NCUA notes that “[t]here is no regulatory minimum or maximum amount for credit union shares and par values are often nominal.” In addition, “to promote membership, a credit union may pay the initial share from its own funds on behalf of a potential member to begin their credit union membership.”¹²⁷

Takeaway

Federal- and state-chartered credit unions may admit new members who fall within their field of membership. Under federal and state law, there are also provisions for expanding the field of membership and federal and state law also provide for accepting non-member accounts in the case of low-income designated credit unions.

5. ChexSystems

Background

ChexSystems is a private reporting agency that gathers data on past issues with deposit accounts, such as checking and savings accounts.¹²⁸ This agency keeps a record of banking

¹²⁴ _____.

¹²⁵ California Financial Code § 14851.

¹²⁶ National Association of Federally Insured Credit Unions, "Back to Basics: Are All Members Created Equal?," in *Compliance*, July 31, 2017, 2017. <https://www.nafcu.org/compliance-blog/back-basics-are-all-members-created-equal>, citing 12 U.S.C. §1759(a); FCU Bylaws, Article III.

¹²⁷ _____.

¹²⁸ Luthi, Ben, "What is ChexSystems?," in *Ask Experian: Experian*, April 18, 2020, 2020. <https://www.experian.com/blogs/ask-experian/what-is-chexsystems/>

history, which banks and credit unions may consult to decide whether to approve applications for new accounts.¹²⁹

Relevant Laws, Policy, and Guidance

No federal or state laws require the use of ChexSystems.

Although nothing in the language of AB1177 specifies whether and how financial institutions may use ChexSystems, section 2(b) of the bill notes:

“Involuntary account closures that are reported to reporting agencies like ChexSystems, which keeps records of customers’ deposit account histories, can then lead to further exclusion from affordable financial services. The Consumer Financial Protection Bureau has found that, based on the most recent data from 2005, up to 19 million people had ChexSystems records. Although the majority of ChexSystems records result from repeated overdrafts, situations where the customer was a victim of fraud, or bank errors, a ChexSystems record can prevent a person from opening a new bank account, resulting in the unbanking of customers.”

A 2013 New York Times investigation revealed that over one million consumers have been denied bank accounts for “past errors” as minor as a single bounced check and negative reports can stay in ChexSystems for seven years.¹³⁰

One of our interviewees noted that financial institutions that open BankOn accounts use ChexSystems and Early Warning Services but only disqualify individuals who have been convicted of fraud.¹³¹ Similarly, in 2014, the New York Attorney General urged banks operating within the state to adopt ChexSystems use policies that would only screen for past fraud.¹³²

Takeaway

CalAccount implementers should consider advising partner financial institutions to only use ChexSystems to screen for past fraud.

6. Use of deposits

Background

California State Treasurer’s Office RFP No. SA000004-23 states that the market analysis should look at “whether deposits can be used by the participating depository financial institutions

¹²⁹ _____.

¹³⁰ Sprague, Aleta, "Next Generation TANF: Reconceptualizing Public Assistance as a Vehicle for Financial Inclusion," *University of the District of Columbia Law Review*, Vol. 18, No. 1, 2015. 18, 144, 151, citing Jessica Silver-Greenberg, Over a Million are Denied Bank Accounts for Past Errors, N.Y. TIMES, July 30, 2013, at A1.

¹³¹ Interview with banking industry expert on December 4, 2023 (Participant 106).

¹³² Sprague.

in the same manner as the institution's current customer's deposits (e.g., for loans to others, etc.). (See Fin. Code, § 100104, subd. (a)(1)(N), (a)(3)(A), and (c)(5).)"

Relevant Laws, Policy, and Guidance

Here are the sections of the California Financial Code cited in the RFP section that discusses the use of deposits issue:

- Fin. Code § 100104, subd. (a)(1)(N): "Would require the board to develop and negotiate a fair and equitable program fee and program revenue sharing structure between the state and the financial services network administrator in furtherance of attaining a financially self-sustaining program, which agreement shall be reevaluated annually and renegotiated as appropriate based on program scope and scale."
- Fin. Code § 100104, subd. (a)(3)(A): "The market analysis required by this subdivision shall also include whether or not CalAccount Program revenue is more likely than not to be sufficient to pay for CalAccount Program costs within six years of the CalAccount Program's implementation."
- Fin. Code § 100104, subd. (c)(5): "The market analysis required by subdivision (a) shall consider all of the following... Potential CalAccount Program revenue streams."

Given the California Financial Code sections cited in the RFP, it appears that the revenue sharing structure aspect of the CalAccount program gives rise to the concern about use of deposits for purposes such as loans.

Code of Federal Regulations, Title 12 Banks and Banking, Part 204, Regulation D (10 CFR §§ 204.1- 204.1)(Reserve Requirements of Depository Institutions) address the use of deposits for purposes such as loans. 10 CFR § 204.2. provides that reserve requirements must be satisfied by holding vault cash and, if vault cash is insufficient, by maintaining a balance in an account at a Federal Reserve Bank.¹³³ An institution may hold that balance directly with a Reserve Bank or with another institution in a pass-through relationship.¹³⁴ Reserve requirements are imposed on "depository institutions," defined as commercial banks, savings banks, savings and loan associations, credit unions, U.S. branches and agencies of foreign banks, Edge corporations, and agreement

¹³³Federal Reserve, "Reserve Requirements," January 22, 2024. As of October 31:

<https://www.federalreserve.gov/monetarypolicy/reservereq.htm> see 10 C.F.R. § 204.5 (Maintenance of required reserves).

¹³⁴_____; see 10 C.F.R. § 204.5 (Maintenance of required reserves).

corporations.¹³⁵ In March 2020, the Board lowered all reserve requirements to zero for the first time.¹³⁶

On initial inspection, nothing in Regulation D appears to raise any CalAccount related concerns, but as proposed revenue sharing arrangements between the state of California and partner institutions under the CalAccount program take shape, the State should explore potential deposit issues in conversations with federal regulators.

Takeaway

Legal analysis on the issue of use of CalAccount deposits is difficult in the absence of details about the proposed revenue sharing arrangements between the state of California and partner institutions under the CalAccount program. The state should explore potential deposit issues in conversations with experts at federal regulators.

In addition, as noted in Section 10 above, federal and state law provide for accepting non-member accounts in the case of low-income designated credit unions, and credit unions can use these nonmember accounts to (1) fund loans, (2) arbitrage and build reserves, or (3) cover expansion or services costs.

7. Legal Liabilities

Two of our interviewees who work in the banking sector noted that fear of legal liabilities on the part of financial institutions is likely to pose a significant barrier to financial institution partnership.¹³⁷ **These interviewees mentioned Banking Secrecy Act/Know Your Customer rules and regulations, liability for fraud and abuse, privacy laws, advertising laws, unfair business practices laws, the Community Reinvestment Act, and liability for discrimination as areas likely to be of concern for financial institutions considering partnering with the state on CalAccount.**¹³⁸ With respect to fraud and abuse, California State Treasurer’s Office RFP No. SA000004-23 states that the market analysis should look at “[w]hat, if any, fraud and abuse controls, or other requirements, would be expected from the participating depository financial institutions” and “[w]ho would bear the financial burden for mitigating fraud and abuse.” Banking Secrecy Act/Know Your Customer rules and regulations are discussed in above. Other potential areas of legal liability mentioned by the interviewees are discussed below.

¹³⁵ ———.; *see* 10 C.F.R. § 204.2 (Definitions).

¹³⁶ *See* ———, *Regulation D: Reserve Requirements of Depository Institutions*, 85 Fed. Reg. 16525, June 1, 2021. Federal Reserve.

¹³⁷ Interview with banking industry and services experts (Participants 108 and 109).

¹³⁸ Interview with banking industry and services experts (Participants 108 and 109).

Fraud and Abuse

Background

At the time of this writing, details of how California and financial institutions would partner to implement the CalAccount program – including contractual obligation, roles, and technology to be deployed - have not been finalized, so it is difficult to anticipate fraud risks and liability for those risks. However, prior collaborations between California agencies and financial institutions demonstrate the types of legal and financial liability that may make financial institutions hesitant to participant in CalAccount. More specifically, the financial and legal liabilities that Bank of America incurred after it contracted with California’s Employment Development Department (EDD) to issue unemployment benefits debit card and the financial liabilities incurred by the State of California as result of electronic benefits transfer (EBT) card fraud provide frameworks for examining the liabilities that may prevent financial institutions from participating in the program and liabilities that the State of California should strive to protect itself against as the details of CalAccount are negotiated.

In 2010, Bank of America entered into an exclusive unemployment debit card contract with EDD. According to CalMatters, under the terms of the contract, EDD did not pay the bank directly for its financial services. Instead, EDD and Bank of America split revenue on merchant transaction fees when the cards were swiped and the bank charged consumer fees for things like ATM use or rush shipping on new debit cards. The contract specified that the state’s share of the fee revenue will “assist in offsetting program costs.” According to CalMatters, EDD made \$22.5 million on unemployment debit card fees. The managing director of transaction services for Bank of America reported that although the bank shared in revenue from the contract, the bank “lost hundreds of millions of dollars on the contract” due to fraud and having to hire customer service workers to handle complaints.¹³⁹

Plaintiffs in a pending class action lawsuit against Bank of America allege that during the pandemic, Bank of America’s failure to implement basic security measures such as chips resulted in unemployment benefits being stolen from California benefits recipients.¹⁴⁰ Plaintiffs also allege that rather than investigating cardholders’ reports of unauthorized transactions on the cards, Bank of America summarily denied their claims, froze their accounts, and failed to handle high volumes of calls from fraud victims.¹⁴¹ The pending class action alleges several claims under state and federal laws including:

¹³⁹ Hepler, Lauren, "How EDD and Bank of America make millions on California unemployment," in *CalMatters*, February 5, 2021.

¹⁴⁰ Danitz, Brian and Andrew F Kirtley, "Claims Against Bank of America to go Forward for Failing to Protect Unemployed Californians During Pandemic," May 26, 2023. As of February 1, 2024: *See also* Koury, Renee "EXCLUSIVE: BofA says it wants out of unemployment benefits contract as EDD renews," *ABC 7News*, July 2, 2021. As of February 1, 2024:

¹⁴¹ Danitz.

- violation of the federal Electronic Funds Transfer Act (which required timely investigation of unauthorized transaction claims);
- violation of the California Consumer Privacy Act by issuing EDD debit cards without security chips and failing to ensure the confidentiality of Plaintiffs' personal information;
- violation of Plaintiffs' due process rights;
- negligence in failing to include security chips;
- negligence in the hiring and supervision of contractors;
- unfair business practices; and
- breached fiduciary duties owed to EDD cardholders.¹⁴²

The CFPB conducted an investigation and found that Bank of America engaged in unfair and abusive acts and practices that resulted in Californians not getting their unemployment benefits. Specifically, the bank used a faulty fraud filter, made it difficult for people to unfreeze their prepaid debit cards, and directed consumers to EDD rather than assisting consumers who sought help. As a result, CFPB fined Bank of America \$100 million, to be paid to CFPB.¹⁴³ The OCC separately imposed a fine of \$125 million on Bank of America, to be remitted to the U.S. Treasury.¹⁴⁴ In 2021, Bank of America reported to news media that it wanted out of the contract, but that EDD renewed the contract for two years.¹⁴⁵ Very recently, EDD entered into a contract, and beginning February 15, 2024, benefits will be issued to Money Network prepaid card rather than to a Bank of America debit card.¹⁴⁶

California's Electronic Benefit Transfer (EBT) Project automated government benefit delivery through the use of on-line electronic funds transfer technology (i.e. magnetic stripe debit cards).¹⁴⁷ According to a report by CalMatters, "in April 2022, California was losing nearly \$2 million a month to EBT thieves, and although cash and food benefits are primarily federally

¹⁴² _____.

¹⁴³ Consumer Financial Protection Bureau, "Federal Regulators Fine Bank of America \$225 Million Over Botched Disbursement of State Unemployment Benefits at Height of Pandemic," July 14, 2022, 2022. As of February 1, 2024:

<https://www.consumerfinance.gov/about-us/newsroom/federal-regulators-fine-bank-of-america-225-million-over-botched-disbursement-of-state-unemployment-benefits-at-height-of-pandemic/>

¹⁴⁴ _____.

¹⁴⁵ Koury.

¹⁴⁶ Employment Development Department, "New: Changes to Your Debit Card." As of February 1:

https://edd.ca.gov/en/about_edd/the_edd_debit_card/

¹⁴⁷ Department of Financial Protection and Innovation, "California Electronic Benefit Transfer (EBT) Project," August 28, 2019. As of February 1:

<https://dfpi.ca.gov/california-electronic-benefit-transfer-cbt-project/>.

funded, California had to pay out of its own funds to reimburse theft victims.¹⁴⁸ According to experts interviewed by CalMatters, chip cards could significantly cut the thefts, and California earmarked \$50 million for the upgrades scheduled to go into effect May 2024.”¹⁴⁹ CalMatters reported that in 2013, the California started reimbursing welfare recipients who have their benefits stolen electronically and that Congress recently passed a spending bill to reimburse states for paying recipients back up to two months of stolen food benefits.¹⁵⁰

Relevant Laws, Policy, and Guidance

As noted above, absent details about contractual obligations, roles, and technology that will be part of the CalAccount program, it is difficult to anticipate fraud risks and liability for those risks. However, as demonstrated in the cases of the state and financial institution government prepaid care partnerships above, fraud can result in substantial financial losses on the part of financial institutions and government partners. In addition, financial institutions may be hesitant to participate in CalAccount because efforts to partner on prepaid card programs resulted in potential legal liability under federal law such as the Electronic Funds Transfer Act, state laws such as the California Consumer Privacy Act, and common law causes of action such as negligence and breach of fiduciary duty; as well as investigations and large fines imposed by CFPB and OCC.

Privacy Laws

Background

One of our banking sector interviewees noted that potential legal liability under state and federal privacy laws as a likely primary area of concern for financial institutions.¹⁵¹ As discussed below, there are a patchwork of state and federal privacy laws.

Relevant Laws, Policy, and Guidance

Two notable federal laws that cover personal financial privacy are the Fair Credit Reporting Act and the Gramm-Leach-Bliley Act.¹⁵² The Gramm-Leach-Bliley Act, Pub. L. No. 106-102 (codified as amended at 15 U.S.C. § 6803, “GLBA”) limits when a “financial institution” may

¹⁴⁸ Kuang, Jeanne "California missed chances to stop EBT theft. It's lost tens of millions of taxpayer dollars since," November 8, 2023. As of February 1, 2024:

<https://calmatters.org/economy/2023/11/california-missed-chances-to-stop-ebt-theft-its-lost-tens-of-millions-of-taxpayer-dollars-since/>.

¹⁴⁹ Department of Financial Protection and Innovation.

¹⁵⁰ _____.

¹⁵¹ Interview with banking industry and services experts (Participants 108 and 109).

¹⁵² Office of the Comptroller of the Currency, "Privacy," Undated. As of October 31:

<https://www.occ.treas.gov/topics/consumers-and-communities/consumer-protection/privacy/index-privacy.html#:~:text=Two%20federal%20laws%20cover%20your,Gramm%2DLeach%2DBliley%20Act.>

disclose a consumer’s “nonpublic personal information (NPI)” to nonaffiliated third parties. The FTC notes that under the statute, “financial institutions must notify their customers about their information-sharing practices and tell consumers of their right to ‘opt-out’ if they don't want their information shared with certain nonaffiliated third parties. In addition, any entity that receives consumer financial information from a financial institution may be restricted in its reuse and redisclosure of that information.”¹⁵³ Mobile payment providers and payment processors may be considered “financial institutions,” “service providers,” or both for purposes of the GLBA (or both) based on the specific services they supply.¹⁵⁴ In addition, the FTC’s Safeguards Rule under the GLBA requires that entities that are “significantly engaged in financial activities, or significantly engaged in activities incidental to such financial activities”¹⁵⁵ to “develop, implement, and maintain an information security program with administrative, technical, and physical safeguards designed to protect customer information.”¹⁵⁶

The Fair Credit Reporting Act (Title VI of the Consumer Credit Protection Act) Pub. L. No. 90-32 (codified as amended at 15 U.S.C. § 1681) protects information collected by consumer reporting agencies. This information may not be provided to anyone who does not have a purpose specified in the Fair Credit Reporting Act.¹⁵⁷ As the CFPB notes, “users of the information for credit, insurance, or employment purposes must notify the consumer when an adverse action is taken on the basis of such reports.”¹⁵⁸ In addition, the Right to Financial Privacy Act, Pub. L. No. 95-360 (codified as amended at 12 U.S.C. §§3401-22) protects the privacy of financial accounts from government scrutiny and sets forth procedures that federal government authorities must follow to obtain a customer’s financial records from financial institutions.¹⁵⁹ These requirements include obtaining subpoenas, notifying the customer of the request, and providing the customer with an opportunity to object.¹⁶⁰

At the state level, the California Financial Information Privacy Act, Cal. Fin. Code 4053, prohibits financial institutions from sharing nonpublic personal information without consumer

¹⁵³ Federal Trade Commission, *How To Comply with the Privacy of Consumer Financial Information Rule of the Gramm-Leach-Bliley Act*, July 2002.

¹⁵⁴ Fonte, Erin "2017 U.S. Regulatory Overview Of Mobile Wallets and Mobile Payments " *Wake Forest Journal of Business and Intellectual Property Law* Vol. 17, No. 4, Summer 2017.

¹⁵⁵ 16 C.F.R. pt. 314

¹⁵⁶ Federal Trade Commission, "FTC Safeguards Rule: What Your Business Needs to Know," May 2022. <https://www.ftc.gov/business-guidance/resources/ftc-safeguards-rule-what-your-business-needs-know>.

¹⁵⁷ Fair Credit Reporting Act (FCRA), 15 U.S.C. § 1681 et seq.

¹⁵⁸ U.S. Code, Fair Credit Reporting Act, 2023.

¹⁵⁹ Federal Deposit Insurance Corporation, Right to Financial Privacy Act .

¹⁶⁰ _____.

consent through an opt-in process.¹⁶¹ The California Attorney General considers “a broad array of businesses” to be subject to the GLBA and FIPA including, for example, “retailers that issue their own credit cards directly to consumers, real estate appraisers, mortgage brokers, career counselors in the finance area, check printing businesses, and accountants who prepare tax returns.”¹⁶²

Advertising Laws

Background

One of our banking sector interviewees noted that potential legal liability under advertising laws, particularly Regulation DD, would be a likely concern for financial institutions considering partnering on CalAccount.¹⁶³

Relevant Laws, Policy, and Guidance

Advertising and marketing in the U.S. are subject to federal, state, and local laws and regulations.¹⁶⁴ For example, Regulation DD (12 CFR 230), which implements the Truth in Savings Act and applies to all depository institutions, requires uniform disclosures to enable consumers to make informed decisions about their accounts at depository institutions.¹⁶⁵ With respect to advertising and marketing, Regulation DD imposes requirements on any commercial message that promotes deposit accounts, regardless of the medium used. Requirements include that commercial messages not be misleading or inaccurate, that terms like “no cost” cannot be

¹⁶¹ States including California, Oregon, Montana, Utah, Colorado, Texas, Iowa, Indiana, Tennessee, Virginia, Connecticut, and Delaware have also implemented more general consumer privacy laws. International Association of Privacy Professionals (IAPP). (n.d.). US State Privacy Legislation Tracker. Retrieved from <https://iapp.org/resources/article/us-state-privacy-legislation-tracker/>. For example, the California Consumer Privacy Act of 2018, Cal. Civ. Code §§ 1798.100-1798.199 (2018) provides that “[a] business that controls the collection of a consumer’s personal information” must inform consumers of the categories of personal information being collected and used, the purposes for which the personal information are being collected and used, and the length of time the business intends to retain each category of personal information. The CCPA also gives consumers the right to delete personal information collected, subject to exceptions. A second privacy act, the California Privacy Rights Act, took effect in 2023. This Act provides consumers with the right to limit the use and disclosure of sensitive personal information collected about them and the right to correct inaccurate personal information that a business has about them. In addition, California and every other state in the U.S. has enacted a data breach notification law, which require businesses as well as governmental entities to notify individuals of security breaches that involve personally identifiable information. National Conference of State Legislatures (NCSL). Security Breach Notification Laws. Retrieved from: <https://www.ncsl.org/technology-and-communication/security-breach-notification-laws>.

¹⁶² California Attorney General’s Office, “Your Financial Privacy Rights.” <https://oag.ca.gov/privacy/facts/financial-privacy/rights>.

¹⁶³ Interview with banking industry and services expert (Participant 108).

¹⁶⁴ Miller, Craig, Harold P. Reichwald, and Charles Washburn Jr., “Top 5 Legal Considerations for FinTech Advertising,” in *JDSupra*.

¹⁶⁵ Federal Reserve, *Truth in Savings*, Board of Governors of the Federal Reserve. As of February 1, 2024: <https://www.federalreserve.gov/boarddocs/caletters/2009/0914/09-14-attachment.pdf>.

used to describe an account if any maintenance or activity fees can be imposed, that rates of return be expressed as an annual percentage yield, and that a record of commercial messages be maintained for two years.¹⁶⁶

Community Reinvestment Act

Background

On of our banking sector interviewees noted that the Community Reinvestment Act would be a likely concern for financial institutions considering partnering on CalAccount.¹⁶⁷ The logic behind this potential concern is detailed in the next section, after the summary of the Act.

Relevant Laws, Policy, and Guidance

Congress enacted the Community Reinvestment Act of 1977 (CRA) to address concerns that federally insured banking institutions were not providing enough credit in the areas where they were chartered and acquiring deposits.¹⁶⁸ Pursuant to the CRA, federal banking regulators (Federal Reserve, OCC, and FDIC) conduct examinations that assess whether a bank is meeting local credit needs and assign CRA credits in each banks “assessment area.”¹⁶⁹ (Assessment areas are “typically encompasses the geographic area that can reasonably be served by each of a bank's locations, including its main office, any branches, and deposit-taking ATMs. It also usually includes the surrounding areas in which the bank originated or purchased a substantial portion of its loans.”¹⁷⁰) Federal regulators then take these ratings into account when banks seek regulator approval, e.g., applying for charters, branches, mergers, and acquisitions.¹⁷¹

In 2023, federal banking regulators revamped the CRA implementing regulations to address stakeholder concerns.¹⁷² For example, one such concern was that as banks provide products and services digitally, they may benefit broader communities outside of their geographical

¹⁶⁶ _____.

¹⁶⁷ Interview with banking industry and services expert (Participant 109).

¹⁶⁸ U.S. House of Representatives *Better, Together: Examining the Unified Proposed Rule to Modernize the Community Reinvestment Act: Hearing Before the Committee on Financial Services Subcommittee on Consumer Protection and Financial Institutions* 7-5700, July 13, 2022. .

¹⁶⁹ . at 1.

¹⁷⁰ Horowitz, Ben "Defining 'Low- And Moderate-Income' and 'Assessment Area'," March 8, 2018.

¹⁷¹ . , at 1.

¹⁷² Bonici, Max and Michael Aphibal, "Harder, Better, Faster, Stronger: The New Interagency Rule for the Community Reinvestment Act," November, 2023, 2023. <https://www.venable.com/-/media/files/publications/2023/11/harder-better-faster-stronger-the-new-interagency.pdf?rev=5dbee4486c2942b9b89703f028620b68>,

assessment area and not receive credit for these products and services.¹⁷³ There was also a general concern that federal regulators were awarding CRA credit inconsistently.¹⁷⁴

The new rule (which banks must comply with by 2026) is “long and complex, with more than 60,000 words, 40 benchmarks, and 20 metrics” and the intricacies of the CRA are beyond the scope of this report.¹⁷⁵ However, in short, the rule applies a new framework to the four tests that federal regulators use to evaluate banks under the CRA:

1. Retail lending test: assesses how well large banks are providing services to low- and moderate-income (LMI) borrowers, small businesses, and small farms
2. Retail services and products test: assesses the accessibility to credit and deposit products, including branches, ATMs, and mobile banking platforms
3. Community development (CD) financing test: assesses bank’s community development loans and investments.
4. CD services test: assesses volunteer activities that support community development such as financial literacy activities.¹⁷⁶

Whether and how these tests are applied to banks depends on whether a bank’s assets qualify the bank as large, intermediate, or small under the CRA.¹⁷⁷

The banking sector interviewee who cited the CRA in the interview noted that banks may be hesitant to participate in CalAccount because participation would require them to undertake more lending in LMI communities where they take CalAccount deposits.¹⁷⁸ The interviewee noted that this can lead to a situation where banks do not provide loans to LMI communities and are penalized under the CRA and other laws that prohibiting redlining.¹⁷⁹¹⁸⁰ The interviewee further noted that on the opposite side of the coin, if banks do increasing lending in LMI communities, banks may consider these loans in and of themselves to be risky and may also perceive these loans and creating potential liability for allegations of predatory lending.¹⁸¹

¹⁷³ .., at 3.

¹⁷⁴ .., at 3.

¹⁷⁵ Bonici., at 1.

¹⁷⁶ _____., at 2-3.

¹⁷⁷ Federal Reserve, *Interagency Overview of the Community Reinvestment Act Final Rule*, October 24, 2023. .

¹⁷⁸ Interview with banking industry and services expert on December 8, 2023 (Participant 109)

¹⁷⁹ “One type of redlining can be defined as the refusal of a bank to make credit available to all of the neighborhoods in its immediate locality, including LMI neighborhoods where the bank may have collected deposits. A second type of redlining is the practice of denying a creditworthy applicant a loan for housing located in a certain neighborhood even though the applicant may qualify for a similar loan in another neighborhood. This type of redlining pertains to circumstances in which a bank refuses to serve all of the residents in an area, perhaps due to discrimination.” Getter (2022), at 2.

¹⁸⁰ Interview with banking industry and services expert on December 8, 2023 (Participant 109).

¹⁸¹ Interview with banking industry and services expert on December 8, 2023 (Participant 109).

By contrast, two interviewees noted that banks may be incentivized to participate in CalAccount because providing access to deposit products through CalAccount could result in CRA credit under the retail services test.¹⁸² Notably, “[p]roducts certified as meeting Bank On National Account Standards have been called out by banking regulators as eligible for the Community Reinvestment Act.”¹⁸³

Liability for Discrimination

Background

Two of our banking sector interviewees noted that potential legal liability laws prohibiting discrimination.¹⁸⁴ One interviewee noted that banks may be hesitant to participate in CalAccount because they may believe it would open them up to legal liability for perceived disparate treatment of CalAccount holders with respect to complaint resolution times, amount of material effort put into opening accounts, ability to access services, and fund availability.¹⁸⁵

Relevant Laws, Policy, and Guidance

The law that a banking sector interviewee specifically mentioned was the Consumer Financial Protection Act (CFPA), which is enforced by the CFPB and prohibits unfair, deceptive and abusive acts and practices (UDAAPs).¹⁸⁶ The CFPB notes that “discrimination may meet the criteria for ‘unfairness’ by causing substantial harm to consumers that they cannot reasonably avoid, where that harm is not outweighed by countervailing benefits to consumers or competition” and that “[c]onsumers can be harmed by discrimination regardless of whether it is intentional.”¹⁸⁷

Takeaway

One of the banking sector interviewees noted that financial institutions’ fear of legal liabilities will be the single biggest barrier to CalAccount.¹⁸⁸ As detailed above, fraud by third parties can lead to financial liability as well as lawsuits and large regulatory fines. In addition, financial institutions may be hesitant to participate in CalAccount for fear of liability for violation of privacy laws and advertising laws. As the design of the CalAccount program

¹⁸² Interviews with banking industry and services experts on December 8 and 13, 2023 (Participants 108 and 112).

¹⁸³ BankOn, "Get Certified: Join the National Bank On Movement," Undated. <https://joinbankon.org/certify/> .

¹⁸⁴ Interviews with banking industry and services experts on December 8, 2023 (Participant 108 and 109).

¹⁸⁵ Interviews with banking industry and services expert on December 8, 2023 (Participant 108).

¹⁸⁶ Consumer Financial Protection Bureau, "CFPB Targets Unfair Discrimination in Consumer Finance," March 16, 2022. <https://www.consumerfinance.gov/about-us/newsroom/cfpb-targets-unfair-discrimination-in-consumer-finance/>.

¹⁸⁷ _____.

¹⁸⁸ Interview with banking services and industry expert on December 8, 2023 (Participant 109).

progresses, it is important to involve legal counsel from all potential partners as well as representative from state and federal regulators in the dialogue.

Abbreviations

| | |
|-------|---|
| AB | Assembly Bill |
| AML | Anti-Money Laundering |
| ATM | Automated Teller Machine |
| BCA | Benefit Cost Analysis |
| BSA | Bank Secrecy Act |
| BSCA | Bank Service Company Act |
| CFPB | Consumer Financial Protection Bureau |
| CIP | Customer Identification Program |
| CRA | Community Reinvestment Act |
| CUMAA | Credit Union Membership Access Act |
| DFPI | Department of Financial Protection and Innovation |
| DLSE | Division of Labor Standards Enforcement |
| EBT | Electronic Benefits Transfer |
| EDD | Employment Development Department |
| EFTA | Electronic Fund Transfer Act |
| EMV | Europay, Mastercard, and Visa |
| FDIC | Federal Deposit Insurance Corporation |
| FFIEC | Federal Financial Institutions Examination Center |
| FIPA | Financial Information Privacy Act |
| GLBA | Gramm Leach Bliley Act |
| KYC | Know Your Customer |
| LMI | Low and Moderate Income |
| NCUA | National Credit Union Administration |
| NPI | Nonpublic Personal Information |
| NSF | Non-Sufficient Funds |
| OCC | Office of the Comptroller of the Currency |
| OFAC | Office of Foreign Asset Control |
| POS | Point of Sale |
| QCEW | Quarterly Census of Employment and Wages |
| RFP | Request for Proposal |
| SAR | Suspicious Activity Report |
| SME | Subject Matter Expert |
| STO | State Treasurer's Office |
| USPS | United States Postal Service |

References

12 C.F.R. § 204

31 C.F.R. § 1020.220

Bank Secrecy Act (BSA), 31 U.S.C. § 5311 et seq.

Beckett, Paul, "Banks Relax Use Of Bad-Checks List To Vet Applicants," *The Wall Street Journal Eastern Edition*, 2000.

———, "Banks to Rethink System Used to Approve Applicants Opening Checking Accounts," *The Wall Street Journal*, August 17, 2000.

———, "Bounce a Check, and You Might Not Write Another for 5 Years," *The Wall Street Journal Eastern Edition*, 2000.

Bills, Steve, "Fifth Third Installs New eFunds System," *The American Banker*, Vol. 171, No. 6, 2006.

———, "In Brief: MicroBilt to Offer eFunds Services," *The American Banker*, Vol. 169, No. 80, 2004.

Bjerke, Paul, "Keep Out Deadbeats With These New Tools," *Credit Union Executive Newsletter*, Vol. 30, No. 16, September 20, 2004.

Boel, Paola and Peter Zimmerman, "Unbanked in America: A Review of the Literature," *Federal Reserve Bank of Cleveland: Economic Commentary*, Vol. 2022-07, May 26, 2022.

Callaway, Leslie, and Mark Kruhm, "

ABA COMPLIANCE CENTER: INBOX," *ABA Banking Journal*, Vol. 106, No. 9, 2014.

Campbell, Dennis, F. Asís Martínez-Jerez, and Peter Tufano, "Bouncing out of the banking system: An empirical analysis of involuntary bank account closures " *Journal of Banking & Finance*, No. 4, 2012.

Campbell, Dennis, Francisco de Asis Martinez-Jerez, Ekins, Emily McClintock and Peter Tufano, "Central Bank: The Chexsystems(Sm) Qualifile(R) Decision," *Harvard Business School*, Vol. Case No. 208-029, July 19, 2007.

Caruthers, Renee, "Santander Is Third Bank to Agree to Ease Screening of New Account Applicants," in *FierceFinanceIT*.

Chu, Kathy, "Identity Theft Could Impede Victims' Banking," *The Wall Street Journal Eastern Edition*, October 26, 2004.

"Citibank Commits to Eliminate Checking and Savings Account Barriers," *Pratt's Bank Law and Regulatory Report*, Vol. 21, No. 3, 2015.

Collins, J. Michael and Collin O'Rourke "Still Holding Out Promise: A Review of Financial Literacy Education and Financial Counseling Studies," *Network Financial Institute: Working Paper Series*, Vol. 2012-WP-02.

Collins, J. Michael, Christi Baker, and Rochelle Gorey, *Financial Coaching: A New Approach for Asset Building?*, Policy Lab Consulting, November 2007.

Emple, Hannah, *Asset-Oriented Rental Assistance Next Generation Reforms for HUD's Family Self-Sufficiency Program* New America Foundation, December 2013.

"Expanding Low-Income Consumers' Access to Bank Accounts," *Teller Vision*, Vol. 1444, 2014.

"Eye On The Competition," *Credit Union Journal*, Vol. 13, No. 39, 2009.

Fellowes, Matt, *Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential* Brookings Institution Reports, 2008.

Franz, Chelsey Erbaugh, *The relationship between financial empowerment and health The relationship between financial empowerment and health related quality of life in Family Scholar House participants. related quality of life in Family Scholar House participants*, Louisville, Kentucky: University of Louisville.

Gerstner, Lisa, "Are Your Bank Accounts at Risk?," October 31, 2017.

Hollister, Robinson, "Measuring the Impact of Community Development Financial Institutions' Activities," in Rubin, Julia Sass, ed., *Financing Low Income Communities*, New York, NY: Russell Sage Foundation.

Huang, Daniel, "Citibank Reaches Pact With New York on ChexSystems Data," *The Wall Street Journal*, January 27, 2015.

Jepson, Kevin, "How Patelco Has Cut New Account Fraud Attempts," *Credit Union Journal*, Vol. 8, No. 39, 2004.

———, "Patelco Chooses Chexsystems To Combat Id Fraud ; ChexSystems Screens IDs in Just a Few Seconds. That's Helped the CU Dramatically Shave Its Fraud Losses in Just over a Year," *Bank Technology News*, Vol. 17, No. 10, 2004.

Kim, Jim, "'Consumer Databases Stoke Controversy,'" in *FierceFinance*.

McCormick, Emily, "More Risk in Capital One's Wallet?," *Bank Director*, Vol. 24, No. 3.

McKendry, Ian, "The ChexSystems Probe Could Benefit the Unbanked," in *American Banker*.

Miller, Margaret, Julia Reichelstein, Christian Salas, and Bilal Zia, "Can You Help Someone Become Financially Capable? A Meta-Analysis of the Literature," *The World Bank Research Observer*, Vol. 30, No. 2, August 2015.

Murphy, Patricia A., "Debit Bureau Offers New Weapon against Bad Check Losses," *Stores*, Vol. 80, No. 4, 1998.

Nemeroff, Evan, "Citi to Update Its Customer-Screening Practices," in *American Banker*.

Newberger, Robin, Audrey Singer, Jeremy Smith, and Anna Paulson, *Financial Access for Immigrants: Lessons from Diverse Perspectives*, Federal Reserve Bank of Chicago, 2006.

"NY AG Announces Capital One Commitment to Expand Access to Bank Accounts," *Pratt's Bank Law and Regulatory Report*, Vol. 20, No. 7, 2014.

Passy, Jacob, "Santander to Overhaul Customer Screening Policies," in *American Banker*.

Perez, JM, "Blacklisted: The Unwarranted Divestment of Access to Bank Accounts," *New York University Law Review (1950)*, Vol. 80, No. 5, 2005.

Peterson, Ann Hayes, "Giving Members a Fresh Start," *Credit Union Magazine*, Vol. 70, No. 3, 2004.

Ramsaran, Cynthia, "Frontier Fights Fraud, With a Smile," *Bank Systems & Technology*, Vol. 41, No. 9, 2004.

Robins, Gary "Check Fraud Defense," Vol. 76, 1994.

Sun, Tao, Guanglei Ren, Qi Jie Wu, Mao song Liu, Qian Yang, Xingwen Cheng, Yuqiao Zhang, Long Zhang, Shun Li, Weidong Shi and Jianming Zhang, "Advanced Organic Materials for Nonmetallic Charge Carrier-Based Batteries*Institute of Q," *Renewables*, Vol. 1, No. 5, October 2023.

"Tech Bytes: Small Ark. Bank to Use An MI Core System," *The American Banker*, Vol. 163, No. 173, 1998.

Wollenberg, Yvonne Chilik, "Getting a Closer Look at Your Consumer History," *MJH Life Sciences Media*, Vol. 82, 2005.

"Your Customer's First Checking Account," *Teller Vision*, No. 1295, March 1, 2002.